CUMMINS INC
Form 10-Q
October 29, 2014
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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 28, 2014

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 o

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 x No o

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 o   Non-accelerated filer o   Smaller reporting company o

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

As of September 28, 2014, there were 182,691,807 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 September 28, 2014	Three months ended September 29, 2013	Nine months ended September 28, 2014	Nine months ended September 29, 2013
NET SALES [(a)]	$4,890	$4,266	$14,131	$12,713
Cost of sales (Note 2)	3,606	3,185	10,543	9,570
GROSS MARGIN	1,284	1,081	3,588	3,143
OPERATING EXPENSES AND INCOME				
Selling, general and administrative expenses (Note 2)	529	464	1,527	1,344
Research, development and engineering expenses	198	173	567	532
Equity, royalty and interest income from investees (Note 5)	99	91	294	281
Other operating income (expense), net	3	(11)	(4)	—
OPERATING INCOME	659	524	1,784	1,548
Interest income	6	6	17	21
Interest expense	15	8	47	22
Other income (expense), net	19	6	68	25
INCOME BEFORE INCOME TAXES	669	528	1,822	1,572
Income tax expense (Note 6)	230	154	553	445
CONSOLIDATED NET INCOME	439	374	1,269	1,127
Less: Net income attributable to noncontrolling interests	16	19	62	76
NET INCOME ATTRIBUTABLE TO CUMMINS INC.	$423	$355	$1,207	$1,051
EARNINGS PER COMMON SHARE ATTRIBUTABLE TO CUMMINS INC.				
Basic	$2.32	$1.91	$6.59	$5.61
Diluted	$2.32	$1.90	$6.58	$5.60
WEIGHTED AVERAGE SHARES OUTSTANDING				
Basic	182.2	186.0	183.1	187.4
Dilutive effect of stock compensation awards	0.5	0.5	0.4	0.4
Diluted	182.7	186.5	183.5	187.8
CASH DIVIDENDS DECLARED PER COMMON SHARE	$0.78	$0.625	$2.03	$1.625

[a] Includes sales to nonconsolidated equity investees of $518 million and $1,656 million and $553 million and $1,681 million for the three and nine month periods ended September 28, 2014 and September 29, 2013, 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 September 28, 2014	Three months ended September 29, 2013	Nine months ended September 28, 2014	Nine months ended September 29, 2013
CONSOLIDATED NET INCOME	$439	$ 374	$1,269	$ 1,127
Other comprehensive income (loss), net of tax (Note 13)				
Foreign currency translation adjustments	(172)	95	(62)	(101)
Unrealized gain (loss) on derivatives	(5)	10	—	(2)
Change in pension and other postretirement defined benefit plans	14	16	28	56
Unrealized gain (loss) on marketable securities	(1)	1	(12)	(2)
Total other comprehensive income (loss), net of tax	(164)	122	(46)	(49)
COMPREHENSIVE INCOME	275	496	1,223	1,078
Less: Comprehensive income attributable to noncontrolling interest	10	10	59	45
COMPREHENSIVE INCOME ATTRIBUTABLE TO CUMMINS INC.	$265	$ 486	$1,164	$ 1,033

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 28, 2014	December 31, 2013
ASSETS		
Current assets		
Cash and cash equivalents	$2,328	$2,699
Marketable securities (Note 7)	53	150
Total cash, cash equivalents and marketable securities	2,381	2,849
Accounts and notes receivable, net		
Trade and other	2,774	2,362
Nonconsolidated equity investees	285	287
Inventories (Note 8)	2,833	2,381
Prepaid expenses and other current assets	795	760
Total current assets	9,068	8,639
Long-term assets		
Property, plant and equipment	6,899	6,410
Accumulated depreciation	(3,435)	(3,254)
Property, plant and equipment, net	3,464	3,156
Investments and advances related to equity method investees (Note 5)	981	931
Goodwill	465	461
Other intangible assets, net	346	357
Prepaid pensions	701	514
Other assets	619	670
Total assets	$15,644	$14,728
LIABILITIES		
Current liabilities		
Loans payable	$78	$17
Accounts payable (principally trade)	1,930	1,557
Current maturities of long-term debt (Note 9)	27	51
Current portion of accrued product warranty (Note 10)	351	360
Accrued compensation, benefits and retirement costs	507	433
Deferred revenue	328	285
Taxes payable (including taxes on income)	134	99
Other accrued expenses	683	566
Total current liabilities	4,038	3,368
Long-term liabilities		
Long-term debt (Note 9)	1,584	1,672
Pensions	234	232
Postretirement benefits other than pensions	333	356
Other liabilities and deferred revenue	1,358	1,230
Total liabilities	7,547	6,858
Commitments and contingencies (Note 11)		
EQUITY		
Cummins Inc. shareholders’ equity		

Common stock, $2.50 par value, 500 shares authorized, 222.3 and 222.3 shares issued	2,125	2,099
Retained earnings	9,243	8,406
Treasury stock, at cost, 39.6 and 35.6 shares	(2,779)	(2,195)
Common stock held by employee benefits trust, at cost, 1.1 and 1.3 shares	(14)	(16)
Accumulated other comprehensive loss (Note 13)		
Defined benefit postretirement plans	(583)	(611)
Other	(244)	(173)
Total accumulated other comprehensive loss	(827)	(784)
Total Cummins Inc. shareholders’ equity	7,748	7,510
Noncontrolling interests	349	360
Total equity	8,097	7,870
Total liabilities and equity	$15,644	$14,728

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 28, 2014	September 29, 2013
CASH FLOWS FROM OPERATING ACTIVITIES		
Consolidated net income	$1,269	$1,127
Adjustments to reconcile consolidated net income to net cash provided by operating activities		
Depreciation and amortization	330	305
Gain on fair value adjustment for consolidated investees (Note 3)	(38)	(12)
Deferred income taxes	(37)	78
Equity in income of investees, net of dividends	(103)	(98)
Pension contributions in excess of expense (Note 4)	(154)	(96)
Other post-retirement benefits payments in excess of expense (Note 4)	(22)	(20)
Stock-based compensation expense	27	29
Excess tax benefits on stock-based awards	(5)	(13)
Translation and hedging activities	(19)	26
Changes in current assets and liabilities, net of acquisitions		
Accounts and notes receivable	(236)	(216)
Inventories	(302)	(206)
Other current assets	(6)	182
Accounts payable	316	252
Accrued expenses	162	(146)
Changes in other liabilities and deferred revenue	184	147
Other, net	22	(6)
Net cash provided by operating activities	1,388	1,333
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(409)	(417)
Investments in internal use software	(40)	(43)
Investments in and advances to equity investees	(39)	(12)
Acquisitions of businesses, net of cash acquired (Note 3)	(266)	(145)
Investments in marketable securities—acquisitions (Note 7)	(213)	(360)
Investments in marketable securities—liquidations (Note 7)	316	433
Cash flows from derivatives not designated as hedges	—	(15)
Other, net	11	14
Net cash used in investing activities	(640)	(545)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from borrowings	39	987
Payments on borrowings and capital lease obligations	(72)	(62)
Net (payments) borrowings under short-term credit agreements	(41)	34
Distributions to noncontrolling interests	(52)	(53)
Dividend payments on common stock	(370)	(305)
Repurchases of common stock	(605)	(289)
Excess tax benefits on stock-based awards	5	13
Other, net	(3)	19

Net cash (used in) provided by financing activities	(1,099)	344
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	(20)	(2)
Net (decrease) increase in cash and cash equivalents	(371)	1,130
Cash and cash equivalents at beginning of year	2,699	1,369
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$2,328	$2,499

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	Accumulated Other Comprehensive Loss	Treasury Stock	Common Stock Held in Trust	Total Cummins Inc. Shareholders' Equity	Noncontrolling Interests	Total Equity
BALANCE AT DECEMBER 31, 2012	$ 556	$ 1,502	$ 7,343	$ (950)	$ (1,830)	$ (18)	$ 6,603	$ 371	$ 6,974
Net income			1,051				1,051	76	1,127
Other comprehensive income (loss)				(18)			(18)	(31)	(49)
Issuance of shares		5					5	—	5
Employee benefits trust activity		18				2	20	—	20
Acquisition of shares					(289)		(289)	—	(289)
Cash dividends on common stock			(305)				(305)	—	(305)
Distribution to noncontrolling interests							—	(53)	(53)
Stock based awards		1			15		16	—	16
Other shareholder transactions		13					13	5	18
BALANCE AT SEPTEMBER 29, 2013	$ 556	$ 1,539	$ 8,089	$ (968)	$ (2,104)	$ (16)	$ 7,096	$ 368	$ 7,464
BALANCE AT DECEMBER 31, 2013	$ 556	$ 1,543	$ 8,406	$ (784)	$ (2,195)	$ (16)	$ 7,510	$ 360	$ 7,870
Net income			1,207				1,207	62	1,269
Other comprehensive income (loss)				(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)
Distribution 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	$ (827)	$ (2,779)	$ (14)	$ 7,748	$ 349	$ 8,097

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, 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 over 600 company-owned and independent distributor locations and over 6,800 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.

We revised the classification of certain amounts for "Cost of sales" and "Selling, general and administrative expenses" for 2014 and 2013. In connection with the integration of recently acquired North American distributors and anticipating the future acquisition and integration of the entire North American channel, our Distribution segment has developed a framework against which Distribution management intends to measure the performance of the distribution channel. The segment EBIT (defined as earnings before interest expense, taxes and noncontrolling interests) performance measure is unchanged, however, certain activities that were previously classified in "Selling, general and administrative expenses" will be classified as "Cost of sales" to align with the new framework and allow for consistent treatment across the channel. We revised the expense presentation of our Condensed Consolidated Statements of Income for the periods presented to follow the new cost framework. The net impact of this revision for the six months ended June 29, 2014 was $39 million and for the three and nine months ended September 29, 2013, were $28 million and $76 million , respectively. The revision had no impact on reported net income, cash flows or the balance sheet.

Additionally, certain other 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 2014 and 2013 ended on September 28 and September 29, respectively. The interim periods for both 2014 and 2013 contained 13 weeks, while the nine month periods both contained 39 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, lease classifications and contingencies. Due to the inherent uncertainty involved in making estimates, actual results reported in future periods may be different from these estimates.

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 28, 2014 and September 29, 2013, were as follows:

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	Three months ended		Nine months ended	
	September 28, 2014	September 29, 2013	September 28, 2014	September 29, 2013
Options excluded	225,773	184,775	110,488	479,276

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, 2013. 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.

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 United States and Canadian distributors over the next three to five years. In each acquisition we recorded a gain related to the remeasurement of our existing ownership interest to fair value in accordance with GAAP. We believe the price paid to the former principal is representative of fair value. As such, we valued our existing ownership interest by applying the price paid to the former principal to our existing ownership on a relative basis. The amount paid to the former principal is determined in accordance with a pre-existing agreement that attempts to value the business on a fair value basis. Gains recognized in the remeasurement are included in other income (expense), in the Condensed Consolidated Statements of Income. The following is a summary of the acquisition activity for the first nine months of 2014 and 2013.

Cummins Eastern Canada LP

On August 4, 2014, we acquired the remaining 50 percent interest in Cummins Eastern Canada LP (Eastern Canada) from the former distributor principal. The preliminary purchase consideration was $62 million, which included $22 million in cash and an additional $32 million to eliminate outstanding debt. The remaining $8 million will be paid in future periods. The intangible assets are primarily customer related, the majority of which will be amortized within one year subject to customary purchase price adjustments. The acquisition was accounted for as a business combination and the results of the acquired entity were included in the Distribution operating segment subsequent to the acquisition date. As a result of this transaction, third quarter 2014 Distribution segment results included an $18 million gain, as we were required to re-measure our pre-existing 50 percent ownership interest in Eastern Canada to fair value in accordance with GAAP. The transaction generated $5 million of goodwill based on the preliminary purchase price allocation. Net sales for Eastern Canada were $228 million for the year ended December 31, 2013. This amount is not fully incremental to our consolidated sales as the amount would be reduced by the elimination of sales to the previously unconsolidated entity.

Cummins Power Systems LLC

On May 5, 2014, we acquired the remaining 30 percent interest in Cummins Power Systems LLC (Power Systems) from the former distributor principal for consideration of approximately $14 million in cash. The entity was previously consolidated and, as a result, the acquisition was accounted for as an equity transaction instead of a business combination.

Cummins Southern Plains LLC

On March 31, 2014, we acquired the remaining 50 percent interest in Cummins Southern Plains LLC (Southern Plains) from the former distributor principal. The purchase consideration was $92 million as presented below, which included $42 million in cash and an additional $48 million paid to eliminate outstanding debt as of September 28, 2014. The intangible assets are primarily customer related and are being amortized over periods ranging from one to five years. The acquisition was accounted for as a business combination and the results of the acquired entity were included in the Distribution operating segment subsequent to the acquisition date. As a result of this transaction, second quarter 2014 Distribution segment results included a $13 million gain, as we were required to re-measure our pre-existing 50 percent ownership interest in Southern Plains to fair value in accordance with GAAP. The transaction generated less than $1 million of goodwill. Net sales for Southern Plains were $433 million for the year ended December 31, 2013. This amount is not fully incremental to our consolidated sales as the amount would be reduced by the elimination of sales to the previously unconsolidated entity.

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The final purchase price allocation was as follows:

In millions	
Accounts receivable	$ 63
Inventory	59
Fixed assets	47
Intangible assets	11
Other current assets	9
Current liabilities	(53)
Total business valuation	136
Fair value of pre-existing 50 percent interest	(44)
Purchase price	$ 92

Cummins Mid-South LLC

On February 14, 2014, we acquired the remaining 62.2 percent interest in Cummins Mid-South LLC (Mid-South) from the former distributor principal. The purchase consideration was $118 million as presented below, which included $32 million in cash paid in the first quarter along with an additional $61 million paid to eliminate outstanding debt. As of September 28, 2014, an additional $23 million had been paid. The intangible assets are primarily customer related and are being amortized over periods ranging from one to five years. The acquisition was accounted for as a business combination and the results of the acquired entity were included in the Distribution operating segment subsequent to the acquisition date. As a result of this transaction, first quarter 2014 Distribution segment results included a $6 million gain, as we were required to re-measure our pre-existing 37.8 percent ownership interest in Mid-South to fair value in accordance with GAAP. In the second quarter of 2014, we recognized an additional $1 million gain as the result of the final valuation. The transaction generated $4 million of goodwill. Net sales for Mid-South were $368 million for the year ended December 31, 2013. This amount is not fully incremental to our consolidated sales as the amount would be reduced by the elimination of sales to the previously unconsolidated entity.

The final purchase price allocation was as follows:

In millions	
Accounts receivable	$ 71
Inventory	70
Fixed assets	37
Intangible assets	8
Goodwill	4
Other current assets	10
Current liabilities	(43)
Other long-term liability	(4)
Total business valuation	153
Fair value of pre-existing 37.8 percent interest	(35)
Purchase price	$ 118

Cummins Rocky Mountain LLC

In May 2013, we acquired the remaining 67 percent interest in Cummins Rocky Mountain LLC (Rocky Mountain) from the former distributor principal for consideration of approximately $62 million in cash and an additional $74 million in cash paid to creditors to eliminate all debt related to the entity. The purchase price was approximately $136 million as presented below. The intangible assets are primarily customer related and are being amortized over periods ranging from one to four years. The acquisition was accounted for as a business combination, with the results of the acquired entity included in the Distribution operating segment subsequent to the acquisition date. Distribution segment results also included a $5 million gain, as we were required to re-measure our pre-existing 33 percent ownership interest in Rocky Mountain to fair value in accordance with GAAP. Net sales for Rocky Mountain were $384 million for the year ended December 31, 2012. This amount is not fully incremental to our consolidated sales as the amount would be reduced by the elimination of sales to the previously unconsolidated entity.

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The final purchase price allocation was as follows:

In millions	
Accounts receivable	$48
Inventory	100
Fixed assets	34
Intangible assets	8
Goodwill	10
Other current assets	8
Current liabilities	(41)
Total business valuation	167
Fair value of pre-existing 33 percent interest	(31)
Purchase price	$136

Cummins Northwest LLC

In January 2013, we acquired the remaining 50 percent interest in Cummins Northwest LLC (Northwest) from the former distributor principal for consideration of approximately $18 million. We immediately formed a new partnership with a new distributor principal and sold 20.01 percent to the new distributor principal. We retained a new ownership in Northwest of 79.99 percent. The acquisition was accounted for as a business combination, with the results of the acquired entity included in the Distribution segment subsequent to the acquisition date. Distribution segment results also included a $7 million gain, as we were required to re-measure our pre-existing 50 percent ownership interest in Northwest to fair value in accordance with GAAP. The transaction generated $3 million of goodwill. Net sales for Northwest were $137 million for the year ended December 31, 2012. This amount is not fully incremental to our consolidated sales as the amount would be reduced by the elimination of sales to the previously unconsolidated entity.

In July 2013, we acquired the remaining 20.01 percent from the new distributor principal for an additional $4 million. Since the entity was already consolidated, the acquisition was accounted for as an equity transaction instead of a business combination.

NOTE 4. PENSION AND OTHER POSTRETIREMENT BENEFITS

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

In millions	Three months ended September 28, 2014	Three months ended September 29, 2013	Nine months ended September 28, 2014	Nine months ended September 29, 2013
Defined benefit pension and other postretirement plans				
Voluntary contribution	$34	$33	$109	$110
Mandatory contribution	7	7	88	51
Defined benefit pension contributions	41	40	197	161
Other postretirement plans	12	11	35	37
Total defined benefit plans	$53	$51	$232	$198
Defined contribution pension plans	$16	$14	$57	$50

We anticipate making additional defined benefit pension contributions and other postretirement benefit payments during the remainder of 2014 of $8 million and $11 million, respectively. The $205 million of pension contributions for the full year include voluntary contributions of approximately $111 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.

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

	Pension					
	U.S. Plans		U.K. Plans		Other Postretirement Benefits	
	Three months ended					
In millions	September 28, 2014	September 29, 2013	September 28, 2014	September 29, 2013	September 28, 2014	September 29, 2013
Service cost	$16	$ 17	$7	$ 5	$ —	$ —
Interest cost	26	23	16	14	4	4
Expected return on plan assets	(43)	(42)	(23)	(17)	—	—
Recognized net actuarial loss	8	16	7	6	—	2
Net periodic benefit cost	$7	$ 14	$7	$ 8	$ 4	$ 6

	Pension					
	U.S. Plans		U.K. Plans		Other Postretirement Benefits	
	Nine months ended					
In millions	September 28, 2014	September 29, 2013	September 28, 2014	September 29, 2013	September 28, 2014	September 29, 2013
Service cost	$50	$ 52	$19	$ 15	$ —	$ —
Interest cost	79	70	49	42	13	12
Expected return on plan assets	(131)	(126)	(66)	(53)	—	—
Recognized net actuarial loss	23	47	20	18	—	5
Net periodic benefit cost	$21	$ 43	$22	$ 22	$ 13	$ 17

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		Nine months ended	
In millions	September 28, 2014	September 29, 2013	September 28, 2014	September 29, 2013
Distribution Entities				
North American distributors	$27	$34	$89	$98
Komatsu Cummins Chile, Ltda.	8	6	22	17
All other distributors	—	1	2	1
Manufacturing Entities				
Dongfeng Cummins Engine Company, Ltd.	15	13	51	45
Chongqing Cummins Engine Company, Ltd.	13	15	39	44
Beijing Foton Cummins Engine Co., Ltd. (Light-duty)	10	4	24	14
Shanghai Fleetguard Filter Co., Ltd.	3	4	9	11
Tata Cummins, Ltd.	2	1	6	4
Cummins Westport, Inc.	2	2	3	5
Beijing Foton Cummins Engine Co., Ltd. (Heavy-duty)	(5)	(4)	(18)	(14)
All other manufacturers	13	7	36	29
Cummins share of net income	88	83	263	254
Royalty and interest income	11	8	31	27

Equity, royalty and interest income from investees	$99	$91	$294	$281

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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, 2013 and has not yet been renewed by Congress. 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 rates for the three and nine month periods ended September 28, 2014, were 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 second quarter $2 million discrete tax benefit for the release of reserves for uncertain tax positions related to multiple state audit settlements, a first quarter $12 million discrete tax expense attributable primarily to state deferred tax adjustments, as well as a first quarter $6 million discrete net tax benefit resulting from a $70 million dividend paid from China earnings generated prior to 2012.

Our effective tax rates for the three and nine month periods ended September 29, 2013, were 29.2 percent and 28.3 percent, respectively. These tax rates include a $7 million discrete net tax expense for the third quarter tax adjustments: $4 million expense attributable to prior year tax return true-up adjustments, $1 million benefit related to release of prior year tax reserves and a discrete tax charge for $4 million related to a third quarter enactment of U.K. tax law changes. In addition, the nine month tax rate includes a discrete tax benefit in the first quarter of 2013 of $28 million attributable to the reinstatement of the research credit back to 2012, as well as a discrete tax expense in the first quarter of 2013 of $17 million, which primarily relates to the write-off of a deferred tax asset deemed unrecoverable.

The increase in the three month effective tax rate from 2013 to 2014 is primarily due to unfavorable changes in the jurisdictional mix of pre-tax income and the 2014 unfavorable discrete tax items.

We anticipate that we may resolve tax matters related primarily to certain tax credits presently under examination in U.S. federal and state tax jurisdictions. As of September 28, 2014, we estimate that it is reasonably possible that unrecognized tax benefits may decrease in an amount ranging from $0 to $75 million in the next 12 months due to the resolution of these issues. We do not expect this resolution to have a material impact on our results of operations.

NOTE 7. MARKETABLE SECURITIES

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

	September 28, 2014			December 31, 2013		
In millions	Cost	Gross unrealized gains/(losses)	Estimated fair value	Cost	Gross unrealized gains/(losses)	Estimated fair value
Available-for-sale						
Level 1[(1)]						
Debt mutual funds	$26	$—	$26	$72	$—	$72
Equity securities and other	7	—	7	10	13	23
Total level 1	33	—	33	82	13	95
Level 2[(2)]						
Debt mutual funds	14	1	15	27	2	29
Bank debentures	3	—	3	2	—	2
Certificates of deposit	—	—	—	22	—	22
Government debt securities-non-U.S.	3	(1)	2	3	(1)	2
Total level 2	20	—	20	54	1	55
Total marketable securities	$53	$—	$53	$136	$14	$150

[1] The fair value of Level 1 securities is estimated primarily by referencing quoted prices in active markets for identical assets.
[2] 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 into or out of Level 2 or 3 during the first nine months of 2014 and 2013.

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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 September 28, 2014	Three months ended September 29, 2013	Nine months ended September 28, 2014	Nine months ended September 29, 2013
Proceeds from sales and maturities of marketable securities	$137	$153	$316	$ 433
Gross realized gains from the sale of available-for-sale securities	1	1	14	12

At September 28, 2014, 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	$16
1 - 5 years	3
5 - 10 years	1
Total	$20

NOTE 8. INVENTORIES

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

In millions	September 28, 2014	December 31, 2013
Finished products	$1,775	$1,487
Work-in-process and raw materials	1,182	1,005
Inventories at FIFO cost	2,957	2,492
Excess of FIFO over LIFO	(124)	(111)
Total inventories	$2,833	$2,381

NOTE 9. DEBT

A summary of long-term debt was as follows:

In millions	September 28, 2014	December 31, 2013
Long-term debt		
Senior notes, 3.65%, due 2023 (1)	$500	$500
Debentures, 6.75%, due 2027	58	58
Debentures, 7.125%, due 2028 (1)	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	7	92
Other	38	65
	1,518	1,630
Unamortized discount	(47)	(48)
Fair value adjustments due to hedge on indebtedness (1)	51	49
Capital leases	89	92
Total long-term debt	1,611	1,723
Less: Current maturities of long-term debt	(27)	(51)
Long-term debt	$1,584	$1,672

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(1) In February 2014, we settled our November 2005 interest rate swap which previously converted our $250 million debt issue, due in 2028, from a fixed rate to a floating rate based on a LIBOR spread. We are amortizing the $52 million gain realized upon settlement over the remaining 14-year term of related debt. Also, in February 2014, we entered into a series of interest rate swaps to effectively convert our September 2013, $500 million debt issue, due in 2023, from a fixed rate of 3.65 percent to a floating rate equal to the one-month LIBOR plus a spread. See Note 12, "DERIVATIVES" for further details.

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

	Required Principal Payments				
In millions	2014	2015	2016	2017	2018
Payment	$11	$22	$32	$12	$16

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 28, 2014	December 31, 2013
Fair value of total debt[1]	$1,922	$1,877
Carrying value of total debt	1,689	1,740

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

NOTE 10. PRODUCT WARRANTY LIABILITY

We charge the estimated costs of warranty programs, other than product recalls, to income when the sale is recorded. We use historical claims experience to develop the estimated liability. We review product recall programs on a quarterly basis and, if necessary, record a liability when we commit to an action, or when they become probable and estimable, which is reflected in the provision for warranties issued line. We also sell extended warranty coverage on several engines. 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:

	Nine months ended	
In millions	September 28, 2014	September 29, 2013
Balance, beginning of year	$1,129	$1,088
Provision for warranties issued	307	317
Deferred revenue on extended warranty contracts sold	175	138
Payments	(313)	(312)
Amortization of deferred revenue on extended warranty contracts	(109)	(84)
Changes in estimates for pre-existing warranties	28	(26)
Foreign currency translation	(4)	(3)
Balance, end of period	$1,213	$1,118

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Warranty related deferred revenue, supplier recovery receivables and the long-term portion of the warranty liability on our September 28, 2014, balance sheet were as follows:

In millions	September 28, 2014	Balance Sheet Location
Deferred revenue related to extended coverage programs		
Current portion	$159	Deferred revenue
Long-term portion	401	Other liabilities and deferred revenue
Total	$560	
Receivables related to estimated supplier recoveries		
Current portion	$9	Trade and other receivables
Long-term portion	3	Other assets
Total	$12	
Long-term portion of warranty liability	$302	Other liabilities and deferred revenue

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.

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

U.S. Distributor Commitments

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

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Other Guarantees and Commitments

In addition to the matters discussed above, from time to time we enter into other guarantee arrangements, including guarantees of non-U.S. distributor financing, residual value guarantees on equipment under operating leases and other miscellaneous guarantees of third-party obligations. As of September 28, 2014, the maximum potential loss related to these other guarantees was $8 million.

We have arrangements with certain suppliers that require us to purchase minimum volumes or be subject to monetary penalties. The penalty amounts are less than our purchase commitments and essentially allow the supplier to recover their tooling costs in most instances. As of September 28, 2014, if we were to stop purchasing from each of these suppliers, the aggregate amount of the penalty would be approximately $86 million, of which $47 million relates to a contract with an engine parts supplier that extends to 2016. These arrangements enable us to secure critical components. We do not currently anticipate paying any penalties under these contracts.

During the second quarter of 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 28, 2014, the total commitments under these contracts were $51 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 $80 million at September 28, 2014 and $66 million at December 31, 2013.

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.

Joint Venture Commitments

As of September 28, 2014, we have committed to invest an additional $4 million in existing joint ventures, of which $1 million is expected to be funded in 2014.

NOTE 12. DERIVATIVES

We are exposed to financial risk resulting from volatility in foreign exchange rates, commodity prices and interest rates. This risk is closely monitored and managed through the use of financial derivative instruments including foreign currency forward contracts, commodity zero-cost collars and interest rate swaps. These instruments, as further described below, are accounted for as cash flow or fair value hedges or as economic hedges not designated as hedges for accounting purposes. Financial derivatives are used expressly for hedging purposes and under no circumstances are they used for speculative purposes. When material, we adjust the estimated fair value of our derivative contracts for counter-party or our credit risk. None of our derivative instruments are subject to collateral requirements. Substantially all of our derivative contracts are subject to master netting arrangements which provide us with the option to settle certain contracts on a net basis when they settle on the same day with the same currency. In addition, these arrangements provide for a net settlement of all contracts with a given counterparty in the event that the arrangement is terminated due to the occurrence of default or a termination event.

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Commodity Price Risk

During the second quarter of 2014, we chose to de-designate and unwind all of our cash flow hedges for platinum and palladium. As of the de-designation date, we had an unrealized net gain of $2 million in "Accumulated other comprehensive loss" (AOCL) that will be reclassified to income during the next year as the related purchases are made. See Note 11, "COMMITMENTS AND CONTINGENCIES" for additional information on new platinum and palladium purchase committments.

Interest Rate Risk

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

In February 2014, we settled our November 2005 interest rate swap which previously converted our $250 million debt issue, due in 2028, from a fixed rate to a floating rate based on a LIBOR spread. We are amortizing the $52 million gain realized upon settlement over the remaining 14-year term of related debt.

Also, in February 2014, we entered into a series of interest rate swaps to effectively convert our September 2013, $500 million debt issue, due in 2023, from a fixed rate of 3.65 percent to a floating rate equal to the one-month LIBOR plus a spread. The terms of the swaps mirror those of the debt, with interest paid semi-annually. The swaps were designated, and will be accounted for, as fair value hedges under GAAP. The gain or loss on these derivative instruments, as well as the offsetting gain or loss on the hedged item attributable to the hedged risk, are recognized in current income as “Interest expense.” The net swap settlements that accrue each period are also reported in interest expense.

The following table summarizes these gains and losses for the three and nine month periods presented below:

	Three months ended				Nine months ended			
In millions	September 28, 2014		September 29, 2013		September 28, 2014		September 29, 2013	
Income Statement Classification	Gain/(Loss) on Swaps	Gain/(Loss) on Borrowings	Gain/(Loss) on Swaps	Gain/(Loss) on Borrowings	Gain/(Loss) on Swaps	Gain/(Loss) on Borrowings	Gain/(Loss) on Swaps	Gain/(Loss) on Borrowings
Interest expense[1]	$—	$ 2	$ (6)	$ 6	$ 8	$ (5)	$ (34)	$ 34

[1]The difference between the gain/(loss) on swaps and borrowings represents hedge ineffectiveness.

Cash Flow Hedging

The following table summarizes the effect on our Condensed Consolidated Statements of Income for derivative instruments classified as cash flow hedges for the three and nine month periods presented below:

In millions[1]	Three months ended		Nine months ended	
Derivatives in cash flow hedging relationships	September 28, 2014	September 29, 2013	September 28, 2014	September 29, 2013
Gain/(loss) reclassified from AOCL into income - Net sales[2]	$ 1	$ (2)	$ 6	$ (4)
Gain/(loss) reclassified from AOCL into income - Cost of sales[3]	1	(2)	(2)	1
Total	$ 2	$ (4)	$ 4	$ (3)

[1]The table does not include amounts related to ineffectiveness or the effective portion of gain (loss) recognized in AOCL as they were not material for the periods presented.

[2]Includes foreign currency forward contracts.

[3]Includes commodity swap contracts.

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Derivatives Not Designated as Hedging Instruments

The following table summarizes the effect on our Condensed Consolidated Statements of Income for derivative instruments not classified as cash flow hedges for the three and nine month periods presented below:

In millions	Three months ended		Nine months ended	
Derivatives not designated as hedging instruments	September 28, 2014	September 29, 2013	September 28, 2014	September 29, 2013
Gain/(loss) recognized in income - Cost of sales[1]	$ 1	$ (1)	$ (2)	$ (2)
Gain/(loss) recognized in income - Other income (expense), net[2]	(12)	19	(5)	(3)
Total	$ (11)	$ 18	$ (7)	$ (5)

[1] Includes foreign currency forward contracts and commodity zero-cost collars.
[2] Includes foreign currency forward contracts.

Fair Value Amount and Location of Derivative Instruments

The following table summarizes the location and fair value of interest rate swap contracts, foreign currency forward contracts, commodity swap contracts and commodity zero-cost collars on our Condensed Consolidated Balance Sheets:

	Derivatives Designated as Hedging Instruments		Derivatives Not Designated as Hedging Instruments	
In millions	September 28, 2014	December 31, 2013	September 28, 2014	December 31, 2013
Notional amount[1]	$ 603	$ 425	$ 747	$ 547
Derivative assets recorded in:				
Prepaid expenses and other current assets	—	5	—	6
Other assets	5	49	—	—
Total derivative assets[2]	$ 5	$ 54	$ —	$ 6
Derivative liabilities recorded in:				
Other accrued expenses	2	5	1	5
Total derivative liabilities[2]	$ 2	$ 5	$ 1	$ 5

[1]Commodity zero-cost collars are not designated as hedging instruments and had a notional quantity of 4,578 and 5,421 metric tons of copper at September 28, 2014 and December 31, 2013, respectively. These instruments are not included in the notional amounts above as they were subject to a USD denominated cap and floor; however, they are included in the total asset and liability balances as appropriate. The average cap and floor at September 28, 2014 and December 31, 2013 were $7,265 and $6,619 and $7,639 and $6,978, respectively.
[2]Estimates of the fair value of all derivative assets and liabilities above are derived from Level 2 inputs, which are 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 input measures and there were no transfers into or out of Level 2 or 3 during the first nine months of 2014 and 2013.

We have elected to present our derivative contracts on a gross basis in our Condensed Consolidated Balance Sheets. Had we chosen to present on a net basis, we would have derivatives in a net asset position of $4 million and $53 million and derivatives in a net liability position of $2 million and $3 million at September 28, 2014 and December 31, 2013, respectively.

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NOTE 13. 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 Change in pensions and other postretirement defined benefit plans	Foreign currency translation adjustment	Unrealized gain (loss) on marketable securities	Unrealized gain (loss) on derivatives	Total attributable to Cummins Inc.	Noncontrolling interests	Total
Balance at June 30, 2013	$(754)	$ (338)	$ 5	$ (12)	$ (1,099)		
Other comprehensive income before reclassifications							
Before tax amount	—	105	2	10	117	$ (9)	$108
Tax (provision) benefit	—	(1)	1	(3)	(3)	—	(3)
After tax amount	—	104	3	7	114	(9)	105
Amounts reclassified from accumulated other comprehensive income[(1)(2)]	16	—	(2)	3	17	—	17
Net current period other comprehensive income (loss)	16	104	1	10	131	$ (9)	$122
Balance at September 29, 2013	$(738)	$ (234)	$ 6	$ (2)	$ (968)		
Balance at June 29, 2014	$(597)	$ (76)	$ —	$ 4	$ (669)		
Other comprehensive income before reclassifications							
Before tax amount	—	(184)	—	(5)	(189)	$ (6)	$(195)
Tax (provision) 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)		

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In millions	Nine months ended Change in pensions and other postretirement defined benefit plans	Foreign currency translation adjustment	Unrealized gain (loss) on marketable securities	Unrealized gain (loss) on derivatives	Total attributable to Cummins Inc.	Noncontrolling interests	Total
Balance at December 31, 2012	$ (794)	$ (161)	$ 5	$ —	$ (950)		
Other comprehensive income before reclassifications							
Before tax amount	13	(86)	10	(7)	(70)	$ (28)	$ (98)
Tax (provision) benefit	(5)	13	(1)	2	9	—	9
After tax amount	8	(73)	9	(5)	(61)	(28)	(89)
Amounts reclassified from accumulated other comprehensive income(1)(2)	48	—	(8)	3	43	(3)	40
Net current period other comprehensive income (loss)	56	(73)	1	(2)	(18)	$ (31)	$ (49)
Balance at September 29, 2013	$ (738)	$ (234)	$ 6	$ (2)	$ (968)		
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 (provision) 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)		

(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		
(Gain)/Loss Components	September 28, 2014	September 29, 2013	September 28, 2014	September 29, 2013	Statement of Income Location
Realized (gain) loss on marketable securities	$(1)	$(1)	$(14)	$(12)	Other income (expense), net
Income tax expense	—	(1)	3	1	Income tax expense
Net realized (gain) loss on marketable securities	(1)	(2)	(11)	(11)	
Realized (gain) loss on derivatives					
Foreign currency forward contracts	(1)	2	(6)	4	Net sales
Commodity swap contracts	(1)	2	2	(1)	Cost of sales
Total before taxes	(2)	4	(4)	3	
Income tax expense	1	(1)	1	—	Income tax expense
Net realized (gain) loss on derivatives	(1)	3	(3)	3	
Change in pension and other postretirement defined benefit plans					
Recognized actuarial loss	18	24	47	71	(1)
Total before taxes	18	24	47	71	
Income tax expense	(4)	(8)	(13)	(23)	Income tax expense
Net change in pensions and other postretirement defined benefit plans	14	16	34	48	
Total reclassifications for the period	$12	$17	$20	$40	

(1) These accumulated other comprehensive income components are included in the computation of net periodic pension cost (see Note 4).

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NOTE 14. OPERATING SEGMENTS

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

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

We use segment EBIT (defined as earnings before interest expense, 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, divestiture gains or losses or income taxes to individual segments. Segment EBIT may not be consistent with measures used by other companies.

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

In millions	Engine	Components	Power Generation	Distribution	Non-segment Items [1]	Total
Three months ended September 28, 2014						
External sales	$2,181	$946	$481	$1,282	$—	$4,890
Intersegment sales	635	341	273	10	(1,259)	—
Total sales	2,816	1,287	754	1,292	(1,259)	4,890
Depreciation and amortization[2]	50	27	13	22	—	112
Research, development and engineering expenses	114	64	18	2	—	198
Equity, royalty and interest income from investees	40	9	13	37	—	99
Interest income	3	1	1	1	—	6
Segment EBIT	330	172	60	131	[3] (9)	684
Three months ended September 29, 2013						
External sales	$2,045	$784	$499	$938	$—	$4,266
Intersegment sales	447	288	213	6	(954)	—
Total sales	2,492	1,072	712	944	(954)	4,266
Depreciation and amortization[2]	53	24	13	15	—	105
Research, development and engineering expenses	103	51	18	1	—	173
Equity, royalty and interest income from investees	31	5	13	42	—	91
Interest income	4	1	1	—	—	6
Segment EBIT	272	132	45	86	[3] 1	536
Nine months ended September 28, 2014						
External sales	$6,449	$2,821	$1,408	$3,453	$—	$14,131
Intersegment sales	1,674	976	728	27	(3,405)	—
Total sales	8,123	3,797	2,136	3,480	(3,405)	14,131
Depreciation and amortization[2]	153	79	38	58	—	328
Research, development and engineering expenses	335	170	55	7	—	567
Equity, royalty and interest income from investees	117	27	30	120	—	294
Interest income	9	3	3	2	—	17
Segment EBIT	910	524	146	333	[3] (44)	1,869
Nine months ended September 29, 2013						
External sales	$6,139	$2,292	$1,621	$2,661	$—	$12,713
Intersegment sales	1,312	915	651	15	(2,893)	—
Total sales	7,451	3,207	2,272	2,676	(2,893)	12,713
Depreciation and amortization[2]	156	71	37	40	—	304
Research, development and engineering expenses	310	165	53	4	—	532
Equity, royalty and interest income from investees	106	21	30	124	—	281

Interest income	13	2	5	1	—	21
Segment EBIT	806	387	172	281 [3]	(52)	1,594

[1] Includes intersegment sales and profit in inventory eliminations and unallocated corporate expenses. There were no significant unallocated corporate expenses for the three and nine months ended September 28, 2014 and September 29, 2013.
[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 $8 million for the nine months ended September 28, 2014 and September 29, 2013, respectively.
[3]Distribution segment EBIT included gains as disclosed in the table below. See Note 3, "ACQUISITIONS" for additional information.

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Distribution segment EBIT included gains on the fair value adjustment resulting from the acquisition of controlling interests in North American distributors in the periods presented below:

In millions	Three months ended September 28, 2014	Three months ended September 29, 2013	Nine months ended September 28, 2014	Nine months ended September 29, 2013
Eastern Canada	$ 18	$ —	$ 18	$ —
Southern Plains	—	—	13	—
Mid-South	—	—	7	—
Rocky Mountain	—	—	—	5
Northwest	—	—	—	7
Total gains included in EBIT	$ 18	$ —	$ 38	$ 12

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 September 28, 2014	Three months ended September 29, 2013	Nine months ended September 28, 2014	Nine months ended September 29, 2013
Total EBIT	$ 684	$ 536	$ 1,869	$ 1,594
Less: Interest expense	15	8	47	22
Income before income taxes	$ 669	$ 528	$ 1,822	$ 1,572

NOTE 15. RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In May 2014, the Financial Accounting Standards Board (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. Early adoption is not permitted. 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 will become effective for annual and interim periods beginning January 1, 2017. We are in the process of evaluating the impact the amendment will have on our Consolidated Financial Statements and determining our method for adoption.

NOTE 16. SUBSEQUENT EVENTS

Acquisition of Cummins Npower LLC

On September 29, 2014, we acquired the remaining 50 percent interest in Cummins Npower LLC (Npower) from the former distributor principal for consideration of approximately $39 million in cash and an additional $33 million paid to creditors to eliminate all debt related to the entity, or total consideration of $72 million, subject to customary purchase price adjustments.

Acquisition of Cummins Power South LLC

On September 29, 2014, we acquired the remaining 50 percent interest in Cummins Power South LLC (Power South) from the former distributor principal for consideration of approximately $19 million in cash and an additional $16 million paid to creditors to eliminate all debt related to the entity, or total consideration of $35 million, subject to customary purchase price adjustments.

These acquisitions will be accounted for as business combinations and the results of the acquired entities will be included in the Distribution operating segment beginning with the fourth quarter of 2014.

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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 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” and in this Form 10-Q, Part II, 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 Consolidated Financial Statements and accompanying Notes to Consolidated Financial Statements in the "Financial Statements" section of our 2013 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 over 600 company-owned and independent distributor locations and over 6,800 dealer locations in more than 190 countries and territories.

Our reportable operating segments consist of the following: Engine, Components, Power Generation and Distribution. This reporting structure is organized according to the products and markets each segment serves and allows management to focus its efforts on providing enhanced service to a wide range of customers. The Engine segment produces engines and parts for sale to customers in on-highway and various industrial markets. Our engines are used in trucks of all sizes, buses and recreational vehicles, as well as in various industrial applications, including construction, mining, agriculture, marine, oil and gas, rail and military equipment. 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. 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. 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 increased 15 percent in the three months ended September 28, 2014, as compared to the same period in 2013, primarily due to improvements in North American on-highway demand. Revenue in the U.S. and Canada improved by 19 percent primarily due to higher demand in the North American on-highway markets driving sales in both the Engine and Components segments, as well as improved Distribution segment sales related to the consolidation of partially-owned North American distributors since June 30, 2013. Despite continued international economic uncertainty in the third quarter of 2014, our international revenues (excludes the U.S. and Canada) improved by 10 percent with sales up or relatively flat in many of our markets. International revenue growth was led by increased demand in the Components segment, especially the emission solutions business in Western Europe and China due to additional content as the result of new emission regulations, increased construction demand in Europe and improved commercial marine engine demand, primarily in China and Europe. These increases were partially offset by decreased international on-highway demand.

Worldwide revenues increased 11 percent in the first nine months of 2014 as compared to the same period in 2013, primarily due to improvements in North American on-highway demand. Revenue in the U.S. and Canada improved by 19 percent primarily due to increased demand in the North American on-highway markets driving sales in both the Engine and Components segments, as well as improved Distribution segment sales related to the consolidation of partially-owned North American distributors since December 31, 2012. These increases were partially offset by the reduced demand in the North American power generation markets. Despite continued international economic uncertainty in the first nine months of 2014, our international revenues improved by 3 percent. International revenue growth was led by increased demand in the Components segment, especially the emission solutions business in Western Europe and China due to additional content as the result of new emission regulations, increased construction demand in Europe and improved commercial marine engine demand, primarily in China and Europe. These increases were partially offset by decreased international on-highway demand with decreased shipments of 13 percent and 12 percent in the heavy-duty and medium-duty truck markets, respectively, and decreased demand in international power generation markets.

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The following tables contain sales and earnings before interest expense, income taxes and noncontrolling interests (EBIT) results by operating segment for the three and nine month periods ended September 28, 2014 and September 29, 2013. Refer to the section titled "Operating Segment Results" for a more detailed discussion of net sales and EBIT by operating segment, including the reconciliation of segment EBIT to income before taxes.

Operating Segments	Three months ended September 28, 2014			September 29, 2013			Percent change 2014 vs. 2013	
In millions	Sales	Percent of Total	EBIT	Sales	Percent of Total	EBIT	Sales	EBIT
Engine	$2,816	58 %	$330	$2,492	58 %	$272	13 %	21 %
Components	1,287	26 %	172	1,072	25 %	132	20 %	30 %
Power Generation	754	15 %	60	712	17 %	45	6 %	33 %
Distribution	1,292	26 %	131	944	22 %	86	37 %	52 %
Intersegment eliminations	(1,259)	(25)%	—	(954)	(22)%	—	32 %	—
Non-segment	—	—	(9)	—	—	1	—	NM
Total	$4,890	100 %	$684	$4,266	100 %	$536	15 %	28 %

"NM" - not meaningful information

Net income attributable to Cummins was $423 million, or $2.32 per diluted share, on sales of $4.9 billion for the three months ended September 28, 2014, versus the comparable prior year period with net income attributable to Cummins of $355 million, or $1.90 per diluted share, on sales of $4.3 billion. The increase in net income and earnings per share was driven by improved gross margin, partially offset by higher selling, general and administrative expenses. The improved gross margin was the result of higher volumes, favorable mix, lower material and commodity costs and improved Distribution segment sales related to the consolidation of partially-owned North American distributors since June 30, 2013, partially offset by unfavorable foreign currency fluctuations. Diluted earnings per share for the three months ended September 28, 2014, benefited $0.01 from lower shares outstanding due to 2014 purchases under the stock repurchase program.

Operating Segments	Nine months ended September 28, 2014			September 29, 2013			Percent change 2014 vs. 2013	
In millions	Sales	Percent of Total	EBIT	Sales	Percent of Total	EBIT	Sales	EBIT
Engine	$8,123	57 %	$910	$7,451	59 %	$806	9 %	13 %
Components	3,797	27 %	524	3,207	25 %	387	18 %	35 %
Power Generation	2,136	15 %	146	2,272	18 %	172	(6)%	(15)%
Distribution	3,480	25 %	333	2,676	21 %	281	30 %	19 %
Intersegment eliminations	(3,405)	(24)%	—	(2,893)	(23)%	—	18 %	—
Non-segment	—	—	(44)	—	—	(52)	—	(15)%
Total	$14,131	100 %	$1,869	$12,713	100 %	$1,594	11 %	17 %

Net income attributable to Cummins was $1,207 million, or $6.58 per diluted share, on sales of $14.1 billion for the nine months ended September 28, 2014, versus the comparable prior year period with net income attributable to Cummins of $1,051 million, or $5.60 per diluted share, on sales of $12.7 billion. The increase in net income and earnings per share was driven by improved gross margin, partially offset by higher selling, general and administrative expenses. The improved gross margin was the result of higher volumes, lower material and commodity costs, favorable mix and improved Distribution segment sales related to the consolidation of partially-owned North American distributors since December 31, 2012, partially offset by unfavorable foreign currency fluctuations. Diluted earnings per share for the nine months ended September 28, 2014, benefited $0.10 from lower shares outstanding, primarily due to purchases under the stock repurchase program.

We generated $1,388 million of operating cash flows for the nine months ended September 28, 2014, compared to $1,333 million for the same period in 2013. Refer to the section titled “Operating Activities” in the “Liquidity and Capital Resources” section for a discussion of items impacting cash flows.

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In September 2013, we announced our intention to acquire the equity that we do not already own in most of our partially-owned United States and Canadian distributors over the next three to five years. During the first nine months of 2014 we spent $324 million on these acquisitions and the related debt retirements. We plan to spend an additional $150 million to $200 million during the fourth quarter of 2014. Refer to Note 3, "ACQUISITIONS" for additional information. We acquired the remaining equity in the following entities during the first nine months of 2014.

- On August 4, 2014, we acquired the remaining 50 percent interest in Cummins Eastern Canada LP (Eastern Canada) from the former distributor principal for $62 million.
- On May 5, 2014, we acquired the remaining 30 percent interest in Cummins Power Systems LLC (Power Systems) from the former distributor principal for $14 million.
- On March 31, 2014, we acquired the remaining 50 percent interest in Cummins Southern Plains LLC (Southern Plains) from the former distributor principal for $92 million.
- On February 14, 2014, we acquired the remaining 62.2 percent interest in Cummins Mid-South LLC (Mid-South) from the former distributor principal for $118 million.

We repurchased $605 million of stock under the 2012 Board of Directors authorized plan during the first nine months of 2014. 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 repurchase plan.

Our debt to capital ratio (total capital defined as debt plus equity) at September 28, 2014, was 17.3 percent, compared to 18.1 percent at December 31, 2013. As of the date of filing this Quarterly Report on Form 10-Q, we had an 'A+' credit rating with a 'Stable' outlook from Standard & Poor’s Rating Services, an 'A' credit rating with a 'Stable' outlook from Fitch Ratings and an 'A3' credit rating with a 'Stable' outlook from Moody’s Investors Service, Inc. In addition to the $2.4 billion in cash and marketable securities on hand, we also have access to our credit facilities, if necessary, to meet currently anticipated investment and funding needs.

In July 2014, the Board of Directors authorized a dividend increase of approximately 25 percent from $0.625 per share to $0.78 per share on a quarterly basis.

Our global pension plans, including our unfunded and non-qualified plans, were 107 percent funded at December 31, 2013. Our U.S. qualified plan, which represents approximately 55 percent of the worldwide pension obligation, was 121 percent funded and our United Kingdom (U.K.) plan was 106 percent funded. We expect to contribute $205 million to our global pension plans in 2014. We anticipate pension and other postretirement benefit cost in 2014 to decrease by approximately $36 million pre-tax, or approximately $0.12 per diluted share, when compared to 2013 due to reduced loss amortization resulting from improved U.S. asset performance and a higher discount rate, 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 2014 to approximate 29.5 percent, excluding any one-time tax items.

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OUTLOOK

Near-Term

In the third quarter of 2014, demand remained strong in several end markets in North America compared to the same period in the prior year, led by strong North American on-highway demand. Demand remained weak in many international markets due to lower on-highway demand.

We currently expect the following positive trends for the remainder of 2014:

- Market share gains in the North American medium-duty truck and bus markets should continue to positively impact sales in both the Engine and Components segments.
- Demand in the North American heavy-duty truck market is expected to remain strong.
- We will acquire three additional North American distributors in Q4 which will increase our Distribution segment revenues and EBIT dollars, however, will be dilutive to Distribution EBIT as a percentage of sales.
- The new Euro VI regulations, effective January 1, 2014, are expected to continue to positively impact sales for aftertreatment products.

We currently expect the following challenges to our business that may reduce our earnings potential for the remainder of 2014:

- Power generation markets are expected to remain weak.
- Demand in most end markets in India is expected to remain weak.
- Weak economic growth in Brazil could continue to negatively impact our on-highway and power generation businesses.
- Demand in certain European markets could remain weak due to continued economic uncertainty.
- Growth in emerging markets could be negatively impacted if emission regulations are not strictly enforced.
- Foreign currency volatility could continue to put pressure on earnings.

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

		Three months ended		Favorable/		Nine months ended		Favorable/	
		September 28,	September 29,	(Unfavorable)		September 28,	September 29,	(Unfavorable)	
In millions (except per share amounts)		2014	2013	Amount	Percent	2014	2013	Amount	Percent
NET SALES		$4,890	$4,266	$624	15 %	$14,131	$12,713	$1,418	11 %
Cost of sales	(1)	3,606	3,185	(421)	(13)%	10,543	9,570	(973)	(10)%
GROSS MARGIN		1,284	1,081	203	19 %	3,588	3,143	445	14 %
OPERATING EXPENSES AND INCOME									
Selling, general and administrative expenses	(1)	529	464	(65)	(14)%	1,527	1,344	(183)	(14)%
Research, development and engineering expenses		198	173	(25)	(14)%	567	532	(35)	(7)%
Equity, royalty and interest income from investees		99	91	8	9 %	294	281	13	5 %
Other operating income (expense), net		3	(11)	14	NM	(4)	—	(4)	NM
OPERATING INCOME		659	524	135	26 %	1,784	1,548	236	15 %
Interest income		6	6	—	— %	17	21	(4)	(19)%
Interest expense		15	8	(7)	(88)%	47	22	(25)	NM
Other income (expense), net		19	6	13	NM	68	25	43	NM
INCOME BEFORE INCOME TAXES		669	528	141	27 %	1,822	1,572	250	16 %
Income tax expense		230	154	(76)	(49)%	553	445	(108)	(24)%
CONSOLIDATED NET INCOME		439	374	65	17 %	1,269	1,127	142	13 %
Less: Net income attributable to noncontrolling interests		16	19	3	16 %	62	76	14	18 %
NET INCOME ATTRIBUTABLE TO CUMMINS INC.		$423	$355	$68	19 %	$1,207	$1,051	$156	15 %
Diluted earnings per common share attributable to Cummins Inc.		$2.32	$1.90	$0.42	22 %	$6.58	$5.60	$0.98	18 %

(1) Certain amounts for "Cost of sales" and "Selling, general and administrative expenses" for 2014 and 2013 were revised to conform to the current classifications. See Note 2, "BASIS OF PRESENTATION," to the Condensed Consolidated Financial Statements for further information.

	Three months ended		Favorable/	Nine months ended		Favorable/
	September 28,	September 29,	(Unfavorable)	September 28,	September 29,	(Unfavorable)
Percent of sales	2014	2013	Percentage Points	2014	2013	Percentage Points
Gross margin	26.3 %	25.3 %	1.0	25.4 %	24.7 %	0.7
Selling, general and administrative expenses	10.8 %	10.9 %	0.1	10.8 %	10.6 %	(0.2)
Research, development and engineering expenses	4.0 %	4.1 %	0.1	4.0 %	4.2 %	0.2

Net Sales

Net sales for the three months ended September 28, 2014, increased versus the comparable period in 2013, primarily due to higher North American on-highway demand and the impact from the acquisitions of the partially-owned North American distributors since June 30, 2013. The primary drivers by segment were as follows:

- Distribution segment sales increased by 37 percent primarily due to the acquisitions of North American distributors.
- Engine segment sales increased by 13 percent due to higher demand in the North American on-highway markets and increased demand in certain industrial markets.

- Components segment sales increased by 20 percent primarily due to higher demand in the North American on-highway markets and increased demand in Europe and China.
- Power Generation segment sales increased by 6 percent mainly due to higher volumes within the power systems and the power products businesses.

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Net sales for the nine months ended September 28, 2014, increased versus the comparable period in 2013, primarily due to higher North American on-highway demand and the impact from the acquisitions of the partially-owned North American distributors since December 31, 2012. The primary drivers by segment were as follows:

- Distribution segment sales increased by 30 percent primarily due to the acquisitions of North American distributors.
- Engine segment sales increased by 9 percent due to higher demand in the North American on-highway markets.
- Components segment sales increased by 18 percent primarily due to higher demand in on-highway markets in North America, Europe and China.

These increases were partially offset by the following:

- Power Generation segment sales decreased by 6 percent mainly due to lower volumes within the power systems and the power products businesses.
- Foreign currency fluctuations unfavorably impacted sales.

A more detailed discussion of sales by segment is presented in the “OPERATING SEGMENT RESULTS” section.
Sales to international markets, based on location of customers, for the three and nine months ended September 28, 2014, were 44 percent and 44 percent, respectively, of total net sales compared with 46 percent and 48 percent of total net sales, respectively, for the comparable periods in 2013. A more detailed discussion of sales by segment is presented in the “OPERATING SEGMENT RESULTS” section.

Gross Margin

Gross margin increased for the three months ended September 28, 2014, versus the comparable period in 2013, and increased as a percentage of sales by 1.0 percentage point as higher volumes, favorable mix, lower material and commodity costs and improved Distribution segment sales related to the consolidation of partially-owned North American distributors since June 30, 2013, were partially offset by higher warranty costs and unfavorable foreign currency fluctuations. Gross margin increased for the nine months ended September 28, 2014, versus the comparable period in 2013, and increased as a percentage of sales by 0.7 percentage points as higher volumes, lower material and commodity costs, favorable mix and improved Distribution segment sales related to the consolidation of partially-owned North American distributors since December 31, 2012, were partially offset by unfavorable foreign currency fluctuations.

The provision for base warranties issued as a percent of sales for the three and nine months ended September 28, 2014, were 1.9 percent and 2.0 percent, respectively, compared to 2.0 percent and 2.2 percent for the comparable periods in 2013. 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 28, 2014, increased versus the comparable period in 2013, primarily due to higher compensation and related expenses of $28 million and acquisition costs in our Distribution segment, partially offset by lower discretionary spending. Selling, general and administrative expenses for the nine months ended September 28, 2014, increased versus the comparable period in 2013 due to higher compensation and related expenses of $61 million, increased discretionary spending of $16 million and acquisition costs in our Distribution segment. Compensation and related expenses include salaries, fringe benefits and variable compensation.

Research, Development and Engineering Expenses

Research, development and engineering expenses for the three months ended September 28, 2014, increased versus the comparable period in 2013, primarily due to higher compensation and related expenses of $12 million and decreased expense recovery of $11 million. Research, development and engineering expenses for the nine months ended September 28, 2014, increased versus the comparable period in 2013 primarily due to higher compensation and related expenses of $25 million, partially offset by decreased consulting expenses of $7 million. Compensation and related expenses include salaries, fringe benefits and variable compensation. Research activities continue to focus on development of new products to meet future emission standards around the world and improvements in fuel economy performance.

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Equity, Royalty and Interest Income From Investees

Equity, royalty and interest income from investees increased for the three and nine months ended September 28, 2014, versus the comparable periods in 2013. The primarily drivers were as follows:

	Increase/(Decrease) September 28, 2014 vs. September 29, 2013	
In millions	Three months ended	Nine months ended
Beijing Foton Cummins Engine Co., Ltd. (Light-duty)	$6	$10
Dongfeng Cummins Engine Company, Ltd.	2	6
Komatsu Cummins Chile, Ltda.	2	5
Beijing Foton Cummins Engine Co., Ltd. (Heavy-duty)	(1)	(4)
Chongqing Cummins Engine Company, Ltd.	(2)	(5)
North American distributors	(7)	(9)
Other equity income	5	6
Cummins share of net income	5	9
Royalty and interest income	3	4
Equity, royalty and interest income from investees	$8	$13

The overall increases for the three and nine months ended September 28, 2014, were primarily due to increased earnings at Beijing Foton Cummins Engine Co., Ltd. (Light-duty), Dongfeng Cummins Engine Company, Ltd. and Komatsu Cummins Chile, Ltda., partially offset by the consolidation of the partially-owned North American distributors since June 30, 2013, and December 31, 2012, respectively.

As we execute our plan to acquire partially-owned distributors, we expect equity earnings for our North American distributors to decrease as the earnings will be included in our consolidated results. See Note 3, “ACQUISITIONS,” to the Condensed Consolidated Financial Statements for further information.

Other Operating Income (Expense), net

Other operating income (expense) was as follows:

	Three months ended		Nine months ended	
In millions	September 28, 2014	September 29, 2013	September 28, 2014	September 29, 2013
Royalty income	$9	$5	$22	$15
Gain (loss) on write off of assets	1	(1)	(6)	(3)
Legal matters	—	(8)	(3)	(2)
Royalty expense	(1)	(2)	(6)	(3)
Amortization of intangible assets	(3)	(3)	(10)	(8)
Other, net	(3)	(2)	(1)	1
Total other operating income (expense), net	$3	$(11)	$(4)	$—

Interest Income

Interest income for the nine months ended September 28, 2014, decreased versus the comparable period in 2013, primarily due to an interest income recovery of a loan previously deemed unrecoverable in the second quarter of 2013.

Interest Expense

Interest expense for the three and nine months ended September 28, 2014, increased versus the comparable periods in 2013 as a result of the $1 billion debt issuance in September 2013.

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Other Income (Expense), net

Other income (expense) was as follows:

In millions	Three months ended September 28, 2014	Three months ended September 29, 2013	Nine months ended September 28, 2014	Nine months ended September 29, 2013
Gain on fair value adjustment for consolidated investees[1]	$18	$ —	$38	$12
Gain (loss) on marketable securities, net	1	1	14	12
Dividend income	1	1	2	4
Foreign currency gains (losses), net	1	(6)	(2)	(21)
Change in cash surrender value of corporate owned life insurance	(2)	7	16	5
Bank charges	(3)	(3)	(8)	(8)
Other, net	3	6	8	21
Total other income (expense), net	$19	$ 6	$68	$25

[1] See Note 3, "ACQUISITIONS," to the Condensed Consolidated Financial Statements for further information.

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, 2013 and has not yet been renewed by Congress. 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 rates for the three and nine month periods ended September 28, 2014, were 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 second quarter $2 million discrete tax benefit for the release of reserves for uncertain tax positions related to multiple state audit settlements, a first quarter $12 million discrete tax expense attributable primarily to state deferred tax adjustments, as well as a first quarter $6 million discrete net tax benefit resulting from a $70 million dividend paid from China earnings generated prior to 2012.

Our effective tax rates for the three and nine month periods ended September 29, 2013, were 29.2 percent and 28.3 percent, respectively. These tax rates include a $7 million discrete net tax expense for the third quarter tax adjustments: $4 million expense attributable to prior year tax return true-up adjustments, $1 million benefit related to release of prior year tax reserves and a discrete tax charge for $4 million related to a third quarter enactment of U.K. tax law changes. In addition, the nine month tax rate includes a discrete tax benefit in the first quarter of 2013 of $28 million attributable to the reinstatement of the research credit back to 2012, as well as a discrete tax expense in the first quarter of 2013 of $17 million, which primarily relates to the write-off of a deferred tax asset deemed unrecoverable.

The increase in the three month effective tax rate from 2013 to 2014 is primarily due to unfavorable changes in the jurisdictional mix of pre-tax income and the 2014 unfavorable discrete tax items.

We anticipate that we may resolve tax matters related primarily to certain tax credits presently under examination in U.S. federal and state tax jurisdictions. As of September 28, 2014, we estimate that it is reasonably possible that unrecognized tax benefits may decrease in an amount ranging from $0 to $75 million in the next 12 months due to the resolution of these issues. We do not expect this resolution to have a material impact on our results of operations.

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 decreased due to the acquisition of the remaining interest in previously consolidated North American distributors and by lower earnings at Cummins India Ltd.

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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 for the three months ended September 28, 2014, increased versus the comparable period in 2013, primarily due to higher gross margin, mainly driven by improved volumes, favorable mix, lower material and commodity costs and improved Distribution segment sales related to the consolidation of partially-owned North American distributors since June 30, 2013. These increases were partially offset by higher selling, general and administrative expenses and a higher effective tax rate for the three months ended September 28, 2014. Diluted earnings per share for the three months ended September 28, 2014, benefited $0.01 from lower shares outstanding due to 2014 purchases under the stock repurchase program.

Net income and diluted earnings per share attributable to Cummins for the nine months ended September 28, 2014, increased versus the comparable period in 2013, primarily due to higher gross margin, mainly driven by improved volumes, lower material and commodity costs, favorable mix and improved Distribution segment sales related to the consolidation of partially-owned North American distributors since December 31, 2012 and higher other income. These increases were partially offset by higher selling, general and administrative expenses and unfavorable foreign currency fluctuations. Diluted earnings per share for the nine months ended September 28, 2014, benefited $0.10 from lower shares outstanding, primarily due to purchases under the stock repurchase program.

OPERATING SEGMENT RESULTS

Our reportable operating segments consist of the following: Engine, Components, Power Generation and Distribution. This reporting structure is organized according to the products and markets each segment serves. 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:

	Three months ended		Favorable/ (Unfavorable)		Nine months ended		Favorable/ (Unfavorable)	
In millions	September 28, 2014	September 29, 2013	Amount	Percent	September 28, 2014	September 29, 2013	Amount	Percent
External sales	$2,181	$2,045	$136	7 %	$6,449	$6,139	$310	5 %
Intersegment sales	635	447	188	42 %	1,674	1,312	362	28 %
Total sales	2,816	2,492	324	13 %	8,123	7,451	672	9 %
Depreciation and amortization	50	53	3	6 %	153	156	3	2 %
Research, development and engineering expenses	114	103	(11)	(11)%	335	310	(25)	(8)%
Equity, royalty and interest income from investees	40	31	9	29 %	117	106	11	10 %
Interest income	3	4	(1)	(25)%	9	13	(4)	(31)%
Segment EBIT	330	272	58	21 %	910	806	104	13 %
			Percentage Points				Percentage Points	
	11.7 %	10.9 %		0.8	11.2 %	10.8 %		0.4

Segment EBIT as a percentage of total sales

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Engine segment net sales by market were as follows:

	Three months ended		Favorable/		Nine months ended		Favorable/	
	September 28,	September 29,	(Unfavorable)		September 28,	September 29,	(Unfavorable)	
In millions	2014	2013	Amount	Percent	2014	2013	Amount	Percent
Heavy-duty truck	$823	$690	$133	19 %	$2,341	$2,067	$274	13 %
Medium-duty truck and bus	631	570	61	11 %	1,878	1,613	265	16 %
Light-duty automotive and RV	354	330	24	7 %	1,051	935	116	12 %
Total on-highway	1,808	1,590	218	14 %	5,270	4,615	655	14 %
Industrial	788	709	79	11 %	2,245	2,185	60	3 %
Stationary power	220	193	27	14 %	608	651	(43)	(7)%
Total sales	$2,816	$2,492	$324	13 %	$8,123	$7,451	$672	9 %

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

	Three months ended		Favorable/		Nine months ended		Favorable/	
	September 28,	September 29,	(Unfavorable)		September 28,	September 29,	(Unfavorable)	
	2014	2013	Amount	Percent	2014	2013	Amount	Percent
Midrange	117,700	113,800	3,900	3 %	355,300	330,300	25,000	8 %
Heavy-duty	32,300	26,500	5,800	22 %	91,400	79,700	11,700	15 %
High-horsepower	3,900	3,500	400	11 %	11,200	11,300	(100)	(1)%
Total unit shipments	153,900	143,800	10,100	7 %	457,900	421,300	36,600	9 %

Sales

Engine segment sales for the three months ended September 28, 2014, increased versus the comparable period in 2013. The following were the primary drivers by market:

- Heavy-duty truck engine sales increased due to improved demand in the North American heavy-duty truck market with increased engine shipments of 36 percent.
- Industrial sales increased primarily due to higher global demand in commercial marine markets with increased engine shipments of 8 percent and improved demand in North American and European construction markets as the result of pre-buy activity ahead of new 2015 emission requirements.
- Medium-duty truck and bus sales increased due to higher demand in the North American medium-duty truck and bus markets primarily due to market share gains.

Total on-highway-related sales for the three months ended September 28, 2014, were 64 percent of total engine segment sales, compared to 64 percent for the comparable period in 2013.

Engine segment sales for the nine months ended September 28, 2014, increased versus the comparable period in 2013. The following were the primary drivers by market:

- Heavy-duty truck sales increased due to improved demand in the North American heavy-duty truck market with increased engine shipments of 27 percent.
- Medium-duty truck and bus sales increased primarily due to market share gains in the North American medium-duty truck and bus markets, partially offset by weaker international demand.
- Light-duty automotive and RV sales increased primarily due to the 10 percent increase in units shipped to Chrysler.

The increases above were partially offset by the following:

- Stationary power engine sales decreased due to lower demand in power generation markets.

- Foreign currency fluctuations unfavorably impacted sales.

Total on-highway-related sales for the nine months ended September 28, 2014, were 65 percent of total engine segment sales, compared to 62 percent for the comparable period in 2013.

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Segment EBIT

Engine segment EBIT for the three months ended September 28, 2014, increased versus the comparable period in 2013 primarily due to higher gross margin and higher equity, royalty and interest income from investees, partially offset by higher research, development and engineering expenses and higher selling, general and administrative expenses. Engine segment EBIT for the nine months ended September 28, 2014, increased versus the comparable period in 2013 primarily due to higher gross margin and higher equity, royalty and interest income from investees, partially offset by higher selling, general and administrative expenses and higher research, development and engineering expenses. Major components of EBIT and related changes to segment EBIT and EBIT as a percentage of sales were as follows:

	Three months ended September 28, 2014 vs. September 29, 2013 Favorable/(Unfavorable) Change			Nine months ended September 28, 2014 vs. September 29, 2013 Favorable/(Unfavorable) Change		
In millions	Amount	Percent	Percentage point change as a percent of total sales	Amount	Percent	Percentage point change as a percent of total sales
Gross margin	$66	12 %	(0.2)	$167	11 %	0.3
Selling, general and administrative expenses	(10)	(5)%	0.6	(43)	(7)%	0.1
Research, development and engineering expenses	(11)	(11)%	0.1	(25)	(8)%	0.1
Equity, royalty and interest income from investees	9	29 %	0.2	11	10 %	—

The increase in gross margin for the three months ended September 28, 2014, versus the comparable period in 2013, was primarily due to higher volumes, favorable mix and improved pricing, partially offset by increased warranty costs. The increase in selling, general and administrative expenses was primarily due to increased headcount and higher variable compensation expenses. The increase in research, development and engineering expenses was primarily due to lower expense recovery and increased investments to support new product initiatives. The increase in equity, royalty and interest income from investees was primarily due to increased earnings at Beijing Foton Cummins Engine Co., Ltd. (Light-duty). The increase in gross margin for the nine months ended September 28, 2014, versus the comparable period in 2013, was primarily due to higher volumes, favorable mix and improved pricing, partially offset by increased warranty costs and higher managed expenses. The increase in selling, general and administrative expenses was primarily due to increased headcount and higher variable compensation expense. The increase in research, development and engineering expenses was primarily due to lower expense recovery and increased investment to support new product initiatives.

Components Segment Results

Financial data for the Components segment was as follows:

	Three months ended		Favorable/ (Unfavorable)		Nine months ended		Favorable/ (Unfavorable)	
In millions	September 28, 2014	September 29, 2013	Amount	Percent	September 28, 2014	September 29, 2013	Amount	Percent
External sales	$946	$784	$162	21 %	$2,821	$2,292	$529	23 %
Intersegment sales	341	288	53	18 %	976	915	61	7 %
Total sales	1,287	1,072	215	20 %	3,797	3,207	590	18 %
Depreciation and amortization	27	24	(3)	(13)%	79	71	(8)	(11)%

Research, development and engineering expenses	64	51	(13)	(25)%	170	165	(5)	(3)%
Equity, royalty and interest income from investees	9	5	4	80%	27	21	6	29%
Interest income	1	1	—	—%	3	2	1	50%
Segment EBIT	172	132	40	30%	524	387	137	35%
			Percentage Points				Percentage Points	
Segment EBIT as a percentage of total sales	13.4%	12.3%		1.1	13.8%	12.1%		1.7

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Sales for our Components segment by business were as follows:

	Three months ended		Favorable/ (Unfavorable)		Nine months ended		Favorable/ (Unfavorable)	
	September 28,	September 29,			September 28,	September 29,		
In millions	2014	2013	Amount	Percent	2014	2013	Amount	Percent
Emission solutions	$598	$458	$140	31 %	$1,723	$1,302	$421	32 %
Turbo technologies	297	263	34	13 %	917	823	94	11 %
Filtration	268	248	20	8 %	808	774	34	4 %
Fuel systems	124	103	21	20 %	349	308	41	13 %
Total sales	$1,287	$1,072	$215	20 %	$3,797	$3,207	$590	18 %

Sales

Components segment sales for the three months ended September 28, 2014, increased versus the comparable period in 2013 in all lines of businesses and across most markets. The following were the primary drivers by business:

- Emission solutions business sales increased primarily due to improved demand in the North American on-highway markets and increased demand for our products in Europe and China to meet new emission requirements. The increases were partially offset by lower demand in Brazil.
- Turbo technologies business sales increased as a result of improved on-highway demand in North America.
- Fuel systems business sales increased due to improved demand in North America and China markets.

Components segment sales for the nine months ended September 28, 2014, increased versus the comparable period in 2013 in all lines of business and across most markets. The following were the primary drivers by business:

- Emission solutions business sales increased primarily due to improved demand in the North American on-highway markets and increased demand for our products in Europe and China to meet new emission requirements. The increases were partially offset by lower demand in Brazil.

- Turbo technologies business sales increased as a result of improved on-highway demand in North America and Europe.

Segment EBIT

Components segment EBIT for the three and nine months ended September 28, 2014, increased versus the comparable periods in 2013, primarily due to higher gross margin and higher equity, royalty and interest income from investees, partially offset by higher selling, general and administrative expenses and higher research, development and engineering expenses. Major components of EBIT and related changes to segment EBIT and EBIT as a percentage of sales were as follows:

	Three months ended September 28, 2014 vs. September 29, 2013 Favorable/(Unfavorable) Change			Nine months ended September 28, 2014 vs. September 29, 2013 Favorable/(Unfavorable) Change		
In millions	Amount	Percent	Percentage point change as a percent of total sales	Amount	Percent	Percentage point change as a percent of total sales
Gross margin	$57	23 %	0.6	$158	22 %	0.6
Selling, general and administrative expenses	(12)	(17)%	0.1	(34)	(17)%	0.1
Research, development and engineering expenses	(13)	(25)%	(0.2)	(5)	(3)%	0.6
	4	80 %	0.2	6	29 %	—

Equity, royalty and interest income
from investees

The increase in gross margin for the three and nine months ended September 28, 2014, versus the comparable periods in 2013, was primarily due to higher volumes, mainly in the emission solutions and turbo technologies businesses and lower material and commodity costs, partially offset by unfavorable pricing and increased product coverage costs. The increase in selling, general and administrative expenses was primarily due to increased headcount and higher consulting expenses. The increase in research, development and engineering expenses for the three months ended September 28, 2014, was primarily due to increased headcount, decreased expense recovery and increased discretionary spending. The increase in research, development and engineering expenses for the nine months ended September 28, 2014, was primarily due to increased headcount and increased discretionary spending, partially offset by increased expense recovery.

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Power Generation Segment Results

Financial data for the Power Generation segment was as follows:

	Three months ended		Favorable/		Nine months ended		Favorable/	
	September 28,	September 29,	(Unfavorable)		September 28,	September 29,	(Unfavorable)	
In millions	2014	2013	Amount	Percent	2014	2013	Amount	Percent
External sales	$481	$499	$(18)	(4)%	$1,408	$1,621	$(213)	(13)%
Intersegment sales	273	213	60	28%	728	651	77	12%
Total sales	754	712	42	6%	2,136	2,272	(136)	(6)%
Depreciation and amortization	13	13	—	—%	38	37	(1)	(3)%
Research, development and engineering expenses	18	18	—	—%	55	53	(2)	(4