

CUMMINS INC
Form 10-Q
July 28, 2011
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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 June 26, 2011

Commission File Number 1-4949

CUMMINS INC.

(Exact name of registrant as specified in its charter)

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Indiana

35-0257090

(State of Incorporation)

(IRS Employer Identification No.)

**500 Jackson Street
Box 3005
Columbus, Indiana 47202-3005**

(Address of principal executive offices)

Telephone (812) 377-5000

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer ☒

Accelerated filer ☐

Non-accelerated filer ☐

Smaller reporting company ☐

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

As of June 26, 2011, there were 194,701,906 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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CUMMINS INC. AND SUBSIDIARIES

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In millions, except per share amounts	Three months ended		Six months ended	
	June 26, 2011	June 27, 2010	June 26, 2011	June 27, 2010
NET SALES (a)	\$ 4,641	\$ 3,208	\$ 8,501	\$ 5,686
Cost of sales	3,438	2,455	6,341	4,332
GROSS MARGIN	1,203	753	2,160	1,354
OPERATING EXPENSES AND INCOME				
Selling, general and administrative expenses	463	354	852	689
Research, development and engineering expenses	157	96	286	188
Equity, royalty and interest income from investees (Note 6)	117	97	213	173
Gain on sale of business (Note 4)	68		68	
Other operating (expense) income, net		(4)	(6)	(8)
OPERATING INCOME	768	396	1,297	642
Interest income	10	5	16	8
Interest expense	13	9	23	18
Other income (expense), net	(3)		(6)	17
INCOME BEFORE INCOME TAXES	762	392	1,284	649
Income tax expense	225	122	382	209
CONSOLIDATED NET INCOME	537	270	902	440
Less: Net income attributable to noncontrolling interests	32	24	54	45
NET INCOME ATTRIBUTABLE TO CUMMINS INC.	\$ 505	\$ 246	\$ 848	\$ 395
EARNINGS PER COMMON SHARE ATTRIBUTABLE TO CUMMINS INC.				
Basic	\$ 2.61	\$ 1.25	\$ 4.36	\$ 2.00
Diluted	\$ 2.60	\$ 1.25	\$ 4.34	\$ 2.00
WEIGHTED AVERAGE SHARES OUTSTANDING				
Basic	193.8	196.9	194.6	197.6
Dilutive effect of stock compensation awards	0.6	0.4	0.6	0.3
Diluted	194.4	197.3	195.2	197.9

CASH DIVIDENDS DECLARED PER COMMON SHARE	\$	0.2625	\$	0.175	\$	0.525	\$	0.35
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(a) Includes sales to nonconsolidated equity investees of \$635 million and \$1,234 million and \$516 million and \$944 million for the three and six months ended June 26, 2011 and June 27, 2010, respectively.

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	June 26, 2011	December 31, 2010
ASSETS		
Current assets		
Cash and cash equivalents	\$ 1,111	\$ 1,023
Marketable securities (Note 5)	363	339
Total cash, cash equivalents and marketable securities	1,474	1,362
Accounts and notes receivable, net		
Trade and other	2,511	1,935
Nonconsolidated equity investees	269	308
Inventories (Note 8)	2,275	1,977
Deferred income taxes	305	314
Prepaid expenses and other current assets	303	393
Total current assets	7,137	6,289
Long-term assets		
Property, plant and equipment	5,103	4,927
Accumulated depreciation	(2,986)	(2,886)
Property, plant and equipment, net	2,117	2,041
Investments and advances related to equity method investees	761	734
Goodwill	348	367
Other intangible assets, net	216	222
Deferred income taxes	115	203
Other assets	619	546
Total assets	\$ 11,313	\$ 10,402
LIABILITIES		
Current liabilities		
Loans payable	\$ 59	\$ 82
Accounts payable (principally trade)	1,686	1,362
Current portion of accrued product warranty (Note 9)	429	421
Accrued compensation, benefits and retirement costs	419	468
Deferred revenue	202	182
Taxes payable (including taxes on income)	255	202
Other accrued expenses	663	543
Total current liabilities	3,713	3,260
Long-term liabilities		
Long-term debt	702	709
Pensions	110	195
Postretirement benefits other than pensions	432	439
Other liabilities and deferred revenue	839	803
Total liabilities	5,796	5,406
Commitments and contingencies (Note 11)		
EQUITY		
Cummins Inc. shareholders' equity		
Common stock, \$2.50 par value, 500 shares authorized, 222.1 and 221.8 shares issued	1,968	1,934
Retained earnings	5,191	4,445

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Treasury stock, at cost, 27.4 and 24.0 shares	(1,333)	(964)
Common stock held by employee benefits trust, at cost, 1.9 and 2.1 shares	(23)	(25)
Accumulated other comprehensive loss		
Defined benefit postretirement plans	(613)	(646)
Other	(32)	(74)
Total accumulated other comprehensive loss	(645)	(720)
Total Cummins Inc. shareholders' equity	5,158	4,670
Noncontrolling interests	359	326
Total equity	5,517	4,996
Total liabilities and equity	\$ 11,313	\$ 10,402

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	June 26, 2011	Six months ended June 27, 2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Consolidated net income	\$ 902	\$ 440
Adjustments to reconcile consolidated net income to net cash provided by operating activities:		
Depreciation and amortization	159	161
Gain on sale of business (Note 4)	(68)	
Gain on fair value adjustment for consolidated investee (Note 4)		(12)
Deferred income taxes	87	43
Equity in income of investees, net of dividends	2	(49)
Pension contributions in excess of expense (Note 10)	(47)	(116)
Excess tax benefits on stock based awards	(4)	(7)
Other post-retirement benefits payments in excess of expense (Note 10)	(10)	(7)
Stock-based compensation expense	18	11
Translation and hedging activities	(6)	3
Changes in current assets and liabilities, net of acquisitions and divestitures:		
Accounts and notes receivable	(513)	(57)
Inventories	(290)	(301)
Other current assets	11	1
Accounts payable	307	239
Accrued expenses	169	(14)
Changes in other liabilities and deferred revenue	58	66
Other, net	(31)	26
Net cash provided by operating activities	744	427
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(215)	(91)
Investments in internal use software	(22)	(22)
Proceeds from disposals of property, plant and equipment	5	42
Investments in and advances to equity investees	(20)	(1)
Proceeds from sale of business, net of cash sold (Note 4)	111	
Acquisition of businesses, net of cash acquired (Note 4)		(71)
Investments in marketable securities acquisitions (Note 5)	(361)	(358)
Investments in marketable securities liquidations (Note 5)	343	278
Cash flows from derivatives not designated as hedges	6	(18)
Other, net	2	(2)
Net cash used in investing activities	(151)	(243)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from borrowings	60	85
Payments on borrowings and capital lease obligations	(94)	(37)
Net borrowings under short-term credit agreements	11	(1)
Distributions to noncontrolling interests	(26)	(4)
Dividend payments on common stock	(102)	(70)
Repurchases of common stock	(373)	(162)
Excess tax benefits on stock-based awards	4	7

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Other, net	7	9
Net cash used in financing activities	(513)	(173)
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	8	(17)
Net increase (decrease) in cash and cash equivalents	88	(6)
Cash and cash equivalents at beginning of year	1,023	930
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 1,111	\$ 924

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	Unearned Compensation	Total Cummins Inc. Shareholder Equity	Noncontrolling Interests	Total Equity
BALANCE AT DECEMBER 31, 2009	\$ 555	\$ 1,306	\$ 3,575	\$ (895)	(731)	\$ (36)	\$ (1)	\$ 3,773	\$ 247	\$ 4,020
Comprehensive income:										
Net income			395					395	45	440
Other comprehensive income (loss) (Note 12)				(65)				(65)		(65)
Total comprehensive income								330	45	375
Issuance of shares		3						3		3
Employee benefits trust activity		9				1		10		10
Acquisition of shares					(162)			(162)		(162)
Cash dividends on common stock			(70)					(70)		(70)
Distribution to noncontrolling interests									(4)	(4)
Stock option exercises					3			3		3
Deconsolidation of variable interest entity									(11)	(11)
Other shareholder transactions		(5)					1	(4)		(4)
BALANCE AT JUNE 27, 2010	\$ 555	\$ 1,313	\$ 3,900	\$ (960)	\$ (890)	\$ (35)	\$	\$ 3,883	\$ 277	\$ 4,160
BALANCE AT DECEMBER 31, 2010	\$ 554	\$ 1,380	\$ 4,445	\$ (720)	\$ (964)	\$ (25)	\$	\$ 4,670	\$ 326	\$ 4,996
Comprehensive income:										
Net income			848					848	54	902
Other comprehensive income (loss) (Note 12)				75				75		75
Total comprehensive income								923	54	977
Issuance of shares	1	7						8		8
Employee benefits trust activity		16				2		18		18
Acquisition of shares					(373)			(373)		(373)
Cash dividends on common stock			(102)					(102)		(102)
Distribution to noncontrolling interests									(26)	(26)
Stock option exercises		1			4			5		5
Other shareholder transactions		9						9	5	14
	\$ 555	\$ 1,413	\$ 5,191	\$ (645)	(1)	\$ (1,333)	\$ (23)	\$ 5,158	\$ 359	\$ 5,517

**BALANCE AT JUNE 26,
2011**

(1) Comprised of defined benefit postretirement plans of \$(613) million, foreign currency translation adjustments of \$(36) million, and unrealized gain on marketable securities of \$4 million.

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, the Company, we, our, or us) is a leading global power provider that designs, manufactures, distributes and services diesel and natural gas engines, electric power generation systems and engine-related component products, including filtration and emissions solutions, fuel systems, controls and air handling systems. We were founded in 1919 as one of the first manufacturers of diesel engines and are headquartered in Columbus, Indiana. We sell our products to Original Equipment Manufacturers (OEMs), distributors and other customers worldwide. We serve our customers through a network of more than 600 company-owned and independent distributor locations and approximately 6,000 dealer locations in more than 190 countries and territories.

NOTE 2. BASIS OF PRESENTATION

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

Our reporting period usually ends on the Sunday closest to the last day of the quarterly calendar period. The second quarters of 2011 and 2010 ended on June 26, and June 27, respectively. The interim periods for both 2011 and 2010 contain 13 weeks. Our fiscal year ends on December 31, regardless of the day of the week on which December 31 falls.

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

In preparing our *Condensed Consolidated Financial Statements*, we evaluated subsequent events through the date our quarterly report was filed with the SEC.

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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 six month periods ended June 26, 2011, and June 27, 2010, were as follows:

	Three months ended		Six months ended	
	June 26, 2011	June 27, 2010	June 26, 2011	June 27, 2010
Options excluded	140,277	6,685	80,858	13,527

You should read these interim condensed financial statements in conjunction with the *Consolidated Financial Statements* included in our Annual Report on Form 10-K for the year ended December 31, 2010. Our interim period financial results for the three and six 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 *Consolidated Balance Sheet* data was derived from audited financial statements, but does not include all disclosures required by GAAP.

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NOTE 3. RECENTLY ADOPTED AND RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

Accounting Pronouncements Recently Adopted

In October 2009, the Financial Accounting Standards Board (FASB) amended its rules regarding the accounting for multiple element revenue arrangements. The objective of the amendment is to allow vendors to account for revenue for different deliverables separately as opposed to part of a combined unit when those deliverables are provided at different times. Specifically, this amendment addresses how to separate deliverables and simplifies the process of allocating revenue to the different deliverables when more than one deliverable exists. The new rules were effective for us beginning January 1, 2011. This amendment did not have a significant impact on our *Condensed Consolidated Financial Statements* as multiple element revenue arrangements are not material to our business.

Accounting Pronouncements Issued But Not Yet Effective

In June 2011, the FASB amended its rules regarding the presentation of comprehensive income. The objective of this amendment is to improve the comparability, consistency and transparency of financial reporting and to increase the prominence of items reported in other comprehensive income. Specifically, this amendment requires that all non-owner changes in shareholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The new rules will become effective during interim and annual periods beginning after December 15, 2011. Because the standard only impacts the display of comprehensive income and does not impact what is included in comprehensive income, the standard will not have a significant impact on our *Consolidated Financial Statements*.

In May 2011, the FASB amended its standards related to fair value measurements and disclosures. The objective of the amendment is to improve the comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with U.S. GAAP and International Financial Reporting Standards. Primarily this amendment changed the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements in addition to clarifying the Board's intent about the application of existing fair value measurement requirements. The new standard also requires additional disclosures related to fair value measurements categorized within Level 3 of the fair value hierarchy and requires disclosure of the categorization in the hierarchy for items which are not recorded at fair value but fair value is required to be disclosed. The new rules will become effective during interim and annual periods beginning after December 15, 2011. As of June 26, 2011, we had no fair value measurements categorized within Level 3. The only impact for us is expected to be the disclosure of the categorization in the fair value hierarchy for those items where fair value is only disclosed (primarily our debt obligations).

NOTE 4. DIVESTITURES AND ACQUISITIONS

Divestitures

In January 2011, we reached an agreement to sell certain assets and liabilities of our exhaust business which manufactures exhaust products and select components for emission systems for a variety of applications not core to our other product offerings. The transaction closed in the

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second quarter of 2011. This business was historically included in our Components segment. The sales price was \$123 million. We recognized a pre-tax gain on the sale of \$68 million, which included an allocation of goodwill of \$19 million. The transaction has a working capital adjustment mechanism that will be determined in the third quarter. We do not expect a significant change to the measurement of the gain. The gain has been excluded from segment results as it was not considered by management in its evaluation of operating results for the three and six months ended June 26, 2011.

Sales for this business were \$171 million, \$126 million and \$169 million in 2010, 2009 and 2008, respectively. Income before income taxes for this business was approximately \$22 million, \$11 million and \$19 million in 2010, 2009 and 2008, respectively.

We signed a non-binding letter of intent to sell certain assets and liabilities of our light-duty filtration business which manufactures light-duty automotive and industrial filtration solutions. The transaction is expected to close in the second half of 2011. The sales price is expected to be approximately \$90 million to \$95 million, subject to a final financial statement review. There are no earnouts or other contingencies associated with the sales price. We expect to recognize a pre-tax gain on the sale of approximately \$45 million to \$50 million, which includes an allocation of goodwill of approximately \$11 million.

Sales for this business were \$74 million, \$54 million and \$75 million in 2010, 2009 and 2008, respectively. Income before income taxes for this business was approximately \$9 million, \$2 million and \$9 million in 2010, 2009 and 2008, respectively.

The assets and liabilities associated with these businesses have not been reclassified and separately presented in the *Condensed Consolidated Balance Sheets* as they are immaterial. We will enter into supply and other agreements with the operations that will represent ongoing involvement and as such, the results of these operations will not be presented as discontinued operations.

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Acquisition

On January 4, 2010, we acquired the remaining 70 percent interest in Cummins Western Canada (CWC) from our former principal for consideration of approximately \$71 million. We formed a new partnership with a new distributor principal where we own 80 percent of CWC and the new distributor principal owns 20 percent. The acquisition was effective on January 1, 2010. The \$71 million of consideration consisted of:

In millions

Borrowings under credit revolver	\$	44
Capital contributed by Cummins Inc.		10
Capital contributed by new principal, as described below		8
Funded from first quarter operations		9
Total consideration	\$	71

The purchase price was approximately \$97 million as presented below. The intangible assets are primarily customer related and are being amortized over periods ranging from one to three years. The acquisition of CWC was accounted for as a business combination, with the results of the acquired entity and the goodwill included in the Distribution operating segment as of the acquisition date. Distribution segment results also include a \$12 million gain for the three months ended March 28, 2010, as we were required to re-measure our pre-existing 30 percent ownership interest in CWC to fair value in accordance with GAAP. Net sales for CWC were \$272 million for the twelve months ended December 31, 2010, which was approximately two percent of Cummins Inc. consolidated sales.

The purchase price was allocated as follows:

In millions

Accounts receivable	\$	31
Inventory		48
Fixed assets		45
Intangible assets		11
Goodwill		2
Other assets		2
Current liabilities		(42)
Total purchase price	\$	97
Fair value of pre-existing 30 percent interest		(26)
Consideration given	\$	71

We provided a loan to our partner of approximately \$8 million to fund the purchase of his 20 percent interest. The purchase transaction resulted in \$8 million of noncontrolling interest (representing our partner's 20 percent interest) which was completely offset by the \$8 million receivable from our partner, reducing the noncontrolling interest impact to zero as of the acquisition date. The interest-bearing loan is expected to be repaid over a period of 3-5 years. The partner also has periodic options to purchase an additional 10 to 15 percent interest in CWC up to a maximum of an additional 30 percent (total ownership not to exceed 50 percent).

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

In millions	Cost	June 26, 2011 Gross unrealized gains/(losses)	Estimated fair value	Cost	December 31, 2010 Gross unrealized gains/(losses)	Estimated fair value
Available-for-sale:						
Debt mutual funds	\$ 184	\$ 3	\$ 187	\$ 179	\$ 1	\$ 180
Bank debentures	91		91	85		85
Certificates of deposit	71		71	59		59
Government debt securities-non-U.S.	4	(1)	3	4	(1)	3
Corporate debt securities	2		2	2		2
Equity securities and other		9	9		10	10
Total marketable securities	\$ 352	\$ 11	\$ 363	\$ 329	\$ 10	\$ 339

At June 26, 2011, the fair value of available-for-sale investments in debt securities by contractual maturity is as follows:

Maturity date	Fair value
In millions	
1 year or less	\$ 88
1-5 years	6
5-10 years	1
After 10 years	1
Total	\$ 96

NOTE 6. EQUITY, ROYALTY AND INTEREST INCOME FROM INVESTEEES

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

In millions	Three months ended		Six months ended	
	June 26, 2011	June 27, 2010	June 26, 2011	June 27, 2010
Distribution Entities				
North American distributors	\$ 35	\$ 23	\$ 65	\$ 46
Komatsu Cummins Chile, Ltda	6	3	10	6
All other distributors	1	1	2	2
Manufacturing Entities				
Dongfeng Cummins Engine Company, Ltd.	26	34	49	52

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Chongqing Cummins Engine Company, Ltd.	19	13	31	23
Shanghai Fleetguard Filter Co., Ltd.	4	4	8	6
Tata Cummins, Ltd.	3	3	7	7
Cummins Westport, Inc.	3	2	4	5
Valvoline Cummins, Ltd.	2	3	4	5
Komatsu manufacturing alliances	(1)	3	1	5
Beijing Foton Cummins Engine Co., Ltd.	(1)	(4)	(3)	(6)
All other manufacturers	6	4	12	7
Cummins share of net income	103	89	190	158
Royalty and interest income	14	8	23	15
Equity, royalty and interest income from investees	\$ 117	\$ 97	\$ 213	\$ 173

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The majority of the assets and liabilities we carry at fair value are available-for-sale (AFS) securities and derivatives. AFS securities are derived from level 1 or level 2 inputs. Derivative assets and liabilities are derived from level 2 inputs. The predominance of market inputs are actively quoted and can be validated through external sources, including brokers, market transactions and third-party pricing services. When material, we adjust the values of our derivative contracts for counter-party or our credit risk. There were no transfers into or out of Levels 2 or 3 in the first six months of 2011.

The following table summarizes our financial instruments recorded at fair value in our *Condensed Consolidated Balance Sheets* at June 26, 2011:

In millions	Fair Value Measurements Using			Total
	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	
Available-for-sale debt securities:				
Debt mutual funds	\$ 85	\$ 102	\$	\$ 187
Bank debentures		91		91
Certificates of deposit		71		71
Government debt securities-non-U.S.		3		3
Corporate debt securities		2		2
Total available-for-sale debt securities	85	269		354
Available-for-sale equity securities:				
Financial services industry	9			9
Total available-for-sale equity securities	9			9
Derivative assets:				
Commodity swap contracts		3		3
Interest rate contracts		51		51
Total derivative assets		54		54
Derivative liabilities:				
Commodity swap contracts		1		1
Foreign currency forward contracts		1		1
Total derivative liabilities		2		2
Total	\$ 94	\$ 321	\$	\$ 415

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The following table summarizes our financial instruments recorded at fair value in our *Condensed Consolidated Balance Sheets* at December 31, 2010:

In millions	Fair Value Measurements Using			
	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Available-for-sale debt securities:				
Debt mutual funds	\$ 75	\$ 105	\$	\$ 180
Bank debentures		85		85
Certificates of deposit		59		59
Government debt securities-non-U.S.		3		3
Corporate debt securities		2		2
Total available-for-sale debt securities	75	254		329
Available-for-sale equity securities:				
Financial services industry	10			10
Total available-for-sale equity securities	10			10
Derivative assets:				
Commodity swap contracts		21		21
Interest rate contracts		41		41
Total derivative assets		62		62
Total	\$ 85	\$ 316	\$	\$ 401

Fair value of derivative assets for foreign currency forward contracts and total derivative liabilities at December 31, 2010, are not material to our *Condensed Consolidated Balance Sheets*.

The substantial majority of our assets were valued utilizing a market approach. A description of the valuation techniques and inputs used for our level 2 fair value measures are as follows:

Debt mutual funds Assets in level 2 consist of exchange traded mutual funds that lack sufficient trading volume to be classified at level 1. The fair value measure for these investments is the daily net asset value published on a regulated governmental website. Daily quoted prices are available from the issuing brokerage and are used on a test basis to corroborate this level 2 input.

Bank debentures and Certificates of deposit These investments provide us with a fixed rate of return and generally range in maturity from six months to one year. The counter-parties to these investments are reputable financial institutions with investment grade credit ratings. Since these instruments are not tradable and must be settled directly by Cummins with the respective financial institution, our fair value measure is the financial institutions month-end statement.

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Government debt securities-non-U.S. and Corporate debt securities The fair value measure for these securities are broker quotes received from reputable firms. These securities are infrequently traded on a national stock exchange and these values are used on a test basis to corroborate our level 2 input measure.

Foreign currency forward contracts The fair value measure for these contracts are determined based on forward foreign exchange rates received from third-party pricing services. These rates are based upon market transactions and are periodically corroborated by comparing to third-party broker quotes.

Commodity swap contracts The fair value measure for these contracts are current spot market data adjusted for the appropriate current forward curves provided by external financial institutions. The current spot price is the most significant component of this valuation and is based upon market transactions. We use third-party pricing services for the spot price component of this valuation which is periodically corroborated by market data from broker quotes.

Interest rate contracts We currently have only one interest rate contract. We utilize the month-end statement from the issuing financial institution as our fair value measure for this investment. We corroborate this valuation through the use of a third-party pricing service for similar assets and liabilities.

Table of Contents**Fair Value of Other Financial Instruments**

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, at June 26, 2011 and December 31, 2010, are set forth in the table below. The carrying values of all other receivables and liabilities approximated fair values.

In millions	June 26, 2011	December 31, 2010
Fair value of total debt	\$ 917	\$ 886
Carrying value of total debt	847	843

NOTE 8. INVENTORIES

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

In millions	June 26, 2011	December 31, 2010
Finished products	\$ 1,196	\$ 1,019
Work-in-process and raw materials	1,182	1,048
Inventories at FIFO cost	2,378	2,067
Excess of FIFO over LIFO	(103)	(90)
Total inventories	\$ 2,275	\$ 1,977

NOTE 9. PRODUCT WARRANTY LIABILITY

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

In millions	June 26, 2011	Six months ended June 27, 2010
Balance, beginning of period	\$ 980	\$ 989
Provision for warranties issued	219	157
Deferred revenue on extended warranty contracts sold	50	51
Payments	(188)	(206)

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Amortization of deferred revenue on extended warranty contracts	(46)	(42)
Changes in estimates for pre-existing warranties	7	(20)
Foreign currency translation	3	(6)
Balance, end of period	\$ 1,025	\$ 923

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Warranty related deferred revenue, supplier recovery receivables and the long-term portion of the warranty liability on our June 26, 2011, balance sheet were as follows:

In millions	June 26, 2011	Balance Sheet Locations
Deferred revenue related to extended coverage programs:		
Current portion	\$ 94	Deferred revenue
Long-term portion	194	Other liabilities and deferred revenue
Total	\$ 288	
Receivables related to estimated supplier recoveries:		
Current portion	\$ 9	Trade and other receivables
Long-term portion	7	Other assets
Total	\$ 16	
Long-term portion of warranty liability	\$ 308	Other liabilities and deferred revenue

NOTE 10. PENSION AND OTHER POSTRETIREMENT BENEFITS

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

In millions	Three months ended		Six months ended	
	June 26, 2011	June 27, 2010	June 26, 2011	June 27, 2010
Defined benefit pension and other postretirement plans:				
Voluntary pension	\$ 35	\$ 35	\$ 70	\$ 95
Mandatory pension	5	5	11	56
Defined benefit pension contributions	40	40	81	151
Other postretirement plans	9	11	18	17
Total defined benefit plans	\$ 49	\$ 51	\$ 99	\$ 168
Defined contribution pension plans	\$ 13	\$ 12	\$ 37	\$ 23

We presently anticipate contributing approximately \$130 million to our defined benefit pension plans in 2011 and paying approximately \$51 million in claims and premiums for other postretirement benefits. The \$130 million of contributions for the full year include voluntary contributions of approximately \$109 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.

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

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In millions	Pension						Other Postretirement Benefits	
	U.S. Plans		Non-U.S. Plans					
	June 26, 2011	June 27, 2010	June 26, 2011	June 27, 2010	June 26, 2011	June 27, 2010	June 26, 2011	June 27, 2010
Service cost	\$ 13	\$ 12	\$ 5	\$ 4	\$		\$	
Interest cost	27	27	15	14			6	7
Expected return on plan assets	(38)	(37)	(19)	(17)				
Amortization of prior service (credit) cost			1				(2)	(2)
Recognized net actuarial loss	10	9	3	5				
Net periodic benefit cost	\$ 12	\$ 11	\$ 5	\$ 6	\$		\$ 4	\$ 5

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In millions	Pension					
	U.S. Plans		Non-U.S. Plans Six months ended		Other Postretirement Benefits	
	June 26, 2011	June 27, 2010	June 26, 2011	June 27, 2010	June 26, 2011	June 27, 2010
Service cost	\$ 26	\$ 23	\$ 10	\$ 9	\$	\$
Interest cost	54	55	30	29	12	14
Expected return on plan assets	(76)	(74)	(37)	(35)		
Amortization of prior service (credit) cost			1	1	(4)	(4)
Recognized net actuarial loss	20	18	6	9		
Net periodic benefit cost	\$ 24	\$ 22	\$ 10	\$ 13	\$ 8	\$ 10

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.

In June 2008, four of our sites in Southern Indiana, including our Technical Center, experienced extensive flood damage. We have submitted a claim for \$220 million to our insurance carriers, which includes a claim for business interruption. As of June 26, 2011, we have received \$92 million in recoveries from the insurance carriers. Our insurance carriers have disputed certain aspects of our claim and the parties have filed suit against each other. Although we believe that we are insured against the full amount of our claim, there is no assurance that we will be successful recovering the amounts we believe are due under the policies.

U.S. Distributor Commitments

Our distribution agreements with independent and partially-owned distributors generally have a 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. The 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

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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.

Other Guarantees and Commitments

We periodically enter into guarantee arrangements, including guarantees of non-U.S. distributor financing, residual value guarantees on equipment leased under operating leases and other miscellaneous guarantees of third-party obligations. As of June 26, 2011, the maximum potential loss related to these other guarantees is \$62 million (\$36 million of which relates to the Beijing Foton guarantee discussed below and \$23 million relates to the Cummins Olayan Energy Limited guarantee discussed below).

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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 June 26, 2011, if we were to stop purchasing from each of these suppliers, the amount of the penalty would be approximately \$54 million, of which \$49 million relates to a contract with an engine parts supplier that extends to 2013. This arrangement enables us to secure critical components. We do not currently anticipate paying any penalties under these contracts.

In July 2008, Beijing Foton Cummins Engine Company, a 50 percent owned entity accounted for under the equity method, entered into a line of credit agreement with a borrowing capacity of up to \$185 million (at current exchange rates). The line will be used primarily to fund equipment purchases for a new manufacturing plant. As a part of this transaction, we guaranteed 50 percent of any outstanding borrowings up to a maximum guarantee of \$93 million (at current exchange rates). As of June 26, 2011, outstanding borrowings under this agreement were \$72 million and our guarantee was \$36 million (at current exchange rates). We recorded a liability for the fair value of this guarantee. The amount of the liability was less than \$1 million. The offset to this liability was an increase in our investment in the joint venture.

In February 2010, Cummins Olayan Energy Limited, a 49 percent owned entity accounted for under the equity method, executed a four-year \$101 million (at current exchange rates) debt financing arrangement to acquire certain rental equipment assets. As a part of this transaction, we guaranteed 49 percent of the total outstanding loan amount or \$50 million (at current exchange rates). As of June 26, 2011, outstanding borrowings under this agreement were \$48 million and our guarantee was \$23 million (at current exchange rates). We recorded a liability for the fair value of this guarantee. The amount of the liability was less than \$1 million. The offset to this liability was an increase in our investment in the joint venture.

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 at June 26, 2011, were \$77 million.

Indemnifications

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

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

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

Joint Venture Commitments

As of June 26, 2011, we have committed to invest an additional \$86 million into existing joint ventures of which \$63 million is expected to be funded in 2011.

Table of Contents**NOTE 12. COMPREHENSIVE INCOME**

The table below provides a summary of total comprehensive income and the allocation of total comprehensive income between the shareholders of Cummins Inc. and the non-controlling interests for the three and six month periods ended June 26, 2011 and June 27, 2010.

In millions	Three months ended					
	Attributable to Cummins Inc.	June 26, 2011 Attributable to Noncontrolling Interests	Total Consolidated	Attributable to Cummins Inc.	June 27, 2010 Attributable to Noncontrolling Interests	Total Consolidated
Net income	\$ 505	\$ 32	\$ 537	\$ 246	\$ 24	\$ 270
Other comprehensive income (loss), net of tax						
Unrealized gain (loss) on marketable securities				1		1
Unrealized gain (loss) on derivatives	(12)		(12)	(2)		(2)
Foreign currency translation adjustments	2	(2)		(12)	(4)	(16)
Change in pensions and other postretirement defined benefit plans	7		7	8		8
Total other comprehensive income (loss)	(3)	(2)	(5)	(5)	(4)	(9)
Total comprehensive income	\$ 502	\$ 30	\$ 532	\$ 241	\$ 20	\$ 261

In millions	Six months ended					
	Attributable to Cummins Inc.	June 26, 2011 Attributable to Noncontrolling Interests	Total Consolidated	Attributable to Cummins Inc.	June 27, 2010 Attributable to Noncontrolling Interests	Total Consolidated
Net income	\$ 848	\$ 54	\$ 902	\$ 395	\$ 45	\$ 440
Other comprehensive income, net of tax						
Unrealized gain (loss) on marketable securities				1		1
Unrealized gain (loss) on derivatives	(12)		(12)	(7)		(7)
Foreign currency translation adjustments	54		54	(61)		(61)
Change in pensions and other postretirement defined benefit plans	33		33	2		2
Total other comprehensive income (loss)	75		75	(65)		(65)
Total comprehensive income	\$ 923	\$ 54	\$ 977	\$ 330	\$ 45	\$ 375

NOTE 13. 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 swap contracts and interest rate swaps. As stated in our policies and procedures, financial derivatives are used expressly for hedging purposes, and under no circumstances are they used for speculative purposes. When material, we adjust the value of our derivative contracts for counter-party or our credit risk. The results and status of our hedging transactions are reported to senior management on a monthly and quarterly basis.

Foreign Exchange Rates

As a result of our international business presence, we are exposed to foreign currency exchange risks. We transact business in foreign currencies and, as a result, our income experiences some volatility related to movements in foreign currency exchange rates. To help manage our exposure to exchange rate volatility, we use foreign exchange forward contracts on a regular basis to hedge forecasted intercompany and third-party sales and purchases denominated in non-functional currencies. Our internal policy allows for managing anticipated foreign currency cash flows for up to one year. These foreign currency forward contracts are designated and qualify as foreign currency cash flow hedges under GAAP. The effective portion of the unrealized gain or loss on the forward contract is deferred and reported as a component of accumulated other comprehensive loss (AOCL). When the hedged forecasted transaction (sale or purchase) occurs, the unrealized gain or loss is reclassified into income in the same line item associated with the hedged transaction in the same period or periods during which the hedged transaction affects income. The ineffective portion of the hedge, unrealized gain or loss, if any, is recognized in current income during the period of change. As of June 26, 2011, the amount we expect to reclassify from AOCL to income over the next year is less than a million. For the six month periods ended June 26, 2011 and June 27, 2010, there were no circumstances that would have resulted in the discontinuance of a foreign currency cash flow hedge.

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To minimize the income volatility resulting from the remeasurement of net monetary assets and payables denominated in a currency other than the functional currency, we enter into foreign currency forward contracts, which are considered economic hedges. The objective is to offset the gain or loss from remeasurement with the gain or loss from the fair market valuation of the forward contract. These derivative instruments are not designated as hedges under GAAP.

The table below summarizes our outstanding foreign currency forward contracts. Only the U.S. dollar forward contracts are designated and qualify for hedge accounting as of each period presented below. The currencies in this table represent 98 percent and 97 percent of the notional amounts of contracts outstanding as of June 26, 2011 and December 31, 2010, respectively.

Currency denomination	Notional amount in millions	
	June 26, 2011	December 31, 2010
United States Dollar (USD)	164	142
British Pound Sterling (GBP)	336	87
Euro (EUR)	62	46
Singapore Dollar (SGD)	22	17
Indian Rupee (INR)	1,852	1,275
Japanese Yen (JPY)	2,801	3,722
Canadian Dollar (CAD)	38	39
South Korea Won (KRW)	32,965	28,028
Chinese Renminbi (CNY)	446	60

Commodity Price Risk

We are exposed to fluctuations in commodity prices due to contractual agreements with component suppliers. In order to protect ourselves against future price volatility and, consequently, fluctuations in gross margins, we periodically enter into commodity swap contracts with designated banks to fix the cost of certain raw material purchases with the objective of minimizing changes in inventory cost due to market price fluctuations. The swap contracts are derivative contracts that are designated as cash flow hedges under GAAP. The effective portion of the unrealized gain or loss is deferred and reported as a component of AOCL. When the hedged forecasted transaction (purchase) occurs, the unrealized gain or loss is reclassified into income in the same line item associated with the hedged transaction in the same period or periods during which the hedged transaction affects income. The ineffective portion of the hedge, if any, is recognized in current income in the period in which the ineffectiveness occurs. As of June 26, 2011, we expect to reclassify an unrealized net gain of \$3 million from AOCL to income over the next year. For the six month periods ended June 26, 2011 and June 27, 2010, there were no material circumstances that would have resulted in the discontinuance of a cash flow hedge. Our internal policy allows for managing these cash flow hedges for up to three years.

The following table summarizes our outstanding commodity swap contracts that were entered into to hedge the cost of certain raw material purchases:

Dollars in millions Commodity	June 26, 2011		December 31, 2010	
	Notional Amount	Quantity	Notional Amount	Quantity
Copper	\$ 72	8,396 metric tons(1)	\$ 55	7,560 metric tons(1)
		33,920 troy ounces(2)		9,157 troy ounces(2)
Platinum	59		11	

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Palladium	5	6,345 troy ounces(2)	1	1,763 troy ounces(2)
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(1)A metric ton is a measurement of mass equal to 1,000 kilograms.

(2)A troy ounce is a measurement of mass equal to approximately 31 grams.

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 November 2005, we entered into an interest rate swap to effectively convert our \$250 million debt issue, due in 2028, from a fixed rate of 7.125% to a floating rate based on a LIBOR spread. The terms of the swap mirror those of the debt, with interest paid semi-annually. This swap qualifies as a fair value hedge under GAAP. The gain or loss on this derivative instrument 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 following table summarizes these gains and losses for the three and six month interim reporting periods presented below:

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In millions Income Statement	Three months ended				Six months ended			
	June 26, 2011		June 27, 2010		June 26, 2011		June 27, 2010	
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	\$ 18	\$ (18)	\$ 22	\$ (22)	\$ 10	\$ (10)	\$ 22	\$ (22)

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 six month interim reporting periods presented below. The table does not include amounts related to ineffectiveness as it was not material for the periods presented.

Foreign currency forward contracts	Net sales	\$ 1	\$ 1	\$ 3	\$ (3)	\$ 5	\$ (7)	\$ 4	\$ (4)
Total		\$ (6)	\$ (5)	\$ 11	\$ (1)	\$ (11)	\$ 18	\$	

Derivatives Not Designated as Hedging Instruments

The following table summarizes the effect on our *Condensed Consolidated Statements of Income* for derivative instruments that are not classified as hedges for the three and six month interim reporting periods presented below.

In millions Derivatives Not Designated as Hedging Instruments	Location of Gain/(Loss) Recognized in Income on Derivatives	Three months ended		Six months ended	
		Amount of Gain/(Loss) Recognized in Income on Derivatives		Amount of Gain/(Loss) Recognized in Income on Derivatives	
		June 26, 2011	June 27, 2010	June 26, 2011	June 27, 2010
Foreign currency forward contracts	Cost of sales	\$ 1	\$ (2)	\$ (3)	\$ 2
Foreign currency forward contracts	Other income (expense), net	(10)	6	(5)	(6)

Fair Value Amount and Location of Derivative Instruments

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The following tables summarize the location and fair value of derivative instruments on our *Condensed Consolidated Balance Sheets*:

In millions	Fair Value		Balance Sheet Location
	June 26, 2011	December 31, 2010	
Derivatives Designated as Hedging Instruments			
Commodity swap contracts	\$ 3	\$ 20	Prepaid expenses and other current assets
Commodity swap contracts		1	Other assets
Interest rate contract	51	41	Other assets
Total Derivatives Designated as Hedging Instruments	54	62	
Total derivative assets	\$ 54	\$ 62	

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In millions	Fair Value		Derivative liabilities	Balance Sheet Location
	June 26, 2011	December 31, 2010		
Derivatives Designated as Hedging Instruments				
Commodity swap contracts	\$ 1	\$		Other accrued expenses
Foreign currency forward contracts			1	Other accrued expenses
Total Derivatives Designated as Hedging Instruments	\$ 1	\$	1	
Derivatives Not Designated as Hedging Instruments				
Foreign currency forward contracts	1			Other accrued expenses
Total Derivatives Not Designated as Hedging Instruments	1			
Total derivative liabilities	\$ 2	\$	1	

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, Power Generation, Components 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. The engines are used in trucks of all sizes, buses and recreational vehicles, as well as various industrial applications including construction, mining, agriculture, marine, oil and gas, rail and military. The Power Generation segment is an integrated provider of power systems which sells engines, generator sets and alternators. The Components segment sells filtration products, exhaust aftertreatment systems, turbochargers and fuel systems. The Distribution segment includes wholly-owned and partially-owned distributorships engaged in wholesaling engines, generator sets and service parts, as well as performing service and repair activities on our products and maintaining relationships with various OEMs throughout the world.

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 the *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 services costs or credits, changes in cash surrender value of corporate owned life

insurance or income taxes to individual segments. Segment EBIT may not be consistent with measures used by other companies.

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

In millions	Engine	Power Generation	Components	Distribution	Non-segment Items(1)	Total
Three months ended						
June 26, 2011						
External sales	\$ 2,476	\$ 649	\$ 741	\$ 775	\$	\$ 4,641
Intersegment sales	424	260	291	10	(985)	
Total sales	2,900	909	1,032	785	(985)	4,641
Depreciation and amortization(2)	44	11	18	5		78
Research, development and engineering expenses	102	12	43			157
Equity, royalty and interest income from investees	49	13	9	46		117
Interest income	6	3	1			10
Segment EBIT	377	105	120	106	67	775
Three months ended						
June 27, 2010						
External sales	\$ 1,595	\$ 518	\$ 522	\$ 573	\$	\$ 3,208
Intersegment sales	304	190	207	3	(704)	
Total sales	1,899	708	729	576	(704)	3,208
Depreciation and amortization(2)	42	11	21	7		81
Research, development and engineering expenses	62	8	26			96
Equity, royalty and interest income from investees	52	9	6	30		97
Interest income	2	1	1	1		5
Segment EBIT	197	76	75	69	(16)	401
Six months ended						
June 26, 2011						
External sales	\$ 4,482	\$ 1,206	\$ 1,401	\$ 1,412	\$	\$ 8,501
Intersegment sales	809	498	555	15	(1,877)	
Total sales	5,291	1,704	1,956	1,427	(1,877)	8,501
Depreciation and amortization(2)	89	21	36	11		157
Research, development and engineering expenses	182	23	80	1		286
Equity, royalty and interest income from investees	91	21	17	84		213
Interest income	9	4	2	1		16
Segment EBIT	667	194	225	195	26	1,307
Six months ended						
June 27, 2010						
External sales	\$ 2,768	\$ 896	\$ 975	\$ 1,047	\$	\$ 5,686
Intersegment sales	554	329	384	5	(1,272)	
Total sales	3,322	1,225	1,359	1,052	(1,272)	5,686
Depreciation and amortization(2)	83	21	41	14		159
	122	15	51			188

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Research, development and engineering expenses

Equity, royalty and interest income from investees	87	15	11	60		173
Interest income	4	2	1	1		8
Segment EBIT	330	110	132	141	(46)	667

(1) Includes intersegment sales and profit in inventory eliminations and unallocated corporate expenses. The three and six months ended June 26, 2011, include a \$68 million gain related to the sale of our exhaust business from the Components segment. The gain has been excluded from segment results as it was not considered by management in its evaluation of operating results for the three and six months ended June 26, 2011. There were no other significant unallocated corporate expenses for the three and six months ended June 26, 2011 and June 27, 2010.

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

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

In millions	Three months ended				Six months ended			
	June 26, 2011		June 27, 2010		June 26, 2011		June 27, 2010	
Segment EBIT	\$	775	\$	401	\$	1,307	\$	667
Less:								
Interest expense		13		9		23		18
Income before income taxes	\$	762	\$	392	\$	1,284	\$	649

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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, the Company, 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. We undertake no obligation to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise. Future factors that could affect the outcome of forward-looking statements include the following:

- price and product competition by foreign and domestic competitors, including new entrants;
- rapid technological developments of diesel engines;
- our ability to continue to introduce competitive new products in a timely, cost-effective manner;
- our sales mix of products;
- our continued achievement of lower costs and expenses;
- domestic and foreign governmental and public policy changes, including environmental regulations;
- protection and validity of our patent and other intellectual property rights;
- our reliance on large customers;
- 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;

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- the overall stability of global economic markets and conditions; and
- other risk factors described in our Form 10-K, Part 1, Item 1A under the caption Risk Factors.

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

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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 2010 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
- Off Balance Sheet Financing
- Application of Critical Accounting Estimates
- Recently Adopted and Recently Issued Accounting Pronouncements

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EXECUTIVE SUMMARY AND FINANCIAL HIGHLIGHTS

We are a global power leader that designs, manufactures, distributes and services diesel and natural gas engines, electric power generation systems and engine-related component products, including filtration, exhaust aftertreatment, fuel systems, controls and air handling systems. We sell our products to original equipment manufacturers (OEMs), distributors and other customers worldwide. We have long-standing relationships with many of the leading manufacturers in the markets we serve, including PACCAR Inc., Chrysler Group, LLC, Daimler Trucks North America, MAN Nutzfahrzeuge AG, Ford Motor Company, Komatsu and Volvo AB. We serve our customers through a network of more than 600 company-owned and independent distributor locations and approximately 6,000 dealer locations in more than 190 countries and territories.

Our reportable operating segments consist of the following: Engine, Power Generation, Components and Distribution. This reporting structure is organized according to the products and markets each segment serves 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. The engines are used in trucks of all sizes, buses and recreational vehicles, as well as various industrial applications including construction, mining, agriculture, marine, oil and gas, rail and military. The Power Generation segment is an integrated provider of power systems which sells engines, generator sets and alternators. The Components segment sells filtration products, exhaust aftertreatment systems, turbochargers and fuel systems. The Distribution segment includes wholly-owned and partially-owned distributorships engaged in wholesaling engines, generator sets and service parts, as well as performing service and repair activities on our products and maintaining relationships with various OEMs throughout the world.

Our financial performance depends, in large part, on varying conditions in the markets we serve, particularly the on-highway, construction and general industrial markets. Demand in these markets tends to fluctuate in response to overall economic conditions and is particularly sensitive to changes in interest rate levels and our customers' access to credit. Our sales may also be impacted by OEM inventory levels and production schedules and stoppages. Economic downturns in markets we serve generally result in reductions in sales and pricing of our products. As a worldwide business, our operations are also affected by political, economic and regulatory matters, including environmental and emissions standards, in the countries we serve. 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 and the economy of any single country on our consolidated results.

In the first six months of 2011, emerging markets continued to experience strong growth, especially in China, India and Brazil. The rate of growth in China is expected to be less, in some industrial markets, in the second half of 2011 as a result of government actions to control inflation through higher interest rates. Certain developed markets began experiencing more robust recoveries, including the North American on-highway markets. The North American on-highway market has demonstrated signs of strong recovery, coupled with the depletion of transition engine inventory purchased in 2009 in advance of the Environmental Protection Agency's (EPA's) 2010 emissions change. Demand for heavy-duty on-highway products in North America was four times higher in the first six months of 2011 as compared to the same period in 2010. In addition, medium-duty truck and bus shipments in North America were three times higher in the first six months of 2011 compared to the prior period in 2010.

On March 11, 2011, Japan incurred a massive earthquake followed by a devastating tsunami and nuclear disaster which significantly damaged or destroyed much of the infrastructure in the affected areas. Although Japan has not historically been a significant market for our products, we worked diligently to evaluate and analyze the impacts of this disaster on all of our business segments, including working closely with our suppliers to evaluate the supply channel for potential disruptions to our customers. We did not experience any material impacts to our results of operations for the second quarter of 2011 and we do not believe we will have any material adverse impacts to our supply channel or future sales in Japan as a result of this disaster.

We expect demand to improve throughout the remainder of 2011 in most markets and we expect demand in emerging markets to remain strong although China's growth may slow in the remainder of 2011. Overall, order trends continue to improve and are consistent with our expectations of organic revenue growth in the remainder of 2011.

The following tables contain sales and earnings before interest and taxes (EBIT) results by operating segment for the three and six months ended June 26, 2011 and June 27, 2010. Refer to the section titled "Operating Segment Results" later in the MD&A for a more detailed discussion of net sales and EBIT by operating segment including the reconciliation of segment EBIT to income before taxes.

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Operating Segments In millions	June 26, 2011			Three months ended June 27, 2010			Percent change 2011 vs. 2010	
	Sales	Percent of Total	EBIT	Sales	Percent of Total	EBIT	Sales	EBIT
Engine	\$ 2,900	62%	\$ 377	\$ 1,899	59%	\$ 197	53%	91%
Power Generation	909	20%	105	708	22%	76	28%	38%
Components	1,032	22%	120	729	23%	75	42%	60%
Distribution	785	17%	106	576	18%	69	36%	54%
Intersegment eliminations	(985)	(21)%		(704)	(22)%		40%	
Non segment			67			(16)		NM
Total	\$ 4,641	100%	\$ 775	\$ 3,208	100%	\$ 401	45%	93%

Net income attributable to Cummins was \$505 million, or \$2.60 per diluted share, on sales of \$4.6 billion for the three month interim reporting period ended June 26, 2011, versus the comparable prior year period with net income attributable to Cummins of \$246 million, or \$1.25 per diluted share, on sales of \$3.2 billion. The increase in income was driven by the recovery of the North American on-highway markets, stronger demand in emerging and domestic markets, significantly improved gross margins, gain on sale of a business and increased equity income. These were partially offset by higher selling, general and administrative expenses, income tax expense and research, development and engineering expenses. We recorded a gain on the sale of our exhaust business of \$68 million (\$37 million after tax or \$0.19 per diluted share). For a detailed discussion of the sale, see Note 4, **DIVESTITURES AND ACQUISITIONS**, to our *Condensed Consolidated Financial Statements*.

Engine	\$ 5,291	62%	\$ 667	\$ 3,322	58%	\$ 330	59%	NM
Components	1,956	23%	225	1,359	24%	132	44%	70%
Intersegment eliminations	(1,877)	(22)%		(1,272)	(22)%		48%	
Total	\$ 8,501	100%	\$ 1,307	\$ 5,686	100%	\$ 667	50%	96%

Net income attributable to Cummins was \$848 million, or \$4.34 per diluted share, on sales of \$8.5 billion for the six month interim reporting period ended June 26, 2011, versus the comparable prior year period with net income attributable to Cummins of \$395 million, or \$2.00 per diluted share, on sales of \$5.7 billion. The increase in income was driven by the recovery of the North American on-highway markets, stronger demand in emerging and domestic markets, significantly improved gross margins, gain on sale of a business and increased equity income. These were partially offset by higher income tax expense, selling, general and administrative expenses and research, development and engineering expenses. We recorded a gain on the sale of our exhaust business of \$68 million (\$37 million after tax or \$0.19 per diluted share). For a detailed discussion of the sale, see Note 4, **DIVESTITURES AND ACQUISITIONS**, to our *Condensed Consolidated Financial Statements*.

We generated \$ 744 million of operating cash flows for the six months ended June 26, 2011, compared to \$427 million for the six months ended June 27, 2010. Refer to the section titled **Operating Activities** later in the MD&A for a discussion of items impacting cash flows. In December 2007, Cummins Board of Directors authorized the acquisition of up to \$500 million of Cummins common stock. In the first quarter of 2011, we completed this stock repurchase program. In February 2011, the Board of Directors authorized the acquisition of up to \$1 billion of Cummins common stock. We repurchased \$373 million in the first six months of 2011, of which \$262 million pertains to the 2011 repurchase program. Our debt to capital ratio (total capital defined as debt plus equity) at June 26, 2011, was 13.3 percent, compared to 14.4 percent at December 31, 2010. In June 2011, Fitch upgraded our credit rating to **A-** and changed our outlook to stable. In addition to the \$1.474 billion in cash and marketable securities on hand, we have sufficient access to our revolver and accounts receivable program to meet currently anticipated

growth and funding needs.

In July 2011, the board of directors increased the quarterly dividend on our common stock from \$0.2625 per share to \$0.40. The dividend is payable on September 1, 2011, to shareholders of record on August 22, 2011.

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We have a pending divestiture in the Components segment expected to generate a pre-tax gain of \$45 million to \$50 million, which is expected to close in the second half of 2011. Finally, our current assessment of the income tax rate indicates an expected 2011 effective tax rate of approximately 29.5 percent, absent any discrete period activity.

Our worldwide pension plans were 96 percent funded at December 31, 2010. The United States (U.S.) qualified plan, which is approximately 62 percent of the worldwide pension obligation, was 99 percent funded, the non-qualified plans were not funded and the United Kingdom (U.K.) plan was 107 percent funded. We anticipate making total contributions of approximately \$130 million to our pension plans in 2011.

OUTLOOK

Near-Term:

In the first six months of 2011, economies in emerging markets, including China, India and Brazil, continued to experience strong growth. The rate of growth in China is expected to be less, in some industrial markets, in the second half of 2011 as a result of government actions to control inflation through higher interest rates. Certain developed markets began experiencing more robust recoveries, including the North American on-highway truck markets.

We expect the following positive trends in the remainder of 2011:

- Markets for the majority of our products in China, India and Brazil should continue to grow, but at a slower pace than experienced in 2010 and we are expanding our capacity in China and India to meet the expected demand.
- Our markets in North America are expected to continue their robust recovery, especially with the on-highway truck markets and a significant improvement in our power generation markets.
- We expect most of our other markets to continue to grow.

We expect the following challenges to our business that will put pressure on earnings in 2011:

- We will increase our investment in new product development.
- Our joint ventures will likely experience slower growth as we invest in capacity.
- Increasing commodity costs could continue to put downward pressure on earnings.

Long-Term:

We see improvements in most of our current markets and we are confident that opportunities for long-term profitable growth will continue in the future.

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RESULTS OF OPERATIONS

In millions (except per share amounts)	Three months ended		Favorable/ (Unfavorable)		Six months ended		Favorable/ (Unfavorable)	
	June 26, 2011	June 27, 2010	Amount	Percent	June 26, 2011	June 27, 2010	Amount	Percent
Net Sales	\$ 4,641	\$ 3,208	\$ 1,433	45%	\$ 8,501	\$ 5,686	\$ 2,815	50%
Cost of sales	3,438	2,455	(983)	(40)%	6,341	4,332	(2,009)	(46)%
Gross Margin	1,203	753	450	60%	2,160	1,354	806	60%
Operating Expenses and Income								
Selling, general and administrative expenses	463	354	(109)	(31)%	852	689	(163)	(24)%
Research, development and engineering expenses	157	96	(61)	(64)%	286	188	(98)	(52)%
Equity, royalty and interest income from investees	117	97	20	21%	213	173	40	23%
Gain on sale of business	68		68	NM	68		68	NM
Other operating (expense) income, net		(4)	4	100%	(6)	(8)	2	25%
Operating Income	768	396	372	94%	1,297	642	655	NM
Interest income	10	5	5	100%	16	8	8	100%
Interest expense	13	9	(4)	(44)%	23	18	(5)	(28)%
Other income (expense), net	(3)		(3)	NM	(6)	17	(23)	NM
Income before income taxes	762	392	370	94%	1,284	649	635	98%
Income tax expense	225	122	(103)	(84)%	382	209	(173)	(83)%
Consolidated Net Income	537	270	267	99%	902	440	462	NM
Less: Net income attributable to noncontrolling interests	32	24	(8)	(33)%	54	45	(9)	(20)%
Net income attributable to Cummins Inc.	\$ 505	\$ 246	\$ 259	NM	\$ 848	\$ 395	\$ 453	NM
Diluted earnings per common share attributable to Cummins Inc.	\$ 2.60	\$ 1.25	\$ 1.35	NM	\$ 4.34	\$ 2.00	\$ 2.34	NM

NM - not meaningful information.

Percent of sales	Three months ended		Favorable/ (Unfavorable)		Six months ended		Favorable/ (Unfavorable)	
	June 26, 2011	June 27, 2010	Percentage Points		June 26, 2011	June 27, 2010	Percentage Points	
Gross margin	25.9%	23.5%	2.4		25.4%	23.8%	1.6	
Selling, general and administrative expenses	10.0%	11.0%	1.0		10.0%	12.1%	2.1	
Research, development and engineering expenses	3.4%	3.0%	(0.4)		3.4%	3.3%	(0.1)	

Net Sales

Net sales for the three and six month periods ended June 26, 2011, increased in all segments versus the comparable periods in 2010, primarily due to increased demand from most markets including recovery of the North American on-highway markets. The primary drivers for the increase in sales were:

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- Engine segment sales increased by 53 percent and 59 percent for the three and six months ended, respectively, due to increased demand in all lines of business led by increases in heavy-duty truck, industrial and medium-duty truck and bus sales for the three months ended; while improvements for the six months ended were led by increased demand in industrial, heavy-duty truck and medium duty truck and bus sales.
- Components segment sales increased by 42 percent and 44 percent for the three and six months ended, respectively, due to increased demand in all lines of business led by emission solutions and turbo technologies businesses.
- Distribution segment sales increased by 36 percent for both the three and six months ended due to increased sales in all product lines and all geographic regions led by North and Central America, Asia Pacific, Europe and Middle East regions.
- Power Generation segment sales increased by 28 percent and 39 percent for the three and six months ended, respectively, due to increased sales in all lines of business led by commercial products and generator technologies.

A more detailed discussion of sales by segment is presented in the **OPERATING SEGMENT RESULTS** section.

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Sales to international markets based on location of customers for the three and six month periods ended June 26, 2011, were 61 percent of total net sales for both periods, compared with 64 percent of total net sales for both of the comparable periods in 2010.

Gross Margin

Gross margin increased for the three and six month periods ended June 26, 2011, versus the comparable periods in 2010, and increased as a percentage of sales by 2.4 percentage points and 1.6 percentage points, respectively. The increase for the three and six month periods ended June 26, 2011, were led by increases in volume and price, which were partially offset by higher base warranty costs due to increased volumes and increasing mix of EPA 2010 products.

The provision for warranties issued as a percent of sales for the three and six month periods ended were 2.2 percent and 2.4 percent in 2011 compared to 3.0 percent and 2.8 percent for the comparable periods in 2010. Accrual rates for engines sold this quarter were generally lower than the rates charged in prior quarters as our warranty costs for EPA 2010 products have been lower than expected. 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 and six month periods ended June 26, 2011, increased versus the comparable periods in 2010, primarily due to an increase of \$69 million and \$97 million in compensation and related expenses including increased headcount to support our growing businesses, merit increases and increased discretionary spending. Compensation and related expenses include salaries, fringe benefits and variable compensation.

Research, Development and Engineering Expenses

Research, development and engineering expenses for the three and six month periods ended June 26, 2011, increased versus the comparable periods in 2010, primarily due to an increase of \$27 million and \$45 million in compensation and related expenses and an increase in the number of engineering programs with increased costs of \$26 million and \$42 million, respectively. 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.

Equity, Royalty and Interest Income From Investees

Equity, royalty and interest income from investees for the three and six month periods ended June 26, 2011, increased versus the comparable periods in 2010, primarily due to the following:

In millions	Increase/(Decrease)	
	June 26, 2011 vs. June 27, 2010	
	Three months ended	Six months ended
North American distributors	\$ 12	\$ 19
Chongqing Cummins Engine Company, Ltd.	6	8
Dongfeng Cummins Engine Company, Ltd.	(8)	(3)
Other	10	16
Total	\$ 20	\$ 40

These overall increases were primarily due to the economic recovery in North America, particularly in the oil and gas markets, and strong demand for power generation and mining products in China by Chongqing Cummins Engine Company, Ltd.

Gain on Sale of Business

In January 2011, we reached an agreement to sell certain assets and liabilities of our exhaust business which manufactures exhaust products and select components for emission systems for a variety of applications not core to our other product offerings. The transaction closed in the second quarter of 2011. This business was historically included in our Components segment. The sales price was \$123 million. We recognized a pre-tax gain on the sale of \$68 million, which included an allocation of goodwill of \$19 million. The transaction has a working capital adjustment mechanism that will be determined in the third quarter. We do not expect a significant change to the measurement of the gain. The gain has been excluded from segment results as it was not considered by management in its evaluation of operating results for the three and six months ended June 26, 2011.

Sales for this business were \$171 million, \$126 million and \$169 million in 2010, 2009 and 2008, respectively. Income before income taxes for this business was approximately \$22 million, \$11 million and \$19 million in 2010, 2009 and 2008, respectively.

Table of Contents***Other Operating (Expense) Income, net***

Other operating (expense) income was as follows:

In millions	Three months ended		Six months ended	
	June 26, 2011	June 27, 2010	June 26, 2011	June 27, 2010
Legal judgment	\$	\$	\$ (7)	\$
Amortization of intangible assets	(1)	(7)	(3)	(11)
Royalty expense	(1)		(1)	(1)
Royalty income	4	2	6	4
Other (expense) income, net	(2)	1	(1)	
Total other operating (expense) income, net	\$	\$ (4)	\$ (6)	\$ (8)

Interest Income

Interest income for the three and six month periods ended June 26, 2011, increased versus the comparable periods in 2010, primarily due to increased investment balances in 2011 compared to 2010.

Other Income (Expense), net

Other income (expense) was as follows:

In millions	Three months ended		Six months ended	
	June 26, 2011	June 27, 2010	June 26, 2011	June 27, 2010
Change in cash surrender value of corporate owned life insurance	\$ 4	\$ 1	\$ 7	\$
Dividend income	2	2	4	3
Gain on fair value adjustment for Cummins Western Canada (CWC)				12
Bank charges	(4)	(4)	(8)	(7)
Foreign currency gains (losses), net	(7)	2	(14)	9
Other, net	2	(1)	5	
Total other income (expense), net	\$ (3)	\$	\$ (6)	\$ 17

Income Tax Expense

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Our effective tax rate for the year is expected to approximate 29.5 percent, absent any discrete period activity. Our tax rate is generally less than the 35 percent U.S. income tax rate primarily due to lower tax rates on foreign income and research tax credits. The tax rates for the three and six month periods ended June 26, 2011, were 29.5 percent and 29.8 percent. The tax rate for the three and six month periods ended June 26, 2011, includes a discrete tax charge of \$4 million related to the enactment of state law changes in Indiana.

Our effective tax rates for the comparable prior year periods were 31.1 percent and 32.2 percent, respectively. The tax rate for the six month period includes a discrete tax charge of \$7 million related to the enactment of the Patient Protection and Affordable Care Act. The lower rate in 2011 compared to 2010 is a result of the geographic mix of earnings.

Noncontrolling Interests

Noncontrolling interests eliminate the income or loss attributable to non-Cummins ownership interests in our consolidated entities. Noncontrolling interests in income of consolidated subsidiaries for the three and six month periods ended June 26, 2011, increased versus the comparable periods in 2010, primarily due to higher income at Cummins India Ltd., a publicly traded company on various exchanges in India, reflecting the economic recovery in emerging markets.

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

Net income and diluted earnings per share attributable to Cummins Inc. for the three and six month periods ended June 26, 2011, increased versus the comparable periods in 2010, primarily due to higher volumes in most markets and geographic regions, including the recovery of the North American on-highway markets, significantly improved gross margins, the gain on sale of the exhaust business and increased equity income. These were partially offset by higher income tax expense, selling, general and administrative expenses and research, development and engineering expenses. Diluted earnings per share benefited \$0.04 per share and \$0.03 per share for the three and six month periods ended June 26, 2011, respectively, from lower shares primarily due to the stock repurchase program.

Table of Contents**OPERATING SEGMENT RESULTS**

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

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

Engine Segment Results

Financial data for the Engine segment was as follows:

In millions	Three months ended		Favorable/ (Unfavorable)		Six months ended		Favorable/ (Unfavorable)	
	June 26, 2011	June 27, 2010	Amount	Percent	June 26, 2011	June 27, 2010	Amount	Percent
External sales	\$ 2,476	\$ 1,595	\$ 881	55%	\$ 4,482	\$ 2,768	\$ 1,714	62%
Intersegment sales	424	304	120	39%	809	554	255	46%
Total sales	2,900	1,899	1,001	53%	5,291	3,322	1,969	59%
Depreciation and amortization	44	42	(2)	(5)%	89	83	(6)	(7)%
Research, development and engineering expenses	102	62	(40)	(65)%	182	122	(60)	(49)%
Equity, royalty and interest income from investees	49	52	(3)	(6)%	91	87	4	5%
Interest income	6	2	4	NM	9	4	5	NM
Segment EBIT	377	197	180	91%	667	330	337	NM
				Percentage Points				Percentage Points
Segment EBIT as a percentage of total sales	13.0%	10.4%		2.6	12.6%	9.9%		2.7

Engine segment net sales by market were as follows:

In millions	Three months ended		Favorable/ (Unfavorable)		Six months ended		Favorable/ (Unfavorable)	
	June 26, 2011	June 27, 2010	Amount	Percent	June 26, 2011	June 27, 2010	Amount	Percent
Heavy-duty truck	\$ 693	\$ 340	\$ 353	NM	\$ 1,178	\$ 592	\$ 586	99%
Medium-duty truck and bus	608	352	256	73%	1,082	569	513	90%
Light-duty auto and RV	310	296	14	5%	606	503	103	20%

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Total on-highway	1,611	988	623	63%	2,866	1,664	1,202	72%
Industrial	988	656	332	51%	1,843	1,233	610	49%
Stationary power	301	255	46	18%	582	425	157	37%
Total sales	\$ 2,900	\$ 1,899	\$ 1,001	53%	\$ 5,291	\$ 3,322	\$ 1,969	59%

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

	Three months ended		Favorable/ (Unfavorable)		Six months ended		Favorable/ (Unfavorable)	
	June 26, 2011	June 27, 2010	Amount	Percent	June 26, 2011	June 27, 2010	Amount	Percent
Midrange	131,300	90,500	40,800	45%	240,700	159,600	81,100	51%
Heavy-duty	29,900	14,500	15,400	NM	49,900	23,200	26,700	NM
High-horsepower	5,700	4,800	900	19%	10,600	8,200	2,400	29%
Total unit shipments	166,900	109,800	57,100	52%	301,200	191,000	110,200	58%

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Sales

Engine segment sales for the three month period ended June 26, 2011, increased versus the comparable period in 2010, due to improved sales in most markets primarily due to a significant rebound in North American on-highway markets as well as stronger demand in emerging markets. The following are the primary drivers by market.

- Heavy-duty truck engine sales increased due to recovery in North American on-highway markets and the depletion of transition engine inventory purchased in 2009 in advance of the EPA's 2010 emission standard changes.
- Industrial market sales increased primarily due to a 47 percent improvement in international construction engine shipments driven by the economic recovery, infrastructure improvements in emerging markets and increased demand in advance of off-highway emission regulations in the U.S. and Europe, more than triple the number of oil and gas engine shipments in North America and a 56 percent increase in units sold in the international mining engine markets due to increased coal and commodity demands.
- Medium-duty truck sales increased primarily due to higher demand in the Brazilian truck engine market driven by a growing economy and government incentives, the recovery in North American on-highway markets and the depletion of transition engine inventory purchased in 2009 in advance of the EPA's 2010 emission standard changes.

Total on-highway-related sales for the three month period ended June 26, 2011, were 56 percent of total engine segment sales, compared to 52 percent for the comparable period in 2010.

Engine segment sales for the six month period ended June 26, 2011, increased versus the comparable period in 2010, due to improved sales in most markets primarily due to a significant rebound in North American on-highway markets as well as stronger demand in emerging economies. The following are the primary drivers by market.

- Industrial market sales increased primarily due to a 56 percent improvement in international construction engine shipments driven by the economic recovery and infrastructure improvements in emerging markets, increased demand in advance of off-highway emission regulations in the U.S. and Europe, more than triple the number of oil and gas engine shipments in North America and a 60 percent increase in the units sold in the international mining engine markets due to increased coal and commodity demands.
- Heavy-duty truck engine sales increased due to recovery in North American on-highway markets and the depletion of transition engine inventory purchased in 2009 in advance of the EPA's 2010 emission standard changes.

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- Medium-duty truck sales increased primarily due to higher demand in the Brazilian truck engine market driven by a growing economy and government incentives, the recovery in North American on-highway markets and the depletion of transition engine inventory purchased in 2009 in advance of the EPA's 2010 emissions change.

Total on-highway-related sales for the six month period ended June 26, 2011, were 54 percent of total engine segment sales, compared to 50 percent for the comparable period in 2010.

Segment EBIT

Engine segment EBIT for the three and six month periods ended June 26, 2011, increased significantly versus the comparable periods in 2010, primarily due to higher gross margin, partially offset by increased selling, general, and administrative expenses and research, development and engineering expenses.

In millions	Three months ended June 26, 2011 vs. June 27, 2010			Six months ended June 26, 2011 vs. June 27, 2010		
	Amount	Percent	Percentage point change as a percent of sales	Amount	Percent	Percentage point change as a percent of sales
Gross margin	\$ 269	74%	2.6	\$ 467	70%	1.4
Selling, general and administrative expenses	(45)	(29)%	1.2	(61)	(20)%	2.2
Research, development and engineering expenses	(40)	(65)%	(0.2)	(60)	(49)%	0.3
Equity, royalty and interest income from investees	(3)	(6)%	(1.0)	4	5%	(0.9)

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The increase in gross margin for the three month period ended June 26, 2011, versus the comparable period in 2010, was primarily due to higher volumes and improved price realization, partially offset by higher base warranty costs due to increased volumes and increasing mix of EPA 2010 products and higher commodity costs. Although our warranty costs increased, our warranty cost as a percentage of sales decreased as actual accrual rates for engines sold this quarter were generally lower than rates charged in prior quarters as our warranty costs for EPA 2010 engines have been lower than expected. The increases in selling, general and administrative expenses and research, development and engineering expenses were primarily due to new product development spending, increased headcount to support our growing business and merit increases.

The increase in gross margin for the six month period ended June 26, 2011, versus the comparable period in 2010, was primarily due to higher volumes, improved price realization and favorable mix, partially offset by higher base warranty costs due to increased volumes and increasing mix of EPA 2010 products and higher commodity costs. The increases in selling, general and administrative expenses and research, development and engineering expenses were primarily due to new product development spending, increased headcount to support our growing business and merit increases.

Power Generation Segment Results

Financial data for the Power Generation segment was as follows:

In millions	Three months ended		Favorable/ (Unfavorable)		Six months ended		Favorable/ (Unfavorable)	
	June 26, 2011	June 27, 2010	Amount	Percent	June 26, 2011	June 27, 2010	Amount	Percent
External sales	\$ 649	\$ 518	\$ 131	25%	\$ 1,206	\$ 896	\$ 310	35%
Intersegment sales	260	190	70	37%	498	329	169	51%
Total sales	909	708	201	28%	1,704	1,225	479	39%
Depreciation and amortization	11	11			21	21		
Research, development and engineering expenses	12	8	(4)	(50)%	23	15	(8)	(53)%
Equity, royalty and interest income from investees	13	9	4	44%	21	15	6	40%
Interest income	3	1	2	NM	4	2	2	100%
Segment EBIT	105	76	29	38%	194	110	84	76%
	Percentage Points				Percentage Points			
Segment EBIT as a percentage of total sales	11.6%	10.7%		0.9	11.4%	9.0%		2.4

Sales for our Power Generation segment by business were as follows:

	Three months ended		Favorable/ (Unfavorable)		Six months ended		Favorable/ (Unfavorable)	
	June 26, 2011	June 27, 2010	Amount	Percent	June 26, 2011	June 27, 2010	Amount	Percent
Commercial products	\$ 568	\$ 436	\$ 132	30%	\$ 1,073	\$ 743	\$ 330	44%
Generator technologies	190	135	55	41%	343	242	101	42%
Commercial projects	58	57	1	2%	113	90	23	26%

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Consumer	53	49	4	8%	103	92	11	12%
Power electronics	40	31	9	29%	72	58	14	24%
Total sales	\$ 909	\$ 708	\$ 201	28%	\$ 1,704	\$ 1,225	\$ 479	39%

Sales

Power Generation segment sales for the three month period ended June 26, 2011, increased in all businesses versus the comparable period in 2010, primarily due to increased demand. The following are the primary drivers by business:

- Commercial products business sales increased due to improving economic conditions in most regions, particularly in Asia, North America, Brazil and the U.K., partially offset by lower demand in Mexico.
- Generator technologies sales increased in most regions, especially in Western Europe, Eastern Asia and the U.K.

Power Generation segment sales for the six month period ended June 26, 2011, increased in all businesses, versus the comparable period in 2010, primarily due to increased demand. The following are the primary drivers by business:

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- Commercial products business sales increased due to improving economic conditions in most regions, particularly in Asia, North America, the U.K. and Brazil.
- Generator technologies sales increased in most regions, especially in Western Europe, East Asia and the U.K., partially offset by a decline in Eastern European sales.

Segment EBIT

Power Generation segment EBIT for the three and six month periods ended June 26, 2011, increased versus the comparable periods in 2010, primarily due to higher gross margins, partially offset by higher selling, general and administrative expense and research, development and engineering expenses. Changes in Power Generation segment EBIT and EBIT as a percentage of sales were as follows:

In millions	Three months ended June 26, 2011 vs. June 27, 2010 Favorable/(Unfavorable) Change			Six months ended June 26, 2011 vs. June 27, 2010 Favorable/(Unfavorable) Change		
	Amount	Percent	Percentage point change as a percent of sales	Amount	Percent	Percentage point change as a percent of sales
Gross margin	\$ 44	33%	0.6	\$ 115	51%	1.6
Selling, general and administrative expenses	(15)	(25)%	0.2	(26)	(22)%	1.2
Research, development and engineering expenses	(4)	(50)%	(0.2)	(8)	(53)%	(0.1)
Equity, royalty and interest income from investees	4	44%	0.1	6	40%	

The increase in gross margin for the three month period ended June 26, 2011, was due to higher volumes and improved price realization, which was partially offset by increased commodity costs. The increases in selling, general and administrative expenses and research, development and engineering expenses were primarily due to increased headcount to support our growing business and merit increases.

The increase in gross margin for the six month period ended June 26, 2011, was due to higher volumes and improved price realization, which was partially offset by increased commodity and material costs. The increases in selling, general and administrative expenses and research, development and engineering expenses were primarily due to increased headcount to support our growing business and merit increases.

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Components Segment Results

Financial data for the Components segment was as follows:

In millions	Three months ended		Favorable/ (Unfavorable)		Six months ended		Favorable/ (Unfavorable)	
	June 26, 2011	June 27, 2010	Amount	Percent	June 26, 2011	June 27, 2010	Amount	Percent
External sales	\$ 741	\$ 522	\$ 219	42%	\$ 1,401	\$ 975	\$ 426	44%
Intersegment sales	291	207	84	41%	555	384	171	45%
Total sales	1,032	729	303	42%	1,956	1,359	597	44%
Depreciation and amortization	18	21	3	14%	36	41	5	12%
Research, development and engineering expenses	43	26	(17)	(65)%	80	51	(29)	(57)%
Equity, royalty and interest income from investees	9	6	3	50%	17	11	6	55%
Interest income	1	1	2	100%	2	1	1	100%
Segment EBIT	120	75	45	60%	225	132	93	70%
Percentage Points				Percentage Points				
Segment EBIT as a percentage of total sales	11.6%	10.3%		1.3	11.5%	9.7%		1.8

Sales for our Components segment by business were as follows:

	Three months ended		Favorable/ (Unfavorable)		Six months ended		Favorable/ (Unfavorable)	
	June 26, 2011	June 27, 2010	Amount	Percent	June 26, 2011	June 27, 2010	Amount	Percent
Emission solutions	\$ 311	\$ 170	\$ 141	83%	\$ 584	\$ 307	\$ 277	90%
Turbo technologies	314	226	88	39%	611	426	185	43%
Filtration	287	250	37	15%	542	478	64	13%
Fuel systems	120	83	37	45%	219	148	71	48%
Total sales	\$ 1,032	\$ 729	\$ 303	42%	\$ 1,956	\$ 1,359	\$ 597	44%

Sales

Components segment sales for the three month period ended June 26, 2011, increased in all businesses versus the comparable period in 2010. The following are the primary drivers by business.

- Emission solutions business sales increased due to higher volume and technology content in North American EPA 2010 aftertreatment systems and increased demand for Euro V aftertreatment systems in Europe, which was partially offset by decreased sales of our EPA 2007 aftertreatment systems and lower sales due to the sale of the exhaust business.

- Turbo technologies business sales increased due to higher OEM demand in North America, Europe and India.
- Fuel systems business sales increased primarily due to improved demand in North American on-highway markets.
- Filtration business sales increased due to improved aftermarket demand, especially in Asia Pacific and Europe, higher OEM demand due to the economic recovery in North American on-highway markets and favorable foreign current impacts.

Components segment sales for the six month period ended June 26, 2011, increased in all businesses versus the comparable period in 2010. The following are the primary regional drivers by business.

- Emission solutions business sales increased due to higher volume and technology content in North American EPA 2010 aftertreatment systems and increased demand for Euro V aftertreatment systems in Europe, which was partially offset by decreased sales of our EPA 2007 aftertreatment systems and lower sales due to the sale of the exhaust business.
- Turbo technologies business sales increased due to higher OEM demand in North America, Europe and India and improved aftermarket demand.
- Fuel systems business sales increased primarily due to improved demand in North American on-highway markets.

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- Filtration business sales increased due to improved aftermarket demand, especially in Asia Pacific, Asia and Europe, higher OEM demand due to the economic recovery in North American on-highway markets and favorable foreign currency impacts.

Segment EBIT

Components segment EBIT for the three and six month periods ended June 26, 2011, increased versus the comparable periods in 2010, primarily due to the improved gross margin which was partially offset by increased research, development and engineering expenses and higher selling, general and administrative expenses. Changes in Components segment EBIT and EBIT as a percentage of sales were as follows:

In millions	Three months ended June 26, 2011 vs. June 27, 2010 Favorable/(Unfavorable) Change			Six months ended June 26, 2011 vs. June 27, 2010 Favorable/(Unfavorable) Change		
	Amount	Percent	Percentage point change as a percent of sales	Amount	Percent	Percentage point change as a percent of sales
Gross margin	\$ 76	52%	1.5	\$ 140	51%	1.1
Selling, general and administrative expenses	(15)	(27)%	0.8	(23)	(21)%	1.3
Research, development and engineering expenses	(17)	(65)%	(0.6)	(29)	(57)%	(0.3)
Equity, royalty and interest income from investees	3	50%	0.1	6	55%	0.1

The increase in gross margin for the three and six month periods ended June 26, 2011, was primarily due to higher volumes for all businesses and increased product content on 2010 North American truck engines, partially offset by higher commodity costs. The increases in research, development and engineering expenses and selling, general and administrative expenses were primarily due to new product development spending and increased headcount to support our growing business.

In the second quarter of 2011 we sold certain assets and liabilities of our exhaust business and recognized a \$68 million pre-tax gain on the sale. The gain has been excluded from Components results as it was not considered by management in its evaluation of Components operating results for the three and six months ended June 26, 2011. See Note 4, DIVESTITURES AND ACQUISITIONS, to our *Condensed Consolidated Financial Statements*.

Distribution Segment Results

Financial data for the Distribution segment was as follows:

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In millions	Three months ended		Favorable/ (Unfavorable)		Six months ended		Favorable/ (Unfavorable)	
	June 26, 2011	June 27, 2010	Amount	Percent	June 26, 2011	June 27, 2010	Amount	Percent
External sales	\$ 775	\$ 573	\$ 202	35%	\$ 1,412	\$ 1,047	\$ 365	35%
Intersegment sales	10	3	7	NM	15	5	10	NM
Total sales	785	576	209	36%	1,427	1,052	375	36%
Depreciation and amortization	5	7	2	29%	11	14	3	21%
Equity, royalty and interest income from investees	46	30	16	53%	84	60	24	40%
Interest income		1	(1)	(100)%	1	1		
Segment EBIT	106	69	37	54%	195	141	54	38%
Segment EBIT as a percentage of total sales	13.5%	12.0%		1.5	13.7%	13.4%		0.3

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Sales for our Distribution segment by region were as follows:

In millions	Three months ended		Favorable/ (Unfavorable)		Six months ended		Favorable/ (Unfavorable)	
	June 26, 2011	June 27, 2010	Amount	Percent	June 26, 2011	June 27, 2010	Amount	Percent
Asia Pacific	\$ 302	\$ 231	\$ 71	31%	\$ 543	\$ 424	\$ 119	28%
Europe and Middle East	222	177	45	25%	397	313	84	27%
North & Central America	195	122	73	60%	368	233	135	58%
Africa	36	26	10	38%	65	46	19	41%
South America	30	20	10	50%	54	36	18	50%
Total sales	\$ 785	\$ 576	\$ 209	36%	\$ 1,427	\$ 1,052	\$ 375	36%

Sales for our Distribution segment by product were as follows:

In millions	Three months ended		Favorable/ (Unfavorable)		Six months ended		Favorable/ (Unfavorable)	
	June 26, 2011	June 27, 2010	Amount	Percent	June 26, 2011	June 27, 2010	Amount	Percent
Parts and filtration	\$ 271	\$ 221	\$ 50	23%	\$ 506	\$ 414	\$ 92	22%
Power generation	195	135	60	44%	340	234	106	45%
Engines	186	109	77	71%	326	192	134	70%
Service	133	111	22	20%	255	212	43	20%
Total sales	\$ 785	\$ 576	\$ 209	36%	\$ 1,427	\$ 1,052	\$ 375	36%

Sales

Distribution segment sales for the three month period ended June 26, 2011, increased for all product lines versus the comparable period in 2010. The following were the primary drivers by line of business:

- Engine product sales increased primarily due to growth in the oil and gas markets in North and Central America, increased demand driven by the economic recovery in Europe and improved engine sales in Africa.
- Power generation product sales increased primarily due to improved project-based business across the Middle East and Europe and the acquisition of a previously independent distributor in the fourth quarter of 2010.
- Parts and filtration product sales increased primarily due to higher industry demand in North and Central America, the acquisition of a previously independent distributor in the fourth quarter of 2010 and improved sales in East Asia.

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- Foreign currency fluctuations also favorably impacted sales.
- Service revenue increased primarily due to stronger sales from mining customers in the South Pacific.

Distribution segment sales for the six month period ended June 26, 2011, increased for all product lines versus the comparable period in 2010. The following were the primary drivers by line of business:

- Engine product sales increased primarily due to growth in the oil and gas markets in North and Central America and increased demand driven by economic recovery in Europe.
- Power generation product sales increased primarily due to improved project-based business across the Middle East, Europe and North and Central America and the acquisition of a previously independent distributor in the fourth quarter of 2010.
- Parts and filtration product sales increased primarily due to the acquisition of a previously independent distributor in the fourth quarter of 2010, higher demand in North and Central America and improved sales in East Asia.
- Foreign currency fluctuations also favorably impacted sales.

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- Service revenue increased primarily due to stronger sales from mining customers in the South Pacific and the increase in maintenance contracts in North and Central America.

Segment EBIT

Distribution segment EBIT for the three month period ended June 26, 2011, increased versus the comparable period in 2010, primarily due to improved gross margin and equity, royalty and interest income from investees, which was partially offset by increased selling, general and administrative expenses. Segment EBIT for the six month period ended June 26, 2011, increased versus the comparable period in 2010, primarily due to improved gross margin and equity, royalty and interest income from investees, which was partially offset by increased selling, general and administrative expenses and the absence of a one-time gain of \$12 million from the acquisition of Cummins Western Canada in the first quarter of 2010.

Changes in Distribution segment EBIT and EBIT as a percentage of sales were as follows:

In millions	Three months ended June 26, 2011 vs. June 27, 2010 Favorable/(Unfavorable) Change			Six months ended June 26, 2011 vs. June 27, 2010 Favorable/(Unfavorable) Change		
	Amount	Percent	Percentage point change as a percent of sales	Amount	Percent	Percentage point change as a percent of sales
Gross margin	\$ 49	39%	0.5	\$ 88	37%	0.3
Equity, royalty and interest income from investees	16	53%	0.7	24	40%	0.2
Selling, general and administrative expenses	(33)	(39)%	(0.3)	(53)	(32)%	0.4

The increase in gross margin for the three month period ended June 26, 2011, versus the comparable period in 2010, was primarily due to higher volumes in most products and favorable foreign currency impacts. The increase in equity, royalty and interest income from investees was primarily due to higher income from North American distributors especially in the oil and gas markets and increased parts sales. The increase in selling, general and administrative expenses was mainly due to higher head count to support our growing business, merit increases and unfavorable foreign currency impacts.

The increase in gross margin for the six month period ended June 26, 2011, versus the comparable period in 2010, was primarily due to higher volumes in most products and favorable foreign currency impacts. The increase in equity, royalty and interest income from investees was primarily due to higher income from North American distributors especially in the oil and gas markets and increased parts sales. The increase in selling, general and administrative expenses was mainly due to higher head count to support our growing business, merit increases and unfavorable foreign currency impacts.

Reconciliation of Segment EBIT to Income Before Income Taxes

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

In millions	Three months ended		Six months ended	
	June 26, 2011	June 27, 2010	June 26, 2011	June 27, 2010
Total segment EBIT	\$ 708	\$ 417	\$ 1,281	\$ 713
Non-segment EBIT (1)	67	(16)	26	(46)
Total EBIT	\$ 775	\$ 401	\$ 1,307	\$ 667
Less:				
Interest expense	13	9	23	18
Income before income taxes	\$ 762	\$ 392	\$ 1,284	\$ 649

(1) Includes intersegment sales and profit in inventory eliminations and unallocated corporate expenses. The three and six months ended June 26, 2011, include a \$68 million gain related to the sale of our exhaust business from the Components segment. The gain has been excluded from segment results as it was not considered by management in its evaluation of operating results for the three and six months ended June 26, 2011. There were no other significant unallocated corporate expenses for the three and six months ended June 26, 2011 and June 27, 2010.

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LIQUIDITY AND CAPITAL RESOURCES

Management's Assessment of Liquidity

Our financial condition and liquidity remain strong. Our solid balance sheet and credit ratings enable us to continue to have ready access to credit.

We assess our liquidity in terms of our ability to generate adequate cash to fund our operating, investing and financing activities. Cash provided by operations is our principal source of liquidity. As of June 26, 2011, other sources of liquidity include:

- cash and cash equivalents of \$ 1.1 billion, of which approximately 37 percent is located in the United States, and 63 percent is located in China, the U.K., Singapore, India and Brazil,
- marketable securities of \$ 363 million, which are located primarily in India and Brazil,
- \$1.21 billion available under our revolving credit facility,
- \$ 274 million available under international and other domestic credit facilities and
- \$ 126 million, based on eligible receivables, available under our accounts receivable sales program.

We believe our liquidity provides us with the financial flexibility needed to fund working capital, capital expenditures, projected pension obligations, dividend payments, common stock repurchases and debt service obligations.

A significant portion of our cash flows is generated outside the U.S. As of June 26, 2011, the total of cash, cash equivalents and marketable securities held by foreign subsidiaries was \$1.1 billion, the vast majority of which was located in India, China, the U.K., Brazil and Singapore. The geographic location of our cash and marketable securities aligns well with our business growth strategy. We manage our worldwide cash requirements considering available funds among the many subsidiaries through which we conduct our business and the cost effectiveness with which those funds can be accessed. As a result, we do not anticipate any local liquidity restrictions to preclude us from funding our expansion or operating needs with local resources. If these funds were repatriated to the U.S. we could be required to accrue and pay U.S. taxes. At present we do not foresee a need to repatriate any earnings in the near future. However, we have and will continue to transfer cash from these subsidiaries to us and to other international subsidiaries when it is cost effective to do so.

We continuously monitor our pension assets and believe that we have limited exposure to the European debt crisis. No sovereign debt instruments of crisis countries are held in the trusts, while any equities are held with large well-diversified multinational firms or are de minimus amounts in large index funds. In addition, we have rebalanced our asset portfolios in the U.S. and the U.K. with equities representing a smaller segment of the total portfolios. Our pension plans have not experienced any significant impact on liquidity or counterparty exposure due to the

volatility in the credit markets.

Working Capital Summary

We fund our working capital with cash from operations and short-term borrowings when necessary. Various assets and liabilities, including short-term debt, can fluctuate significantly from month to month depending on short-term liquidity needs. As a result, working capital is a prime focus of management attention.

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In millions	Change June 26, 2011 vs.					
	June 26, 2011	December 31, 2010	June 27, 2010	December 31, 2010	June 27, 2010	
Cash and cash equivalents	\$ 1,111	\$ 1,023	\$ 924	\$ 88	\$ 187	
Marketable securities	363	339	269	24	94	
Accounts and notes receivable	2,780	2,243	2,052	537	728	
Inventories	2,275	1,977	1,652	298	623	
Other current assets	608	707	548	(99)	60	
Current assets	7,137	6,289	5,445	848	1,692	
Accounts and loans payable	1,745	1,444	1,300	301	445	
Current portion of accrued warranty	429	421	407	8	22	
Other accrued expenses	1,539	1,395	1,100	144	439	
Current liabilities	3,713	3,260	2,807	453	906	
Working capital	\$ 3,424	\$ 3,029	\$ 2,638	\$ 395	\$ 786	
Current ratio	1.92	1.93	1.94	(0.01)	(0.02)	
Days sales in receivables	54	59	65	(5)	(11)	
Inventory turnover	5.8	5.8	5.6		0.2	

Current assets increased compared to December 31, 2010, primarily due to an increase in accounts receivable due to higher sales and an increase in inventory levels to meet anticipated demand.

Current liabilities increased compared to December 31, 2010, primarily due to higher accounts and loans payable and other accrued expenses, which was the result of increased purchasing requirements to support higher sales volume in the businesses.

Cash Flows

Cash and cash equivalents increased \$ 88 million during the six month period ended June 26, 2011, compared to a \$6 million decrease in cash and cash equivalents during the comparable period in 2010. The change in cash and cash equivalents was as follows:

Operating Activities

In millions	Six months ended		Change
	June 26, 2011	June 27, 2010	
Consolidated net income	\$ 902	\$ 440	\$ 462
Depreciation and amortization	159	161	(2)
Gain on sale of business	(68)		(68)
Gain on fair value adjustment for consolidated investee		(12)	12
Deferred income taxes	87	43	44
Equity in income of investees, net of dividends	2	(49)	51

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Pension contributions, in excess of expense	(47)	(116)	69
Excess tax benefits on stock based awards	(4)	(7)	3
Other post-retirement benefits payments in excess of expense	(10)	(7)	(3)
Stock-based compensation expense	18	11	7
Translation and hedging activities	(6)	3	(9)
Changes in:			
Accounts and notes receivable	(513)	(57)	(456)
Inventories	(290)	(301)	11
Other current assets	11	1	10
Accounts payable	307	239	68
Accrued expenses	169	(14)	183
Changes in long-term liabilities and deferred revenue	58	66	(8)
Other, net	(31)	26	(57)
Net cash provided by operating activities	\$ 744	\$ 427	\$ 317

Net cash provided by operating activities increased for the six months ended June 26, 2011, versus the comparable period in 2010, primarily due to significantly higher consolidated net income, increases in accrued expenses and accounts payable as the result of increased purchasing to support higher sales volumes, lower pension contributions and higher dividends from equity investees. This was partially offset by significantly higher accounts and notes receivables consistent with the increase in sales volumes.

Table of Contents**Pensions**

The funded status of our pension plans is dependent upon a variety of variables and assumptions including return on invested assets, market interest rates and levels of voluntary contributions to the plans. In the second quarter of 2011, financial markets continued to recover from the global economic recession. As a result, for the six months ended June 26, 2011, the return for our U.S. plan was 5.6 percent while our U.K. plan return was approximately 3.0 percent. Approximately 94 percent of our pension plan assets are invested in highly liquid investments such as equity and fixed income securities. The remaining six percent of our plan assets are invested in less liquid, but market valued investments, including real estate and private equity. We made \$81 million of pension contributions in the six months ended June 26, 2011, and we anticipate making total contributions of approximately \$130 million to our defined benefit pension plans in 2011. Expected contributions to our defined benefit pension plans in 2011 will meet or exceed the current funding requirements. Claims and premiums for other postretirement benefits are expected to approximate \$51 million in 2011. The \$81 million of pension contributions in the six months ended June 26, 2011, included voluntary contributions of \$70 million. These contributions and payments include payments from our funds either to increase pension plan assets or to make direct payments to participants.

Investing Activities

In millions	Six months ended		Change
	June 26, 2011	June 27, 2010	
Capital expenditures	\$ (215)	\$ (91)	\$ (124)
Investments in internal use software	(22)	(22)	
Proceeds from disposals of property, plant and equipment	5	42	(37)
Investments in and advances to equity investees	(20)	(1)	(19)
Proceeds from the sale of business, net of cash sold	111		111
Acquisition of businesses, net of cash acquired		(71)	71
Investments in marketable securities acquisitions	(361)	(358)	(3)
Investments in marketable securities liquidations	343	278	65
Cash flows from derivatives not designated as hedges	6	(18)	24
Other, net	2	(2)	4
Net cash used in investing activities	\$ (151)	\$ (243)	\$ 92

Net cash used in investing activities decreased for the six months ended June 26, 2011, versus the comparable period in 2010, primarily due to the recent disposition of the exhaust business (See Note 4, **DIVESTITURES AND ACQUISITIONS** to our *Condensed Consolidated Financial Statements*), the acquisition of CWC in 2010 and increased liquidations of investments in marketable securities, which were partially offset by increased capital expenditures and lower proceeds from the disposal of property, plant and equipment.

Capital expenditures for the six month period ended June 26, 2011, were \$ 215 million compared to \$ 91 million in the comparable period in 2010. We expect capital expenditures to accelerate in the remainder of 2011. We continue to invest in the development of new products and we plan to spend approximately \$600 million to \$650 million in 2011. Approximately two thirds of our capital expenditures will be invested outside of the U.S.

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We signed a non-binding letter of intent to sell certain assets and liabilities of our light-duty filtration business which manufactures light-duty automotive and industrial filtration solutions. The transaction is expected to close in the second half of 2011. The sales price is expected to be approximately \$90 million to \$95 million, subject to a final financial statement review. There are no earnouts or other contingencies associated with the sales price. We expect to recognize a pre-tax gain on the sale of approximately \$45 million to \$50 million, which includes an allocation of goodwill of approximately \$11 million.

Table of Contents**Financing Activities**

In millions	Six months ended		Change
	June 26, 2011	June 27, 2010	
Proceeds from borrowings	\$ 60	\$ 85	\$ (25)
Payments on borrowings and capital lease obligations	(94)	(37)	(57)
Net borrowings under short-term credit agreements	11	(1)	12
Distributions to noncontrolling interests	(26)	(4)	(22)
Dividend payments on common stock	(102)	(70)	(32)
Repurchases of common stock	(373)	(162)	(211)
Excess tax benefits on stock-based awards	4	7	(3)
Other, net	7	9	(2)
Net cash used in financing activities	\$ (513)	\$ (173)	\$ (340)

Net cash used in financing activities increased for the six months ended June 26, 2011, versus the comparable period in 2010, primarily due to higher repurchases of common stock and increased payments on borrowings and capital leases.

Our total debt was \$847 million as of June 26, 2011, compared with \$843 million as of December 31, 2010. Total debt as a percent of our total capital, including total long-term debt, was 13.3 percent at June 26, 2011, compared with 14.4 percent at December 31, 2010.

In July 2011, the Board of Directors increased the quarterly dividend on our common stock from \$0.2625 per share to \$0.40. The dividend is payable on September 1, 2011, to shareholders of record on August 22, 2011.

In December 2007, the Board of Directors authorized the acquisition of up to \$500 million of Cummins common stock. In February 2011, we purchased \$111 million of our common stock and completed the \$500 million repurchase program.

In February 2011, the Board of Directors approved a new share repurchase program and authorized the acquisition of up to \$1 billion of Cummins common stock upon completion of the \$500 million program. In 2011, we made the following quarterly purchases under these plans: