CUMMINS INC
Form 10-Q
May 01, 2008

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 March 30, 2008
Commission File Number 1-4949

CUMMINS INC.

(Exact name of registrant as specified in its charter)

Indiana	**35 0257090**
(State of Incorporation)	(IRS Employer Identification No.)

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

Telephone (812) 377-5000

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes X 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 X 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 X

As of March 30, 2008, there were 203,117,182 shares of common stock outstanding with a par value of $2.50 per share.

Website Access to Company's Reports

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

CUMMINS INC. AND SUBSIDIARIES

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ITEM 1. Condensed Financial Statements

CUMMINS INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

	Three months ended March 30, 2008	April 1, 2007
	Millions (except per share amounts)	
NET SALES (a)	$ 3,474	$ 2,817
Cost of sales	2,767	2,265
GROSS MARGIN	707	552
OPERATING EXPENSES AND INCOME		
Selling, general and administrative expenses	351	283
Research, development and engineering expenses	103	80
Equity, royalty and interest income from investees (Note 5)	67	36
Other operating expense, net	1	2
OPERATING INCOME	319	223
Interest income	6	11
Interest expense	11	16
Other (expense) income, net	(10)	9
INCOME BEFORE INCOME TAXES AND MINORITY INTERESTS	304	227
Income tax expense	102	75
Minority interest in income of consolidated subsidiaries	12	9
NET INCOME	$ 190	$ 143
EARNINGS PER COMMON SHARE		
Basic	$ 0.97	$ 0.72
Diluted	$ 0.97	$ 0.71
WEIGHTED AVERAGE SHARES OUTSTANDING		
Basic	195.1	200.0
Dilutive effect of stock compensation awards	1.3	1.1
Diluted	196.4	201.1
CASH DIVIDENDS DECLARED PER COMMON SHARE	$ 0.125	$ 0.09

(a) Includes sales to nonconsolidated equity investees of $512 million and $454 million for the three months ended March 30, 2008, and April 1, 2007, respectively.

The accompanying notes are an integral part of the condensed consolidated financial statements.

CUMMINS INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

	March 30, 2008	December 31, 2007
	Millions, (except par value)	
ASSETS		
Current assets		
Cash and cash equivalents	$ 446	$ 577
Marketable securities	108	120
Accounts and notes receivable, net		
Trade and other	1,948	1,754
Nonconsolidated equity investees	276	244
Inventories (Note 6)	1,877	1,692
Deferred income taxes	288	276
Prepaid expenses and other current assets	189	152
Total current assets	5,132	4,815
Long-term assets		
Property, plant and equipment	4,377	4,313
Accumulated depreciation	(2,705)	(2,668)
Property, plant and equipment, net	1,672	1,645
Investments and advances related to equity method investees	588	514
Goodwill and other intangible assets, net	555	538
Deferred income taxes and other assets	678	683
Total assets	$ 8,625	$ 8,195
LIABILITIES		
Current liabilities		
Current portion of long-term debt and loans payable	$ 119	$ 119
Accounts payable (principally trade)	1,454	1,263
Current portion of accrued product warranty	347	337
Accrued compensation, benefits and retirement costs	286	441
Other accrued expenses	656	551
Total current liabilities	2,862	2,711
Long-term liabilities		
Long-term debt	578	555
Pensions and other postretirement benefits	629	633
Other liabilities and deferred revenue	635	594
Total liabilities	4,704	4,493
Commitments and contingencies (Note 8)	—	—
MINORITY INTERESTS	313	293
SHAREHOLDERS' EQUITY		
Common stock, $2.50 par value, 300 shares authorized, 203.1 and 220.4 shares issued	1,726	1,719
Retained earnings	2,820	2,660
Treasury stock, at cost, 18.4 and 18.2 shares	(603)	(593)

Common stock held by employee benefits trust, at cost, 6.5 and 6.5 shares	(79)	(79)
Unearned compensation	(8)	(11)
Accumulated other comprehensive loss		
Defined benefit postretirement plans	(373)	(378)
Other	125	91
Total accumulated other comprehensive loss	(248)	(287)
Total shareholders’ equity	3,608	3,409
Total liabilities, minority interests and shareholders’ equity	$ 8,625	$ 8,195

The accompanying notes are an integral part of the condensed consolidated financial statements.

CUMMINS INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Three months ended March 30, 2008	Three months ended April 1, 2007
CASH FLOWS FROM OPERATING ACTIVITIES	**Millions**	
Net income	$ 190	$ 143
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	75	68
Net loss on disposal of property, plant and equipment	—	2
Deferred income taxes	(7)	31
Equity in earnings of investees, net of dividends	(39)	(12)
Minority interest in income of consolidated subsidiaries	12	9
Pension expense	18	24
Pension contributions	(17)	(61)
Other post-retirement benefits expense, net of cash payments	(6)	(1)
Stock-based compensation expense	8	6
Excess tax benefits on stock-based awards	(10)	(9)
Translation and hedging activities	6	(5)
Changes in current assets and liabilities, net of acquisitions and dispositions:		
Accounts and notes receivable	(193)	(153)
Inventories	(165)	(165)
Other current assets	(5)	(6)
Accounts payable	164	126
Accrued expenses	(23)	(140)
Changes in long-term liabilities	25	15
Other, net	4	15
Net cash provided by (used in) operating activities	37	(113)
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(90)	(48)
Investments in internal use software	(14)	(13)
Proceeds from disposals of property, plant and equipment	1	2
Investments in and advances to equity investees	(20)	(17)
Acquisition of businesses, net of cash acquired	(29)	(20)
Investments in marketable securities—acquisitions	(60)	(68)
Investments in marketable securities—liquidations	69	94
Other, net	(9)	(3)
Net cash used in investing activities	(152)	(73)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from borrowings	42	4
Payments on borrowings and capital lease obligations	(47)	(101)
Net borrowings under short-term credit agreements	14	(2)
Distributions to minority shareholders	(6)	(6)

Dividend payments on common stock	(25)	(19)
Repurchases of common stock	(11)	(13)
Excess tax benefits on stock-based awards	10	9
Other, net	1	(7)
Net cash used in financing activities	(22)	(135)
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	6	2
Net decrease in cash and cash equivalents	(131)	(319)
Cash and cash equivalents at beginning of year	577	840
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 446	$ 521

The accompanying notes are an integral part of the condensed consolidated financial statements.

CUMMINS INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(Unaudited)

	Common Stock	Additional paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Common Stock Held in Trust	Unearned Compensation	Total Shareholders' Equity
	Millions							
BALANCE AT DECEMBER 31, 2006	$ 137	$ 1,500	$ 2,009	$ (526)	$ (212)	$ (92)	$ (14)	$ 2,802
Comprehensive income:								
Net income			143					143
Other comprehensive income (loss):								
Unrealized loss on derivatives				(1)				(1)
Foreign currency translation adjustments				47				47
Change in pensions and other postretirement defined benefit plans				(33)				(33)
Total comprehensive income								156
Issuance of shares		4			3			7
Stock splits	138	(138)						—
Acquisition of shares					(13)			(13)
Cash dividends on common stock			(19)					(19)
Other shareholder transactions		2	1				1	4
BALANCE AT APRIL 1, 2007	$ 275	$ 1,368	$ 2,134	$ (513)	$ (222)	$ (92)	$ (13)	$ 2,937
BALANCE AT DECEMBER 31, 2007	$ 551	$ 1,168	$ 2,660	$ (287)	$ (593)	$ (79)	$ (11)	$ 3,409
Comprehensive income:								
Net income			**190**					**190**
Other comprehensive income (loss):								
Unrealized loss on marketable securities				**(3)**				**(3)**
Unrealized gain on derivatives				**20**				**20**
Foreign currency translation adjustments				**17**				**17**
Change in pensions and other postretirement defined benefit plans				**7**				**7**
Total comprehensive income								**231**

Effect of changing pension plan measurement date pursuant to SFAS No. 158			(5)	(2)				(7)
Issuance of shares	3	2			1			6
Acquisition of shares					(11)			(11)
Cash dividends on common stock			(25)					(25)
Stock option exercises		(1)						(1)
Other shareholder transactions		3					3	6
BALANCE AT MARCH 30, 2008	**$ 554**	**$ 1,172**	**$ 2,820**	**$ (248)**(1)	**$ (603)**	**$ (79)**	**$ (8)**	**$ 3,608**

(1) Comprised of defined benefit postretirement plans of $(373) million, foreign currency translation adjustments of $99 million, unrealized gain on marketable securities of $3 million and unrealized gain on derivatives of $23 million.

The accompanying notes are an integral part of the condensed consolidated financial statements.

CUMMINS INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1. NATURE OF OPERATIONS

Cummins Inc. ("Cummins," "the Company," "the registrant," "we," "our," or "us") is a global power leader that designs, manufactures, distributes and services diesel and natural gas engines, electric power generation systems and engine-related component products, including filtration and emissions solutions, fuel systems, controls and air handling systems. We were founded in 1919 as one of the first manufacturers of diesel engines and are headquartered in Columbus, Indiana. We sell our products to Original Equipment Manufacturers (OEMs), distributors and other customers worldwide. We serve our customers through a network of more than 500 company-owned and independent distributor locations and approximately 5,200 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 (SEC) and in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with GAAP have been condensed or omitted as permitted by such rules and regulations. Certain reclassifications have been made to prior period amounts to conform to the presentation of the current period condensed financial statements.

Our reporting period ends on the Sunday closest to the last day of the quarterly calendar period. The first quarter of 2008 and 2007 ended on March 30, and April 1, respectively. The interim periods for both 2008 and 2007 contain 13 weeks. Our fiscal year ends on December 31, regardless of the day of the week on which December 31 falls.

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

You should read these interim condensed financial statements in conjunction with the *Consolidated Financial Statements* included in our Annual Report on Form 10-K for the year ended December 31, 2007. Our interim period financial results for the three 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 balance sheet data was derived from audited financial statements, but does not include all disclosures required by GAAP.

NOTE 3. RECENTLY ADOPTED AND RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

Accounting Pronouncements Recently Adopted

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" (SFAS 157), which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. The adoption of SFAS 157, effective January 1, 2008, did not have a material impact on our *Condensed Consolidated Financial Statements***.** See Note 9 for further information regarding the adoption of this standard**.**

Accounting Pronouncements Issued But Not Yet Effective

In December 2007, the FASB issued SFAS No. 141 (revised 2007), "Business Combinations" (SFAS 141R), which is effective for fiscal years beginning after December 15, 2008. SFAS 141R makes significant changes to both the accounting and disclosures related to the acquisition of a business and could materially impact how we account for future business combination transactions. Because the standard will only impact transactions entered into after January 1, 2009, SFAS 141R will not impact our *Condensed Consolidated Financial Statements* upon adoption.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements" (SFAS 160), which is effective for fiscal years beginning after December 15, 2008. SFAS 160 amends Accounting Research Bulletin No. 51, "Consolidated Financial Statements" (ARB 51) and establishes accounting and reporting standards for the noncontrolling interest in a subsidiary and for the accounting for future ownership changes with respect to those subsidiaries. For Cummins, the most significant impact of the standard, at adoption, will be to reclass our minority interests ($313 million at March 30, 2008) to be included as a part of equity, which may affect certain performance and equity ratios. We are currently evaluating the potential additional impact that SFAS 160 may have on our *Condensed Consolidated Financial Statements*.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities" (SFAS 161), which is effective for fiscal years beginning after November 15, 2008. SFAS 161 amends SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" (SFAS 133) and requires enhanced disclosures about a company's derivative and hedging activities. We do not expect the adoption of SFAS 161 to have a material impact on our *Condensed Consolidated Financial Statements*, but are still evaluating the additional disclosure requirements.

NOTE 4. PENSION AND OTHER POSTRETIREMENT BENEFITS

We sponsor both funded and unfunded domestic and foreign defined benefit pension and postretirement plans. Contributions to these plans during the first three months of 2008 and 2007 were as follows:

	Three months ended March 30, 2008	Three months ended April 1, 2007
	Millions	
Defined benefit plans:		
Voluntary	$ 12	$ 40
Mandatory	16	27
Total defined benefit plans	$ 28	$ 67
Defined contribution plans	$ 10	$ 11

We presently anticipate contributing $90 million to $100 million to our defined benefit pension plans in 2008 and paying approximately $60 million in claims and premiums for other postretirement benefits. The $90 million to $100 million of contributions for the full year includes voluntary contributions of $70 million to $75 million. These contributions and payments include payments from Company funds to either increase pension assets or to make direct payments to plan participants.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 158, “Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans – an amendment of FASB Statements No. 87, 88, 106 and 132(R)” (SFAS 158). This statement requires balance sheet recognition of the overfunded or underfunded status of pension and postretirement benefit plans. In addition, the measurement date (the date at which plan assets and the benefit obligation are measured) is required to be the company’s fiscal year end. Except for the measurement date provisions, which are not effective until fiscal years ending after December 15, 2008, the provisions of SFAS 158 were effective for fiscal years ending after December 15, 2006 and as such, were adopted during 2006.

We have adopted the measurement date provisions of SFAS 158 effective January 1, 2008. The majority of our pension and postretirement plans previously used a November 30 measurement date. All plans are now measured at December 31, consistent with the company’s fiscal year end. The non-cash effect of the adoption of the measurement date provisions of SFAS 158 decreased shareholders’ equity by approximately $7 million and increased long-term liabilities by approximately $10 million. There was no effect on our results of operations.

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

	Pension				Postretirement	
	U.S. Plans		Non-U.S. Plans		Benefits	
	Three months ended					
	March 30, 2008	April 1, 2007	March 30, 2008	April 1, 2007	March 30, 2008	April 1, 2007
	Millions					
Service cost	$ 12	$ 11	$ 7	$ 8	$ —	$ —
Interest cost	29	27	16	15	8	8
Expected return on plan assets	(38)	(35)	(19)	(17)	—	—
Amortization of prior service cost (credit)	—	—	1	1	(3)	(3)
Recognized net actuarial loss	5	8	5	6	—	—
Other net periodic benefit cost	$ 8	$ 11	$ 10	$ 13	$ 5	$ 5

NOTE 5. EQUITY, ROYALTY AND INTEREST INCOME FROM INVESTEES

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

	Three months ended	
	March 30, 2008	April 1, 2007
	Millions	
North American distributors	$ 22	$ 15
Dongfeng Cummins Engine Co. Ltd.	14	6
Chongqing Cummins Engine Company Limited	7	5
Tata Cummins Ltd.	5	2
Cummins MerCruiser Diesel Marine LLC	4	3
Shanghai Fleetguard Filter Co., Ltd.	3	1
All others	7	1
Cummins share of net earnings	62	33
Royalty and interest income	5	3
Equity, royalty and interest income from investees	$ 67	$ 36

NOTE 6. INVENTORIES

Inventories included the following:

	March 30, 2008	December 31, 2007
	Millions	
Finished products	$ 868	$ 770
Work-in-process and raw materials	1,096	1,007
Inventories at FIFO cost	1,964	1,777
Excess of FIFO over LIFO	(87)	(85)

Total inventories	$	1,877	$	1,692

NOTE 7. PRODUCT WARRANTY LIABILITY

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

	Three months ended March 30, 2008	April 1, 2007
	Millions	
Balance, beginning of period	$ 749	$ 652
Provision for warranties issued	107	79
Deferred revenue on extended warranty contracts sold	16	17
Payments	(95)	(74)
Amortization of deferred revenue on extended warranty contracts	(15)	(12)
Changes in estimates for pre-existing warranties	33	(14)
Foreign currency translation	1	1
Balance, end of period	$ 796	$ 649

The amount of deferred revenue related to extended coverage programs at March 30, 2008, was $188 million. At March 30, 2008, we had $18 million of receivables related to estimated supplier recoveries of which $8 million was included in “Receivables, net” and $10 million was included in “Other assets” on our *Condensed Consolidated Balance Sheets*.

NOTE 8. COMMITMENTS AND CONTINGENCIES

We are defendants in a number of pending legal actions, including actions related to the use and performance of our products. We carry product liability insurance covering significant claims for damages involving personal injury and property damage. We also establish reserves for these and other matters in which losses are probable and can be reasonably estimated. In the event we are determined to be liable for damages in connection with actions and proceedings, the unaccrued portion of such liability is not expected to be material. We also have been identified as a potentially responsible party at several waste disposal sites under U.S. 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 deny liability with respect to many of these legal actions and environmental proceedings and are vigorously defending such actions or proceedings. We have established reserves that we believe are adequate for our expected future liability in such actions and proceedings where the nature and extent of such liability can be reasonably estimated based upon presently available information.

U.S. Distributor Guarantees

Since 1997 we have had an operating agreement with a financial institution that requires us to guarantee revolving loans, equipment term loans and leases, real property loans and letters of credit made by the financial institution to certain independent Cummins and Onan distributors in the United States, and to certain distributors in which we own an equity interest. In the first quarter of 2006, we amended, restated and simplified the terms of the operating agreement and removed the Cummins guarantee of distributor borrowings.

If any distributor defaults under its financing arrangement with the financial institution, and the maturity of amounts owed under the agreement is accelerated, then we are required to purchase from the financial institution at amounts approximating fair market value certain property, inventory and rental generator sets manufactured by Cummins that are secured by the distributor's financing agreement.

The operating agreement will continue to be in effect until February 7, 2009.

Residual Value Guarantees

We have various residual value guarantees on equipment leased under operating leases. The total amount of these residual value guarantees at March 30, 2008, was $8 million.

Other Guarantees

In addition to the guarantees discussed above, from time to time we enter into other guarantee arrangements, including guarantees of non-U.S. distributor financing and other miscellaneous guarantees of third-party obligations. The maximum potential loss related to these other guarantees is $4 million at March 30, 2008.

We have arrangements with certain suppliers that require us to purchase minimum volumes or be subject to monetary penalties. The penalty amounts are less than our purchase commitments and essentially allow the supplier to recover their tooling costs. At March 30, 2008, if we were to stop purchasing from each of these suppliers, the amount of the penalty would be approximately $18 million. However, based on current forecasts, we do not anticipate paying any penalties under these contracts.

Indemnifications

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

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

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

Joint Venture Commitments

As of March 30, 2008, we have committed to invest $21 million into existing joint ventures and joint ventures that will be formed in 2008. It is expected that $2 million will be funded in 2008, while $19 million will be funded in 2009.

NOTE 9. FAIR VALUE OF FINANCIAL INSTRUMENTS

In September 2006, the FASB issued SFAS No. 157, “Fair Value Measurements” (SFAS 157), which defines fair value, establishes a market-based framework for measuring fair value and expands disclosures about fair value measurements. SFAS 157 is applicable whenever another accounting pronouncement requires or permits assets and liabilities to be measured at fair value. SFAS 157 does not expand or require any new fair value measures. SFAS 157 is effective for financial assets and financial liabilities for fiscal years beginning after November 15, 2007. FASB Staff Position (FSP) 157-2 “Partial Deferral of the Effective Date of Statement No. 157” (FSP 157-2), deferred the effective date of SFAS No. 157 for most non-financial assets and non-financial liabilities to fiscal years beginning after November 15, 2008. We adopted this statement prospectively for our fiscal year beginning January 1, 2008, except for non-financial assets and non-financial liabilities as deferred until January 1, 2009 by FSP 157-2. SFAS 157 does not require retroactive restatement of prior periods. The adoption of SFAS 157 did not materially impact our consolidated financial statements.

As defined in SFAS 157, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). We utilize market data or assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated, or generally unobservable. We primarily apply the market approach for recurring fair value measurements and utilize the best available information. Accordingly, we utilize valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. The company is able to classify fair value balances based on the observability of those inputs. SFAS 157 establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurement) and the lowest priority to unobservable inputs (level 3 measurement). The three levels of the fair value hierarchy defined by SFAS 157 are as follows:

Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions for the asset or liability occur in sufficient frequency and volume to provide pricing information on an ongoing basis. Level 1 primarily consists of financial instruments such as exchange-traded derivatives, listed equities and publicly traded bonds.

Level 2 – Pricing inputs are other than quoted prices in active markets included in level 1, which are either directly or indirectly observable as of the reported date. Level 2 includes those financial instruments that are valued using models or other valuation methodologies. These models are primarily industry-standard models that consider various assumptions, including quoted forward prices for commodities, time value, volatility factors, and current market and contractual prices for the underlying instruments, as well as other relevant economic measures. Substantially all of these assumptions are observable in the marketplace throughout the full term of the instrument, can be derived from observable data or are supported by observable levels at which transactions are executed in the marketplace. Instruments in this category include non-exchange-traded derivatives such as over-the-counter forwards and options.

Level 3 – Pricing inputs include significant inputs that are generally less observable from objective sources. These inputs may be used with internally developed methodologies that result in management’s best estimate of fair value. At each balance sheet date, the company performs an analysis of all instruments subject to SFAS 157 and includes in level 3 all of those whose fair value is based on significant unobservable inputs. At March 30, 2008, we did not have any level 3 financial assets or liabilities.

The majority of the assets and liabilities we carry at fair value are available-for-sale (AFS) securities and derivatives. AFS securities are derived from level 1 or level 2 inputs. The predominance of market inputs are actively quoted and can be validated through external sources, including brokers, market transactions and third-party pricing services.

The fair value measurement of derivatives results primarily from level 2 inputs. Many of our derivative contracts are valued utilizing publicly available pricing data of contracts with similar terms. In other cases, the contracts are valued using current spot market data adjusted for the appropriate current forward curves provided by external financial institutions. We participate in commodity swap contracts, currency forward contracts, and interest rate swaps. We enter into hedging transactions with banking institutions that have strong credit ratings, and thus the credit risk associated with these contracts is not considered significant. For more discussion regarding our derivative instruments, see Note 18 of our Annual Report on Form 10-K for the year ended December 31, 2007.

The following table summarizes the fair value of our financial instruments at March 30, 2008:

	Fair Value Measurements Using		
Quoted Prices in Active Markets for Identical Assets (Level 1)	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Total**

		Millions		
Available-for-sale securities	$ 55	$ 53	$ —	$ 108
Net derivative asset (1)	—	52	—	52
Total	$ 55	$ 105	$ —	$ 160

(1) Includes approximately $4 million of Level 2 derivative liabilities, which are netted against derivative assets.

NOTE 10. OPERATING SEGMENTS

Our reportable operating segments consist of the following: Engine, Power Generation, Components and Distribution. This reporting structure is organized according to the products and markets each segment serves. We use segment EBIT (defined as earnings before interest expense, income taxes and minority interests) as the primary basis for the chief operating decision-maker to evaluate the performance of each operating segment.

A summary of operating results by segment for the three month periods is shown below:

	Engine	Power Generation	Components	Distribution	Non-segment items (1)	Total
			Millions			
Three months ended March 30, 2008						
External sales	$ 1,885	$ 581	$ 567	$ 441	$ —	$ 3,474
Intersegment sales	324	206	253	4	(787)	—
Total sales	2,209	787	820	445	(787)	3,474
Depreciation and amortization (2)	44	11	15	4	—	74
Research, development and engineering expense	70	10	23	—	—	103
Equity, royalty and interest income from investees	33	5	4	25	—	67
Interest income	3	1	1	1	—	6
Segment EBIT	194	78	37	49	(43)	315
Three months ended April 1, 2007						
External sales	$ 1,522	$ 531	$ 455	$ 309	$ —	$ 2,817
Intersegment sales	243	144	202	—	(589)	—
Total sales	1,765	675	657	309	(589)	2,817
Depreciation and amortization (2)	41	10	14	2	—	67
Research, development and engineering expense	52	8	20	—	—	80
Equity, royalty and interest income from investees	17	3	(1)	17	—	36
Interest income	8	2	1	—	—	11
Segment EBIT	128	77	24	39	(25)	243

(1) Includes intersegment sales and profit in inventory eliminations and unallocated corporate expenses.

(2) Depreciation and amortization as shown on a segment basis excludes the amortization of debt discount that is included in the *Condensed Consolidated Statements of Income* as Interest expense.

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

	Three months ended March 30, 2008	Three months ended April 1, 2007
	Millions	
Segment EBIT	$ 315	$ 243
Less:		
Interest expense	11	16
Income before income taxes and minority interests	$ 304	$ 227

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," "the Company," "the registrant," "we," "our," or "us."

CAUTIONARY STATEMENTS REGARDING FORWARD-LOOKING INFORMATION

Certain parts of this quarterly report contain forward-looking statements 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" or similar expressions. 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. Future factors that could cause our results to differ materially from the results discussed in such forward-looking statements are discussed below. We undertake no obligation to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise. Future factors that could affect the outcome of forward-looking statements include the following:

- price and product competition by foreign and domestic competitors, including new entrants;
- rapid technological developments of diesel engines;
- the ability to continue to introduce competitive new products in a timely, cost-effective basis;
- the sales mix of products;
- the continued achievement of lower costs and expenses;
- domestic and foreign governmental and public policy changes, including environmental regulations;
- protection and validity of patent and other intellectual property rights;
- reliance on large customers;
- technological, implementation and cost/financial risks in increasing use of large, multi-year contracts;
- the cyclical nature of some of our markets;
- the outcome of pending and future litigation and governmental proceedings;
- continued availability of financing, financial instruments and financial resources in the amounts, at the times and on the terms required to support our future business; and
- other risk factors described in Part II of this report under the caption "Risk Factors."

In addition, such statements could be affected by general industry and market conditions and growth rates, general domestic and international economic conditions, including the price of crude oil (diesel fuel), interest rate and currency exchange rate fluctuations and other future factors.

ORGANIZATION OF INFORMATION

The following Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") was prepared to provide the reader with a view and perspective of our business through the eyes of management and should be read in conjunction with our *Consolidated Financial Statements* and related *Notes to Consolidated Financial Statements* in the "Financial Statements" section of our 2007 Annual Report on Form 10-K. Our MD&A is presented in the following sections:

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

EXECUTIVE SUMMARY AND FINANCIAL HIGHLIGHTS

We are a global power leader that designs, manufactures, distributes and services diesel and natural gas engines, electric power generation systems and engine-related component products, including filtration and exhaust aftertreatment, fuel systems, controls and air handling 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 Chrysler LLC, Daimler AG, Volvo AB, PACCAR Inc., International Truck and Engine Corporation (Navistar International Corporation), CNH Global N.V., Komatsu, Scania AB, Ford Motor Company and Volkswagen. We serve our customers through a network of more than 500 company-owned and independent distributor locations and approximately 5,200 dealer locations in more than 190 countries and territories.

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

Our financial performance depends, in large part, on varying conditions in the markets we serve, particularly the on-highway, construction and general industrial markets. Demand in these markets tends to fluctuate in response to overall economic conditions and is particularly sensitive to changes in interest rate levels. Our sales may also be impacted by OEM inventory levels and production schedules and stoppages. Economic downturns in markets we serve generally result in reductions in sales and pricing of our products. As a worldwide business, our operations are also affected by political, economic and regulatory matters, including environmental and emissions standards, in the countries we serve. However, our geographic diversity and broad product and service offerings have helped limit the impact of any one industry and the economy of any single country upon our consolidated results. In the first quarter of 2008, softness in the North American heavy-duty truck, pick-up truck, recreational vehicle, and recreational marine markets continued and the United States economy began a downturn. Despite these unfavorable conditions, we reported increased net sales and net income over the prior year period. Approximately 54 percent of our 2007 sales came from countries other than the United States and that trend grew to 57 percent in the first quarter of 2008. The diversity of our business portfolio has contributed to the significant organic growth we have experienced over the past several years continuing into 2008.

Financial highlights for the three months ended were as follows:

	Three months ended	
	March 30, 2008	April 1, 2007
	Millions	
Consolidated Results	**(except earnings per share)**	

Net sales	$ 3,474	$ 2,817
Gross margin	707	552
Equity, royalty and interest income from investees	67	36
Operating income	319	223
Net income	190	143
Diluted earnings per share	$ 0.97	$ 0.71

We experienced strong operating performance in the first quarter of 2008 with net income of $190 million, or $0.97 per diluted share, on net sales of $3.5 billion, compared to first quarter 2007 net income of $143 million, or $0.71 per diluted share, on net sales of $2.8 billion. First quarter net income and net sales increases were led by record sales and earnings in our Engine segment. In addition, we continued to see strong demand in our Power Generation, Components and Distribution segments as all reported strong sales increases. Higher volumes and price realization led to improved gross margins which combined with a significant improvement in income from equity investees to increase net income 33 percent in the first quarter of 2008.

RESULTS OF OPERATIONS

	Three Months Ended		Favorable/(Unfavorable)	
	March 30, 2008	April 1, 2007	Amount	Percent