

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K
ANNUAL REPORT PURSUANT TO SECTION 13 or 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

For the Fiscal Year Ended December 31, 1996

CUMMINS ENGINE COMPANY, INC.

Incorporated in the State of Indiana I.R.S. Employer Identification
No. 35-0257090500 Jackson Street, Box 3005, Columbus, Indiana 47202-3005
(Principal Executive Office)
Telephone Number: (812) 377-5000Securities registered pursuant to Section 12(b) of the Act: Common
Stock, \$2.50 par value, which is registered on the New York Stock
Exchange and on the Pacific Stock Exchange.

Securities registered pursuant to Section 12(g) of the Act: None.

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 if disclosures of delinquent filers pursuant to
Item 405 of Regulation S-K are not contained herein and will not be
contained, to the best of registrant's knowledge, in definitive proxy
or information statements incorporated by reference in Part III of
this Form 10-K or any amendment to this Form 10-K. The aggregate market value of the voting stock held by non-affiliates
was approximately \$2.1 billion at January 26, 1997.As of January 26, 1997, there were outstanding 41.9 million shares of
the only class of common stock.

Documents Incorporated by Reference

Portions of the registrant's definitive Proxy Statement filed with the
Securities and Exchange Commission pursuant to Regulation 14A are
incorporated by reference in Part III of this Form 10-K.

TABLE OF CONTENTS

| Part | Item | Description | Page |
|------|------|----------------------------------------------------------------------------------------|------|
| I | 1 | Business | 3 |
| | 2 | Properties | 15 |
| | 3 | Legal Proceedings | 16 |
| | 4 | Submission of Matters to Vote of Security Holders | 16 |
| II | 5 | Market for the Registrant's Common Equity and Related Stockholder Matters | 16 |
| | 6 | Selected Financial Data | 17 |
| | 7 | Management's Discussion & Analysis of Results of Operations and Financial Condition | 18 |
| | 8 | Financial Statements & Supplemental Data | 24 |
| | 9 | Disagreements on Accounting & Financial Disclosure | 25 |
| III | 10 | Directors & Executive Officers of the Registrant | 25 |
| | 11 | Executive Compensation | 26 |
| | 12 | Security Ownership of Certain Beneficial Owners and Management | 27 |
| | 13 | Certain Relationships & Related Transactions | 27 |
| IV | 14 | Exhibits, Financial Statement Schedules and Reports on Form 8-K | 27 |

| | |
|-------------------------------|----|
| Index to Financial Statements | 28 |
| Signatures | 52 |
| Exhibit Index | 54 |

PART I

ITEM 1. BUSINESS

OVERVIEW

Cummins Engine Company, Inc. ("Cummins" or "the Company") is a leading worldwide designer and manufacturer of diesel engines, ranging from 76 to 6,000 horsepower. The Company also produces alternate fueled engines and engine components and subsystems. Cummins provides power and components for a wide variety of equipment in its key markets: automotive, power generation, industrial and filtration.

Cummins sells its products to original equipment manufacturers ("OEMs"), distributors and other customers worldwide and conducts manufacturing, sales, distribution and service activities in most areas of the world. Sales of products to major international firms outside North America are transacted by exports directly from the United States and shipments from foreign facilities (operated through subsidiaries, affiliates, joint ventures or licensees) which manufacture and/or assemble Cummins' products.

In 1996, approximately 56 percent of net sales were in the United States. Major international markets include Asia, the Far East and Australia (17 percent of net sales); Europe (14 percent of net sales); Canada (6 percent of net sales); and Mexico and South America (5 percent of net sales).

BUSINESS MARKETS

Automotive

Heavy-duty Truck

Cummins has a complete line of 8-, 10-, 11- and 14-litre diesel engines that range from 260 to 525 horsepower serving the heavy-duty truck market. The Company's heavy-duty diesel engines are offered as standard or optional power by most major heavy-duty truck manufacturers in North America. The seven largest US heavy-duty truck OEMs produced approximately 97 percent of the heavy-duty trucks sold in the United States and Canada in 1996. The Company's largest customer for heavy-duty truck engines in 1996 was Freightliner Corporation, which represented approximately 5 percent of the Company's net sales.

In 1996, factory retail sales of North American heavy-duty trucks were approximately 23 percent lower than the previous year's level. Factory retail sales were 176,000 units in 1996, compared to 227,000 units in 1995, and 207,000 in 1994. The Company's share of the North American heavy-duty truck engine market was 35 percent in 1996 based on data published by the American Automotive Manufacturers Association. The Company's share of the North American heavy-duty truck engine market was 35 percent in 1995 and 34 percent in 1994.

Based on data published by the Society of Motor Manufacturers and Traders, the Company's share of engines for trucks sold in the United Kingdom was 11 percent in 1996 and 15 percent in 1995.

Based on data published by the National Association of Truck and Bus Manufacturers, Cummins remained the leader of the heavy-duty truck market in Mexico, where the economy began to recover in 1996.

In 1995, the Company introduced new versions of its M11 and N14 engines, both of which have advanced electronic controls and information technology. In 1995, the Company also began to ship alternate fueled engines for urban special-purpose truck markets and regional haul operations.

In the heavy-duty truck market, the Company competes with independent engine manufacturers as well as truck producers who manufacture diesel engines for their own products. Certain of these integrated manufacturers also are customers of the Company. In North America, the Company's primary competitors in the heavy-duty truck engine market are Caterpillar, Inc., Detroit Diesel Corporation and Mack Trucks, Inc. The Company's principal competitors in international markets vary from country to country, with local manufacturers generally predominant in each geographic market. Other diesel engine

manufacturers in international markets include Mercedes Benz, AB Volvo, Renault Vehicules Industriels, Iveco Diesel Engines, Hino Motors, Ltd., Mitsubishi Heavy Industries, Ltd., Isuzu Motors, Ltd., DAF Trucks N.V., Scania A.B., Nissan Diesel and Perkins Engines.

Midrange Truck

The Company has a line of diesel engines ranging from 130 to 300 horsepower serving midrange and intercity delivery truck customers worldwide. In 1996, the Company began introducing its next generation of midrange diesel engines, with higher horsepower and electronic controls.

The Company entered the North American midrange diesel engine truck market in 1990. Based upon data published by R. L. Polk, the Company's share of the market for diesel-powered medium-duty trucks in 1996 was 31 percent, compared to 35 percent in 1995 and 34 percent in 1994. Ford Motor Company was the Company's largest customer for midrange engines for this market in 1996, representing approximately 4 percent of the Company's net sales.

The Company sells its B and C Series engines and engine components outside North America to midrange truck markets in Asia, Europe, South America and India. In 1996, operations in China at Dongfeng were expanded from a license for B Series engines to include a joint venture for production of C Series engines.

In the midrange truck market, the Company competes with independent engine manufacturers as well as truck producers who manufacture diesel engines for their own products. Certain of these integrated manufacturers also are customers of the Company. Primary engine competitors in the midrange truck market in North America are Navistar International Corporation and Caterpillar, Inc. The Company's principal competitors in international markets vary from country to country, with local manufacturers generally predominant in each geographic market. Other diesel engine manufacturers in international markets include Mercedes Benz, AB Volvo, Renault Vehicules Industriels, Iveco Diesel Engines, Hino Motors Ltd., Mitsubishi Heavy Industries, Ltd., Isuzu Motors, Ltd., DAF Group N.V., Scania A.B., Perkins Engines Ltd., Nissan Diesel and MWM Brazil.

Bus and Light Commercial Vehicles

For this market, Cummins has both diesel and alternate fueled engines for pickup trucks, school buses, transit buses, delivery trucks and recreational vehicles.

In North America, Chrysler, which offers the Cummins B Series engines in its Dodge Ram pickup truck, was the Company's largest customer for midrange engines in this market, representing approximately 8 percent of the Company's net sales in 1996. The Company's new 5.9 litre engine will be introduced first into the recreational vehicle market and, by early 1998, into the Dodge Ram pickup truck. This engine will increase horsepower from 215 to 235 in the manual transmission option.

The Company's C Series and M11 diesel engines and L10 natural gas engine are available for the US transit bus market. The demand for alternate fueled products continues to grow. At the 1996 Olympics in Atlanta, 95 of the 100 alternate fueled buses were equipped with the Company's engines. In 1994, Cummins introduced its B Series alternate fueled engine for school buses in the United States and, in 1995, introduced the C Series.

In these markets, the Company competes with both independent manufacturers of diesel engines and with vehicle producers who manufacture diesel engines for their own products. Primary competitors who manufacture diesel engines for the bus and light commercial vehicle markets are Detroit Diesel Corporation, General Motors Corporation, Navistar International Corporation, Perkins Engines Ltd., MAN, AB Volvo, Mercedes Benz, Scania A.B. and MWM Brazil.

Power Generation

In 1996, power generation sales represented 23 percent of the Company's net sales. Products include Cummins engines, Onan and Petbow generator sets and Newage alternators.

In stationary power, electrical power generation products and services are provided to major markets worldwide. The Company's joint venture with Wartsila Diesel of Finland to produce high-horsepower engines is proceeding on schedule. The QSZ engine family was introduced in 1996

with initial deliveries in Europe and Asia. The QSW engine family will be introduced in 1997. Providing power generation products for the utility industry has become an increasingly important market, with utilities turning to generator sets to manage peak and seasonal demands in lieu of making capital investments in additional capacity. In the mobile business, generator sets and gasoline engines are produced for a wide variety of applications, with Onan a leading supplier of power generation sets for recreational vehicles in the United States.

Newage is a leading manufacturer of alternators in its product range. During 1996, plans were initiated to expand manufacturing capacity at Newage's joint venture in India, and a joint venture was announced in China, with production scheduled to commence in the first half of 1997.

In Power Generation, Cummins competes on a global scale with a variety of engine manufacturers and generator set assemblers. Caterpillar, Inc., Detroit Diesel Corporation, Perkins Engines and AB Volvo are the major engine manufacturers with a presence in the high-speed segment of the market. Onan competes with Caterpillar, F G Wilson and Kohler, among others, in the generator set business. Newage competes globally with Leroy Somer, Marathon and Meccalte, among others. In recent years, Emerson Electric, which already owned Leroy Somer, has become a major player with its acquisition of F G Wilson. Caterpillar also has an investment in F G Wilson.

Industrial

During 1996, the first full year of US emissions standards for industrial engines, the Company's comprehensive product line, ranging from 76 to 6,000 horsepower, made strong advances. Cummins' engines power more than 3,000 models of equipment for the construction, logging, mining, agricultural, petroleum, rail and government markets throughout the world. In 1996, engine shipments to these markets were a record 72,500 engines, an increase of approximately 8 percent, compared to 1995. In addition, the Company shipped 5,300 engines for marine applications in 1996.

In construction markets, the Company's relationship with Komatsu continued to expand. Cummins and Komatsu formed joint ventures in 1993 to produce Cummins B Series engines in Japan and Komatsu's 30-litre engine in the United States. Production at both joint venture sites began on schedule. Coupled with Cummins' relationship with Case in North America, these alliances provide a strong base in the Company's construction markets.

The Company's high-horsepower QUANTUM engine was introduced in 1995 and enhanced in late 1996 with the announcement of two new products for the mining market.

Marine product applications include recreational and commercial markets. The Company's joint venture with Wartsila will expand commercial product offerings to 6,000 horsepower for the marine market, significantly higher than the 1,800 horsepower currently available.

Filtration and Other

Fleetguard, Cummins' filtration subsidiary, is a leading manufacturer of products for the North American heavy-duty filter industry. Its products also are produced and sold in international markets, including Europe, Mexico, India, Australia and the Far East. A new distribution center in South Africa opened in 1996. A manufacturing facility also was opened in Shanghai as part of a joint venture with Shenlong Auto Accessories Corporation of China, a majority-owned subsidiary of Dongfeng Motor Corporation.

Holset's turbochargers and vibration dampers also are sold worldwide. In 1994, Holset introduced a variable geometry turbocharger design for truck powertrains. Holset's joint venture with TELCO assembled and shipped its first turbochargers in 1996. A joint venture with Wuxi in China also began production in 1996. An alliance with Mitsubishi Heavy Industries of Japan will begin production of its jointly developed turbochargers in 1997.

BUSINESS OPERATIONS

International

The Company has manufacturing facilities worldwide, including major operations in Europe, India, Mexico and Brazil. Cummins has entered into license agreements that provide for the manufacture and sale of the Company's products in Turkey, China, Pakistan, South Korea and other countries. A license agreement was entered in late 1996 with PT Perkasa Heavyndo of Indonesia to produce the B Series engines.

In addition, the Company has entered into alliances with business partners in various areas of the world. A joint venture was formed in 1996 with the Fiat Group companies -- Iveco (trucks and buses) and New Holland (agricultural equipment) -- to design and manufacture the next generation of 4-, 5- and 6-litre engines based on Cummins' 4- and 6-litre B Series engines. In 1996, operations at Dongfeng Motor Corporation were expanded to form a joint venture for production of C Series engines in addition to the license for B Series engines. Cummins and Scania of Sweden have a joint venture to develop a fuel system for heavy-duty diesel engines. Cummins has a joint venture with TELCO of India to manufacture the Cummins B Series engines in India for TELCO trucks. Cummins and Komatsu Ltd. of Japan have formed joint ventures to manufacture the B Series engines in Japan and high-horsepower Komatsu-designed engines in the United States. In 1995, the Company formed a joint venture with China National Heavy Duty Truck Corporation in Chongqing, previously a Cummins' licensee, to manufacture a broad line of diesel engines in China. In 1995, the Company also entered into a joint venture with Wartsila Diesel International of Finland to manufacture both diesel and natural gas engines above 2,500 horsepower. Several of the Company's subsidiaries have ventures throughout the world.

Because of the Company's increasingly global business, its operations are subject to risks, such as currency controls and fluctuations, import restrictions and changes in national governments and policies.

Research and Development

Cummins conducts an extensive research and engineering program to achieve product improvements, innovations and cost reductions for its customers, as well as to satisfy legislated emissions requirements. The Company is in the midst of a program to refurbish and extend its engine range. Cummins has introduced a variety of concepts in the diesel industry that combine electronic controls, computing capability and information technology. The Company also offers alternate fueled engines for certain of its markets. As disclosed in Note 1 to the Consolidated Financial Statements, research and development expenditures approximated \$235 million in 1996, \$230 million in 1995 and \$200 million in 1994.

Sales and Distribution

While the Company has supply agreements with some customers for Cummins engines in both on- and off-highway markets, most of the Company's business is done on open purchase orders. These purchase orders usually may be canceled on reasonable notice without cancellation charges. Therefore, while incoming orders generally are indicative of anticipated future demand, the actual demand for the Company's products may change at any time. While the Company typically does not measure backlog, customers provide information about future demand, which is used by the Company for production planning. Lead times for the Company's engines are dependent upon the customer, market and application.

Historically, during the third quarter of the year, the Company has experienced modest seasonal declines in production, which have had an effect on the demand for Cummins' products during that quarter of each year.

The Company's products compete on a number of factors, including performance, price, delivery, quality and customer support. Cummins believes that its continued focus on cost, quality and delivery, extensive technical investment, full product line and customer-led support programs are key elements of its competitive position.

Cummins warrants its engines, subject to proper use and maintenance, against defects in factory workmanship or materials for either a specified time period or mileage or hours of use. Warranty periods vary by engine family and market segment.

There are approximately 6,500 locations in North America, primarily owned and operated by OEMs or their dealers, at which Cummins-trained service personnel and parts are available to maintain and repair Cummins engines. The Company's parts distribution centers are located strategically throughout the world.

Cummins also sells engines, parts and related products through distributorships worldwide. The Company believes its distribution system is an important part of its marketing strategy and competitive position. Most of its North American distributors are independently owned and operated. The Company has agreements with each of these distributors, which typically are for a term of three years, subject to certain termination provisions. Upon termination or expiration of the agreement, the Company is obligated to purchase various assets of the distributorship. The purchase obligation of the Company relates primarily to inventory of the Company's products, which can be resold by the Company over a reasonable period of time. In the event the Company had been required to fulfill its obligations to purchase assets from all distributors simultaneously at December 31, 1996, the aggregate cost would have been approximately \$240 million. Management believes it is unlikely that a significant number of distributors would terminate their agreements at the same time, requiring the Company to fulfill its purchase obligation.

Supply

The Company machines many of the components used in its engines, including blocks, heads, rods, turbochargers, crankshafts and fuel systems. Cummins has adequate sources of supply of raw materials and components required for its operations. The Company has arrangements with certain suppliers who are the sole sources for specific products. While the Company believes it has adequate assurances of continued supply, the inability of a supplier to deliver could have an adverse effect on production at certain of the Company's manufacturing locations.

Employment

At December 31, 1996, Cummins employed 23,500 persons worldwide, approximately 8,800 of whom are represented by various unions. The Company has labor agreements covering employees in North America, South America and the United Kingdom. In 1995, members of the Diesel Workers Union and the Office Committee Union at the Company's midrange engine plant in Southern Indiana ratified 5-year agreements. In 1995, members of the Office Committee Union ratified an early agreement which extends until 1999 for offices and plants in Southern Indiana and the Company's Technical Center. In 1993, members of the Diesel Workers Union reached an agreement that extends until the year 2004. In 1995, members of the United Auto Workers at the Company's crankshaft plant in Fostoria, Ohio, reached an agreement which extends for five years. In January 1997, negotiations were completed with members of the United Auto Workers on the closure of the Company's facility in Huntsville, Alabama.

ENVIRONMENTAL COMPLIANCE

Product Environmental Compliance

Cummins engines are subject to extensive statutory and regulatory requirements that directly or indirectly impose standards with respect to emissions and noise. Cummins' products comply with emissions standards that the US Environmental Protection Agency ("EPA") and California Air Resources Board ("CARB") have established for heavy-duty on-highway diesel and gas engines and off-highway engines produced through 1997. Cummins' ability to comply with these and future emissions standards is an essential element in maintaining its leadership position in the North American regulated markets. The Company will make significant capital and research expenditures to comply with these standards. Failure to comply could result in adverse effects on future financial results.

Cummins has successfully completed the certification of its 1996 on-highway products, which include both midrange and heavy-duty engines. All of these products underwent extensive laboratory and field testing prior to their release.

Emissions Averaging, Banking and Trading regulations were promulgated by the EPA in July 1990. By selling 1994, 1995 and 1996 model year engines with emissions levels below applicable standards, Cummins generated oxides of nitrogen and particulate matter credits. Those credits expire on December 31, 1997 if not used before this date. While a portion of the Company's 1997 products will use some of these credits as part of an effort to achieve cost-effective compliance, the Company does not believe that the cost of compliance without relying on these credits would be material. The Company closely manages credit generation and use and believes that engines currently using credits will be brought into compliance during the course of normal

engineering improvements or will be replaced by engines meeting future emissions standards without any material financial effect.

The next major change in emissions requirements for heavy-duty on-highway diesel engines occurs in 1998, when the oxides of nitrogen standard is lowered from 5.0 to 4.0 g/bhp-hr. 1998 is also the effective date for the Clean Fuel Fleet Vehicle program. Beginning January 1, 1998, fifty percent of new vehicles purchased by certain centrally fueled fleets in 22 ozone non-attainment areas in the United States must be powered by engines which meet a combined oxides of nitrogen plus non-methane hydrocarbon standard of 3.8 g/bhp-hr. Design and development activities aimed at meeting these standards are well underway.

Contained in the environmental regulations are several means for the EPA to ensure and verify compliance with emissions standards. Two of the principal means are tests of new engines as they come off the assembly line, referred to as selective enforcement audits ("SEA"), and tests of field engines, commonly called in-use compliance tests. The SEA provisions have been used by the EPA to verify the compliance of heavy-duty engines for several years. In 1996, three such audit tests were performed on Cummins engines; all were passed. The failure of an SEA could result in cessation of production of the noncompliant engines and the recall of engines produced prior to the audit. In the product development process, Cummins anticipates SEA requirements when it sets emissions design targets.

No Cummins engines were chosen for in-use compliance testing in 1996. It is anticipated that the EPA will increase the in-use test rate in future years, raising the probability that one or more of the Company's engines will be selected. As with SEA testing, if an in-use test is failed, an engine recall may be necessary.

In 1996, EPA raised an issue with the Company relating to the definition of rated speed, a parameter in engine emissions certification testing. For years, the Company has been operating under a long-standing interpretation of this area of the regulations. In 1996, EPA questioned the Company's interpretation and requested further information. If the EPA maintains, and ultimately prevails in, its more stringent position, a small number of the Company's 1996 and earlier model year on-highway engines would be affected. In this event, EPA may require a recall of the affected engines and also may impose penalties. The Company believes it has a strong legal basis for its regulatory interpretation and, even if the Company had to pay penalties, these penalties would have no material financial effect on the Company.

In 1988, CARB promulgated a rule that necessitates the reporting of failures of emissions-related components when the failure rate reaches a specified level (25 component failures or one percent of build, whichever is greater). At somewhat higher failure rates (50 components or four percent of build), a recall may be required. The Company continues to monitor such failures. In 1996, there were no emissions-related failures which reached a level that required a report.

In January 1992, CARB promulgated a regulation for engines rated at or above 175 horsepower used in mobile off-highway applications. In mid-1994, the EPA also promulgated regulations for this category. The EPA regulation covers engines rated at or above 50 horsepower. In all other material respects these two regulations are the same. The effective dates are staged according to rated horsepower and began phasing in on January 1, 1996. Cummins has successfully completed certification of the majority of its mobile off-highway products which are included in the first and second phases (those with ratings between 100 to 750 horsepower). All of these products have undergone extensive laboratory and field tests prior to their release.

Emissions standards in international markets, including Europe and Japan, are becoming more stringent. Given the Company's experience in meeting US emissions standards, it believes that it is well positioned to take advantage of opportunities in these markets as the need for emissions-control capability grows.

There are several Federal and state regulations which encourage and, in some cases, mandate the use of alternate fueled heavy-duty engines. The Company currently offers natural gas fueled versions of its L10 and B5.9 engines, ranging from 150 to 300 horsepower.

Vehicles and certain industrial equipment in which diesel engines are installed must meet Federal noise standards. The Company believes that applications in which its engines are now installed meet those noise standards and that future installations also will be in compliance.

Cummins believes it is in compliance in all material respects with laws and regulations applicable to the plants and operations of the Company and its subsidiaries. During the past five years, expenditures for environmental control activities and environmental remediation projects at the Company's operating facilities in the United States have not been a major portion of annual capital outlays and are not expected to be material in 1997.

Pursuant to notices received from Federal and state agencies and/or defendant parties in site environmental contribution actions, the Company and its subsidiaries have been identified as potentially responsible parties ("PRPs") under the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended, or similar state laws, at a number of waste disposal sites. Under such laws, PRPs typically are jointly and severally liable for any investigation and remediation costs incurred with respect to the sites. Therefore, the Company's ultimate responsibility for such costs could be a percentage greater than the percentage of waste actually contributed to the site by the Company.

The sites at which the Company or its subsidiaries are currently named as a PRP are the following: Old City Landfill, Columbus, Indiana; Purity Oil Site, Fresno, California; Oak Grove Sanitary Landfill, Anoka County, Minnesota; Waste Disposal Engineering Landfill, Andover, Minnesota; White House Waste Oil Pits, Jacksonville, Florida; Seaboard Chemical, Jamestown, North Carolina; Double Eagle Refinery, Oklahoma City, Oklahoma; Wastex Research, East St. Louis, Illinois; North Hollywood Dump, Memphis, Tennessee; Commercial Oil, Oregon, Ohio; Berliner & Ferro, Swartz Creek, Michigan; Schnitzer Iron & Metal, St. Paul, Minnesota; Four County Landfill, Culver, Indiana; Schumann Site, South Bend, Indiana; Great Lakes Asphalt, Zionsville, Indiana; Third Site, Zionsville, Indiana; Auto-Ion, Kalamazoo, Michigan; PCB Treatment Inc., Kansas City, Kansas; ENRx, Buffalo, New York; Uniontown Landfill, Uniontown, Indiana; Sand Springs, Oklahoma; United Steel Drum, East St. Louis, Illinois; Putnam County Landfill, Cookeville, Tennessee; Enterprise Oil, Detroit, Michigan; and Wayne Reclamation & Recycling, Ft. Wayne, Indiana. The Company presently is contesting its status as a PRP at several of these sites. At some of these sites, the Company will be released from liability at the site as a de minimis PRP for a nominal amount.

While the Company is unable at this time to determine the aggregate cost of remediation at these sites, it has attempted to analyze its proportionate and actual liability by analyzing the amounts of waste contributed to the sites by the Company, the estimated costs for total remediation at the sites, the number of identities of other PRPs and the level of insurance coverage. The results of that analysis are described below.

The Company and its subsidiaries have entered into administrative agreements at certain of these sites to perform remedial actions. At the Old City Landfill, the Company and two other PRPs have entered into a Consent Order with the Indiana Department of Environmental Management to implement the Record of Decision issued by EPA in 1992. The cost to implement the Consent Order is estimated to be approximately \$300,000, of which the Company will pay 50 percent.

At the Purity Oil Site, a subsidiary of the Company has been identified as a PRP and is one of several PRPs who have been issued an order by EPA to undertake remedial action at the site. The Company's subsidiary has contributed \$282,000 toward the first phase of the remedial action at the site. Through the Alternative Dispute Resolution process conducted in 1996, the Company's subsidiary has agreed to fund in the range from \$225,000 to \$275,000 of the total estimated \$12 million for a final remediation at this site. The Company has reserved these funds.

Onan Corporation, a subsidiary of the Company, has entered into an administrative agreement to participate in remediation of the Waste Disposal Engineering Landfill. The cost of remediation at this site is estimated to range from \$10 million to \$15 million, of which Onan expects to contribute approximately \$600,000, which has been reserved fully. Construction of the major remedies at the site have been completed, leaving only treatment and periodic sampling to be accomplished. Onan also has entered into an administrative agreement for the Oak Grove Landfill. The estimated cost to remediate this site is approximately \$6 million. Onan has contributed \$127,000 to cover its share of the costs of remediation. Construction is complete at this site, and only treatment and periodic sampling remain. Onan has filed litigation against its insurer at Oak Grove and Waste Disposal in order to enforce its contract of insurance for both the remedial

costs and all related defense costs at those sites. This litigation is in its early stages. In addition, the Steering Committees for both sites have submitted each site for reimbursement under the Minnesota Landfill Cleanup Program, a legislative initiative that would reimburse parties for remediating hazardous waste landfills. To date, Onan has been reimbursed in excess of \$150,000 for both sites and anticipates further recoveries.

With respect to other sites at which the Company or its subsidiaries have been named as PRPs, the Company cannot accurately estimate the future remediation costs. At several sites, the remedial action to be implemented has not been determined for the site. In other cases, the Company or its subsidiary has only recently been named as a PRP and is collecting information on the site. Finally, in some cases, the Company believes it has no liability at the site and is actively contesting designation as a PRP.

Based upon the Company's prior experiences at similar sites, however, the aggregate future cost to all PRPs to remediate these sites is not likely to be significant. In each of these cases, the Company believes that it has good defenses at several of the sites, that its percentage contribution at other sites is likely to be de minimis or that other PRPs will bear most of the future remediation costs. However, the environmental laws impose joint and several liability and, consequently, the Company's ultimate responsibility may be based upon many factors outside the Company's control and could be material in the event that the Company becomes obligated to pay a significant portion of these expenses. Based upon information presently available, the Company believes that such an outcome is unlikely and that its actual and proportionate costs of participating in the remediation of these sites will not be material.

In 1996, the Company and all of its subsidiaries completed appropriate permit applications for the new Title V Air Permitting requirements under the Clean Air Act of 1990. While the review of the applications by respective state and Federal agencies will take some months, the Company believes that appropriate permits will be issued. Additionally, the Company has not been required to undertake any significant capital or expense projects in order to meet the Title V requirements.

ITEM 2. PROPERTIES

Cummins' worldwide manufacturing facilities occupy approximately 16 million square feet, including approximately 7 million square feet outside the United States. Principal manufacturing facilities in the United States include the Company's plants in Southern Indiana; Jamestown, New York; Lake Mills, Iowa; Cookeville, Tennessee; and Fridley, Minnesota, as well as an engine plant in Rocky Mount, North Carolina, which is operated in partnership with Case Corporation.

Countries of manufacture outside of the United States include England, Brazil, Mexico, France and Australia. In addition, engines and engine components are manufactured by joint ventures or independent licensees at plants in England, France, China, India, Japan, Pakistan, South Korea, Turkey and Indonesia.

Cummins believes that all of its plants have been maintained adequately, are in good operating condition and are suitable for its current needs through productive utilization of the facilities.

ITEM 3. LEGAL PROCEEDINGS

The information appearing in Note 13 to the Consolidated Financial Statements is incorporated herein by reference. The material in Item 1 "Other Environmental Statutes and Regulations" also is incorporated herein by reference.

ITEM 4. SUBMISSION OF MATTERS TO VOTE OF SECURITY HOLDERS

None.

PART II

ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

The Company's common stock is listed on the New York Stock Exchange and the Pacific Stock Exchange under the symbol "CUM". The following table sets forth, for the calendar quarters shown, the range of high and low composite prices of the common stock and the cash dividends

declared on the common stock.

| | High | Low | Dividends Declared |
|----------------|----------|----------|--------------------|
| 1996 | | | |
| First quarter | \$42 7/8 | \$34 1/2 | \$.25 |
| Second quarter | 47 3/4 | 40 1/4 | .25 |
| Third quarter | 41 7/8 | 36 7/8 | .25 |
| Fourth quarter | 47 3/4 | 39 | .25 |

1995

| | | | |
|----------------|----------|----------|-------|
| First quarter | \$46 7/8 | \$41 1/2 | \$.25 |
| Second quarter | 48 5/8 | 42 1/4 | .25 |
| Third quarter | 47 1/4 | 36 5/8 | .25 |
| Fourth quarter | 39 3/4 | 34 | .25 |

At December 31, 1996, the approximate number of holders of record of the Company's common stock was 4,800.

The Board of Directors in 1994 authorized repurchase by the Company of up to 2.5 million shares of its common stock. In 1996, the Company completed this program with the repurchase of .8 million shares of stock in the open market at an aggregate purchase price of \$34 million, or average price of \$41.35 per share. The Company repurchased 1.6 million shares at an aggregate purchase price of \$69 million, or average price of \$43.57 per share, in 1995 and .1 million shares at an aggregate purchase price of \$5 million, or average price of \$42.47 per share, in 1994. All of the acquired shares are held as common stock in treasury.

In January 1997, the Company announced that it will issue 3.75 million shares of its common stock to an employee benefits trust to fund obligations of employee benefit and compensation plans, principally retirement savings plans. Shares of the common stock held by this trust will not be used in the calculation of the Company's earnings per share until distributed from the trust and allocated to a benefit plan. The Company also announced in January 1997 repurchase of 1.3 million shares of its common stock from Ford Motor Company and that the Board of Directors has authorized the repurchase of an additional 1.7 million shares in the open market.

Certain of the Company's loan indentures and agreements contain provisions which permit the holders to require the Company to repurchase the obligations upon a change of control of the Company, as defined in the applicable debt instruments.

As more fully described in Note 10 to the Consolidated Financial Statements, which information is incorporated herein by reference, the Company has a Shareholders' Rights Plan.

The Company's bylaws provide that Cummins is not subject to the provisions of the Indiana Control Share Act. However, Cummins is governed by certain other laws of the State of Indiana applicable to transactions involving a potential change of control of the Company.

ITEM 6. SELECTED FINANCIAL DATA

| \$ Millions, Except per Share Amounts | 1996 | 1995 | 1994 | 1993 | 1992 |
|------------------------------------------|---------|---------|---------|---------|---------|
| Net sales | \$5,257 | \$5,245 | \$4,737 | \$4,248 | \$3,749 |
| Net earnings (loss) | 160 | 224 | 253 | 177 | (190) |
| Earnings (loss) per share: | | | | | |
| Primary | 4.01 | 5.52 | 6.11 | 4.79 | (6.01) |
| Fully diluted | 4.01 | 5.52 | 6.11 | 4.63 | (6.01) |
| Cash dividends per share | 1.00 | 1.00 | .625 | .20 | .10 |
| Total assets | 3,369 | 3,056 | 2,706 | 2,390 | 2,230 |
| Long-term debt | 283 | 117 | 155 | 190 | 412 |

In 1995, the Company's results included restructuring charges of \$118 million (\$77 million after taxes) to reduce the worldwide work force and to close or restructure selected operations in Europe, Brazil and North America. Net earnings in 1995 also included release of the tax valuation allowance of \$68 million.

In 1993, the Company sold 2.6 million shares of its common stock in a public offering and used a portion of the proceeds to redeem \$77 million in principal amount of the Company's outstanding 9 3/4 percent

sinking fund debentures. This early extinguishment of debt resulted in an extraordinary charge of \$6 million.

In 1992, the Company's results included a charge of \$251 million for the cumulative effect of changes in accounting as prescribed by SFAS Nos. 106, 109 and 112 related to accounting for retirees' health care and life insurance benefits, income taxes and postemployment benefits. In 1992, the Company sold 4.6 million shares of its common stock in a public offering and used a portion of the proceeds to extinguish \$71 million of debt of Consolidated Diesel Company, an unconsolidated, 50-percent owned partnership, \$8 million of the Company's 8 7/8 percent sinking fund debentures and \$11 million of a 15-percent note payable to an insurance company. These early extinguishments of debt resulted in an extraordinary charge of \$6 million.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

OVERVIEW

In 1996, the Company had record sales of \$5.3 billion, \$12 million higher than 1995 and 11 percent higher than 1994. This record performance was achieved despite a 27-percent reduction in engine shipments to the North American heavy-duty truck market as a result of the slowdown in that market. The Company shipped 332,300 engines in 1996, compared to 338,900 in 1995 and 304,300 in 1994 as follows:

| Engine Shipments | 1996 | 1995 | 1994 |
|-------------------------|---------|---------|---------|
| Midrange engines | 237,400 | 222,100 | 195,600 |
| Heavy-duty engines | 85,000 | 107,300 | 99,900 |
| High-horsepower engines | 9,900 | 9,500 | 8,800 |
| Total engine shipments | 332,300 | 338,900 | 304,300 |

Net earnings were \$160 million, or \$4.01 per share, in 1996. Net earnings were \$224 million, or \$5.52 per share, in 1995 and \$253 million, or \$6.11 per share, in 1994.

RESULTS OF OPERATIONS

The percentage relationship between net sales and other elements of the Company's Consolidated Statement of Earnings for each of the last three years was:

| Percent of Net Sales | 1996 | 1995 | 1994 |
|------------------------------------------------------|-------|-------|-------|
| Net sales | 100.0 | 100.0 | 100.0 |
| Cost of goods sold | 77.5 | 75.8 | 75.0 |
| Gross profit | 22.5 | 24.2 | 25.0 |
| Selling & administrative expenses | 13.8 | 13.2 | 13.5 |
| Research & engineering expenses | 4.8 | 5.0 | 5.0 |
| Net expense (income) of joint ventures and alliances | - | - | (.1) |
| Interest expense | .3 | .2 | .4 |
| Other (income) expense, net | (.5) | .2 | - |
| Restructuring charges | - | 2.2 | - |
| Earnings before income taxes | 4.1 | 3.4 | 6.2 |
| Provision (credit) for income taxes | 1.1 | (.9) | .9 |
| Net earnings | 3.0 | 4.3 | 5.3 |

Sales by Market

The Company's sales for each of its key markets during the last three years were:

| \$ Millions | 1996 | | 1995 | | 1994 | |
|------------------|---------|---------|---------|---------|---------|---------|
| | Dollars | Percent | Dollars | Percent | Dollars | Percent |
| Automotive: | | | | | | |
| Heavy-duty truck | 1,261 | 24 | 1,550 | 30 | 1,483 | 31 |
| Midrange truck | 587 | 11 | 607 | 11 | 500 | 11 |
| Bus and light | | | | | | |

| | | | | | | |
|----------------------|--------------|------------|--------------|------------|--------------|------------|
| commercial vehicles | 599 | 12 | 532 | 10 | 469 | 10 |
| Power generation | 1,213 | 23 | 1,092 | 21 | 980 | 21 |
| Industrial | 863 | 16 | 776 | 15 | 686 | 14 |
| Filtration and other | 734 | 14 | 688 | 13 | 619 | 13 |
| Net sales | <u>5,257</u> | <u>100</u> | <u>5,245</u> | <u>100</u> | <u>4,737</u> | <u>100</u> |

Automotive

Sales to the heavy-duty truck market were almost 20 percent lower than in 1995 and 15 percent lower than 1994. The lower level of sales in 1996 was due to a decline in demand for the North American heavy-duty truck market. In 1996, factory retail sales of heavy-duty trucks in North America were 23 percent lower than the previous year's level. This lower market size resulted in the Company's lower level of engine shipments in North America. Cummins continued to lead this market, however, with a market share of 35 percent in 1996. The Company's market share was 35 percent in 1995 and 34 percent in 1994. In the fourth quarter of 1996, the North American market was stronger, indicating it may be reaching the bottom of the current down cycle.

International engine shipments for heavy-duty trucks were 14 percent lower than in 1995 and 49 percent below 1994. The decline in engine shipments in 1996 was due primarily to lower demand in European markets. However, in the fourth quarter, certain international markets showed signs of improvement, particularly in Mexico.

Sales of engines for the midrange truck market in 1996 were 3 percent lower than 1995 and 17 percent higher than in 1994. Overall, there was a decrease in demand for medium-duty trucks in North America during 1996, which caused a 3-percent decline in the Company's engine shipments in North America. Midrange engines for international markets were 7 percent higher than in 1995 and 16 percent higher than 1994, primarily in Brazil and Mexico.

In the bus and light commercial vehicles market, sales were 13 percent higher than 1995 and 28 percent higher than 1994. The increase in 1996 was due to record demand for the Company's midrange engines in the Dodge Ram pickup truck, which was 13 percent above 1995.

Power Generation

Sales of power generation represented 23 percent of the Company's net sales in 1996. Record sales of \$1.2 billion in 1996 were \$121 million higher, a 11-percent increase compared to 1995, and \$233 million, or 23 percent higher, than 1994. The increase in sales in 1996 was due to a 20-percent increase in international markets, reflecting strong demand in China, India and Southeast Asia.

Industrial

Record sales of \$863 million to industrial markets were 11 percent higher than 1995 and 26 percent higher than 1994. The increase in sales in 1996 was primarily due to strong demand for construction applications in both North American and international markets. In addition, there was strong demand for the Company's engines in marine applications worldwide in 1996, almost 30 percent above 1995 and 55 percent higher than 1994.

Filtration and Other

Sales of \$734 million in 1996 for filtration and other products were 7 percent higher than 1995 and 19 percent higher than 1994. The increase in sales during 1996 was due primarily to strong demand in international markets.

Gross Profit

The Company's gross profit percentage was 22.5 percent of net sales in 1996, compared to 24.2 percent in 1995 and 25.0 percent in 1994.

The Company's gross profit was affected by several factors in 1996, the most significant of which was the decline in heavy-duty engine production that resulted in lower fixed cost absorption. Gross profit also was affected by the softer market for midrange truck engines, higher sales of lower margin power generation products, and costs associated with the restructuring actions and new product introductions. While restructuring activities are proceeding, as reflected by gains on disposals of certain operations in "other

income", expenses associated with implementation of certain of these actions adversely affected gross profit. As disclosed in Note 13 to the Consolidated Financial Statements, the Company has entered into commodity swap contracts that have the effect of fixing the cost of certain material purchases.

The cost of product coverage programs was 2.7 percent of net sales in 1996, compared to 2.4 percent of net sales in 1995 and 2.3 percent of net sales in 1994.

Operating Expenses

Selling and administrative expenses were \$725 million (13.8 percent of net sales) in 1996, compared to \$692 million (13.2 percent of net sales) in 1995 and \$641 million (13.5 percent of net sales) in 1994. In 1996, expenditures associated with the restructuring actions, marketing programs and new product launches offset the decrease in salaries and wages as a result of headcount reductions.

Research and engineering expenses of \$252 million in 1996 were 4.8 percent of net sales, compared to \$263 million in 1995 and \$238 million in 1994, both of which were 5.0 percent of net sales.

In 1996, the Company's share of start-up losses of its joint venture with Wartsila were offset by earnings from Kirloskar Cummins, due to strong demand in its markets.

Other Income and Expense

Interest expense of \$18 million was \$5 million higher than 1995 due to the higher level of borrowings. In 1996, other income of \$24 million was due to interest income and gains on the disposal of certain operations and businesses associated with the restructuring actions.

Restructuring Charges

As disclosed in Note 2 to the Consolidated Financial Statements, results of operations in 1995 included restructuring charges of \$118 million (\$77 million after taxes) for costs to consolidate operations and reduce the worldwide work force. Approximately 2,300 employees have separated from the Company as a result of the actions.

Provision for Income Taxes

The Company's income tax provision in 1996 was \$54 million, an effective tax rate of 25 percent, reflecting tax breaks on export sales and \$6 million for reinstatement of the research tax credit in the second half of 1996. Tax provisions of the Small Business Job Protection Act that was signed into law in August 1996 included reinstatement of this credit for an 11-month period, beginning July 1, 1996.

The Company reduced its valuation allowance for tax benefit carryforwards \$68 million in 1995 and \$32 million in 1994. The tax provision for 1995 also included a credit of \$35 million for additional tax benefits related to the amendment of prior years' returns.

CASH FLOW AND FINANCIAL CONDITION

Key elements of the Consolidated Statement of Cash Flows were:

| \$ Millions | 1996 | 1995 | 1994 |
|-------------------------------------------------------------------|-------|--------|-------|
| Net cash provided by operating activities | \$193 | \$406 | \$376 |
| Net cash used in investing activities | (259) | (373) | (261) |
| Net cash (used in) provided by operating and investing activities | (66) | 33 | 115 |
| Net cash provided from (used for) financing activities | 110 | (121) | (50) |
| Effect of exchange rate changes on cash | 4 | 1 | 5 |
| Net change in cash & cash equivalents | \$ 48 | \$(87) | \$ 70 |

During 1996, net cash used in operating and investing activities was \$66 million. The lower level of net cash provided by operating activities was due to net cash requirements for the restructuring activities, including increased inventories at certain locations, and an increase in accounts receivable. In the second quarter of 1996, an

agreement for the sale of up to \$110 million of accounts receivable was not renewed by the Company, which resulted in the increase in receivables. Capital expenditures during 1996 were \$304 million, compared to \$223 million in 1995 and \$238 million in 1994. The increased level of expenditures in 1996 was related to continued investments for new products. The Company expects a significant increase in these expenditures in 1997, some of which may be funded externally.

Investments in joint ventures and alliances of \$5 million reflected the net effect of repayment of temporary advances to Consolidated Diesel at the end of 1995 and capital contributions of \$50 million during 1996, primarily to the Company's joint venture with Wartsila. The Company expects to continue to make investments in certain of its joint ventures during 1997.

Net cash provided from financing activities was \$110 million in 1996. As disclosed in Note 5 to the Consolidated Financial Statements, the Company issued commercial paper in 1996 to replace a financing arrangement whereby receivables were previously sold without recourse. A subsidiary of the Company also issued notes in 1996, which resulted in net proceeds of \$100 million. In February 1997, the Company issued \$120 million in debentures under its shelf registration statement.

As disclosed in Note 9 to the Consolidated Financial Statements, the Company completed a program begun in 1994 to repurchase 2.5 million shares of its common stock. In January 1997, the Company repurchased 1.3 million shares of its common stock from Ford Motor Company and was authorized by the Board of Directors to repurchase an additional 1.7 million shares in the open market. In January 1997, the Company also announced that it will issue 3.75 million shares of its common stock to an employee benefits trust.

Forward-looking Statements

This Management's Discussion and Analysis of Results of Operations and Financial Condition and other sections of this Form 10-K contain forward-looking statements that are based on current expectations, estimates and projections about the industries in which Cummins operates, management's beliefs and assumptions made by management. Words, such as "expects", "anticipates", "intends", "plans", "believes", "seeks", "estimates", variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions ("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. Cummins undertakes no obligation to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

Future Factors include increasing price and product competition by foreign and domestic competitors, including new entrants; rapid technological developments and changes; the ability to continue to introduce competitive new products on a timely, cost-effective basis; the mix of products; the achievement of lower costs and expenses; domestic and foreign governmental and public policy changes, including environmental regulations; protection and validity of patent and other intellectual property rights; reliance on large customers; technological, implementation and cost/financial risks in increasing use of large, multi-year contracts; the cyclical nature of Cummins' business; the outcome of pending and future litigation and governmental proceedings and continued availability of financing, financial instruments and financial resources in the amounts, at the times and on the terms required to support Cummins' future business.

These are representative of the Future Factors that could affect the outcome of the forward-looking statements. In addition, such statements could be affected by general industry and market conditions and growth rates, general domestic and international economic conditions, including interest rate and currency exchange rate fluctuations, and other Future Factors.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTAL DATA

See Index to Financial Statements on page 28.

ITEM 9. DISAGREEMENTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The information appearing under the caption "Election of Directors" of the Company's definitive Proxy Statement for the Annual Meeting of the Shareholders to be held on April 1, 1997 ("the Proxy Statement") is incorporated by reference in partial answer to this item. Except as otherwise specifically incorporated by reference, the Proxy Statement is not to be deemed filed as part of this report.

The executive officers of the Company at December 31, 1996 are set forth below. The Chairman of the Board and President are elected annually by the Board of Directors at the Board's first meeting following the Annual Meeting of the Shareholders. Other officers are appointed by the Chairman and ratified by the Board of Directors and hold office for such period as the Board of Directors or Chairman of the Board may prescribe.

| Name | Age | Present Position and Business Experience During Last 5 Years |
|--------------------|-----|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Mark E. Chesnut | 49 | Vice President - Corporate Responsibility & Public Affairs (1995 to present), Vice President - Quality & Organizational Effectiveness (1992 to 1995) |
| C. Roberto Cordaro | 46 | Executive Vice President, Group President - Automotive (1996 to present), Group Vice President - Marketing (1990 to 1996) |
| John K. Edwards | 52 | Executive Vice President, Group President - Power Generation and International (1996 to present), Vice President - International (1989 to 1996) |
| Mark R. Gerstle | 41 | Vice President - General Counsel and Secretary (1995 to present), Assistant General Counsel (1991 to 1995) |
| James A. Henderson | 62 | Chairman and Chief Executive Officer (1995 to present), President & Chief Executive Officer (1994 to 1995), President and Chief Operating Officer (1977-1994) |
| M. David Jones | 49 | Vice President - Filtration Group and President, Fleetguard, Inc. (1996 to present), Vice President - Aftermarket Group (1989 to 1996) |
| F. Joseph Loughrey | 47 | Executive Vice President, Group President - Industrial and Chief Technical Officer (1996 to present), Group Vice President - Worldwide Operations & Technology (1995 to 1996), Group Vice President - Worldwide Operations (1990 to 1995) |
| John McLachlan | 64 | Vice President - Corporate Controller (1991 to present) |
| Kiran M. Patel | 48 | Vice President and Chief Financial Officer (1996 to present), President - Fleetguard, Inc. (1993 to 1996), President - CUMBRASIL (1990 to 1993) |
| Brenda S. Pitts | 46 | Vice President - Human Resources (1991 to present) |
| Theodore M. Solso | 49 | President and Chief Operating Officer (1995 to present), Executive Vice President and Chief Operating Officer (1994 to 1995), Executive Vice President - Operations (1992 to 1994) |

ITEM 11. EXECUTIVE COMPENSATION

The information appearing under the following captions in the Company's Proxy Statement is hereby incorporated by reference: "The Board of Directors and Its Committees", "Executive Compensation -- Compensation Tables and Other Information", "Executive Compensation -- Change of Control Arrangements" and "Executive Compensation -- Compensation Committee Interlocks and Insider Participation".

The Company has adopted various benefit and compensation plans covering officers and other key employees under which certain benefits become payable upon a change of control of the Company. Cummins also has adopted an employee retention program covering approximately 600

employees of the Company and its subsidiaries, which provides for the payment of severance benefits in the event of termination of employment following a change of control of Cummins. The Company and its subsidiaries also have severance programs for other exempt employees of the Company whose employment is terminated following a change of control of the Company. Certain of the pension plans covering employees of the Company provide, upon a change of control of Cummins, that excess plan assets become dedicated solely to fund benefits for plan participants.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

A discussion of the security ownership of certain beneficial owners and management appearing under the captions "Principal Security Ownership", "Election of Directors" and "Executive Compensation -- Security Ownership of Management" in the Proxy Statement is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information appearing under the captions "The Board of Directors and Its Committees", "Executive Compensation - Compensation Committee Interlocks and Insider Participation" and "Other Transactions and Agreements with Directors, Officers and Certain Shareholders" in the Proxy Statement is incorporated herein by reference.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

Documents filed as a part of this report:

1. See Index to Financial Statements on page 28 for a list of the financial statements filed as a part of this report.
2. See Exhibit Index on page 54 for a list of the exhibits filed or incorporated herein as a part of this report.

No reports on Form 8-K were filed during the fourth quarter of 1996.

INDEX TO FINANCIAL STATEMENTS

| | Page |
|------------------------------------------------------|------|
| Management's Responsibility for Financial Statements | 29 |
| Report of the Independent Public Accountants | 30 |
| Consolidated Statement of Earnings | 31 |
| Consolidated Statement of Financial Position | 32 |
| Consolidated Statement of Cash Flows | 34 |
| Consolidated Statement of Shareholders' Investment | 36 |
| Notes to Consolidated Financial Statements | 38 |
| Quarterly Financial Data | 50 |

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

Management is responsible for the preparation of the Company's consolidated financial statements and all related information appearing in this Form 10-K. The statements and notes have been prepared in conformity with generally accepted accounting principles and include some amounts which are estimates based upon currently available information and management's judgment of current conditions and circumstances. The Company engaged Arthur Andersen LLP, independent public accountants, to examine the consolidated financial statements. Their report appears on the following page.

To provide reasonable assurance that assets are safeguarded against loss from unauthorized use or disposition and that accounting records are reliable for preparing financial statements, management maintains a system of accounting and controls, including an internal audit program. The system of accounting and controls is improved and modified in response to changes in business conditions and operations and recommendations made by the independent public accountants and the internal auditors.

The Board of Directors has an Audit Committee whose members are not employees of the Company. The committee met four times in 1996 with

management, internal auditors and representatives of the Company's independent public accountants to review the Company's program of internal controls, audit plans and results, and the recommendations of the internal and external auditors and management's responses to those recommendations.

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Shareholders and Board of Directors of Cummins Engine Company, Inc.:

We have audited the accompanying consolidated statement of financial position of Cummins Engine Company, Inc., (an Indiana corporation) and subsidiaries as of December 31, 1996 and 1995, and the related consolidated statements of earnings, cash flows and shareholders' investment for each of the three years in the period ended December 31, 1996. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Cummins Engine Company, Inc., and subsidiaries as of December 31, 1996 and 1995, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1996, in conformity with generally accepted accounting principles.

Arthur Andersen LLP

Chicago, Illinois,
January 27, 1997.

CUMMINS ENGINE COMPANY, INC.
CONSOLIDATED STATEMENT OF EARNINGS

| Millions, Except per Share Amounts | 1996 | 1995 | 1994 |
|------------------------------------------------------|---------|---------|---------|
| Net sales | \$5,257 | \$5,245 | \$4,737 |
| Cost of goods sold | 4,072 | 3,974 | 3,551 |
| Gross profit | 1,185 | 1,271 | 1,186 |
| Selling & administrative expenses | 725 | 692 | 641 |
| Research & engineering expenses | 252 | 263 | 238 |
| Net expense (income) of joint ventures and alliances | - | 2 | (4) |
| Interest expense | 18 | 13 | 17 |
| Other (income) expense, net | (24) | 6 | - |
| Restructuring charges | - | 118 | - |
| Earnings before income taxes | 214 | 177 | 294 |
| Provision (credit) for income taxes | 54 | (47) | 41 |
| Net earnings | \$ 160 | \$ 224 | \$ 253 |
| Earnings per share | \$4.01 | \$5.52 | \$6.11 |

The accompanying notes are an integral part of this statement.

CUMMINS ENGINE COMPANY, INC.
CONSOLIDATED STATEMENT OF FINANCIAL POSITION

Millions, Except per Share Amounts

| | December 31, 1996 | 1995 |
|--|----------------------|------|
|--|----------------------|------|

| | | |
|-----------------------------------------------------|----------------|----------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 108 | \$ 60 |
| Receivables | 669 | 597 |
| Inventories | 587 | 513 |
| Other current assets | 189 | 218 |
| | <u>1,553</u> | <u>1,388</u> |
| Investments and other assets: | | |
| Investments in joint ventures and alliances | 207 | 211 |
| Other assets | 119 | 115 |
| | <u>326</u> | <u>326</u> |
| Property, plant and equipment: | | |
| Land and buildings | 460 | 436 |
| Machinery, equipment and fixtures | 1,931 | 1,875 |
| Construction in progress | 270 | 164 |
| | <u>2,661</u> | <u>2,475</u> |
| Less accumulated depreciation | 1,375 | 1,327 |
| | <u>1,286</u> | <u>1,148</u> |
| Intangibles, deferred taxes & deferred charges | 204 | 194 |
| Total assets | <u>\$3,369</u> | <u>\$3,056</u> |
| Liabilities and shareholders' investment | | |
| Current liabilities: | | |
| Loans payable | \$ 93 | \$ 60 |
| Current maturities of long-term debt | 39 | 42 |
| Accounts payable | 380 | 376 |
| Accrued salaries and wages | 84 | 85 |
| Accrued product coverage & marketing expenses | 126 | 152 |
| Income taxes payable | 16 | 30 |
| Other accrued expenses | 283 | 308 |
| | <u>1,021</u> | <u>1,053</u> |
| Long-term debt | <u>283</u> | <u>117</u> |
| Other liabilities | <u>753</u> | <u>703</u> |
| Shareholders' investment: | | |
| Common stock, \$2.50 par value, 43.9 shares issued | 110 | 110 |
| Additional contributed capital | 929 | 926 |
| Retained earnings | 535 | 406 |
| Common stock in treasury, at cost, 4.5 & 3.7 shares | (169) | (135) |
| Unearned compensation | (46) | (51) |
| Cumulative translation adjustments | (47) | (73) |
| | <u>1,312</u> | <u>1,183</u> |
| Total liabilities & shareholders' investment | <u>\$3,369</u> | <u>\$3,056</u> |

The accompanying notes are an integral part of this statement.

CUMMINS ENGINE COMPANY, INC.
CONSOLIDATED STATEMENT OF CASH FLOWS

| Millions | 1996 | 1995 | 1994 |
|------------------------------------------------------------------------------|--------|--------|--------|
| Cash flows from operating activities: | | | |
| Net earnings | \$ 160 | \$ 224 | \$ 253 |
| Adjustments to reconcile net earnings to net cash from operating activities: | | | |
| Depreciation and amortization | 149 | 143 | 128 |
| Restructuring actions | (42) | 114 | - |
| Accounts receivable | (56) | (91) | (37) |
| Inventories | (62) | 3 | (46) |
| Accounts payable and accrued expenses | 28 | 99 | 69 |
| Deferred income taxes | 17 | (100) | (7) |

| | | | |
|-------------------------------------------------------------------|--------------|--------------|--------------|
| Other | (1) | 14 | 16 |
| Total adjustments | <u>33</u> | <u>182</u> | <u>123</u> |
| Net cash provided by operating activities | <u>193</u> | <u>406</u> | <u>376</u> |
| Cash flows from investing activities: | | | |
| Property, plant and equipment: | | | |
| Additions | (304) | (223) | (238) |
| Disposals | 26 | 6 | 5 |
| Investments in joint ventures and alliances | (5) | (147) | (9) |
| Other | 24 | (9) | (19) |
| Net cash used in investing activities | <u>(259)</u> | <u>(373)</u> | <u>(261)</u> |
| Net cash (used in) provided by operating and investing activities | <u>(66)</u> | <u>33</u> | <u>115</u> |
| Cash flows from financing activities: | | | |
| Proceeds from borrowings | 200 | 2 | - |
| Payments on borrowings | (47) | (37) | (34) |
| Net borrowings under credit agreements | 32 | 19 | 17 |
| Repurchases of common stock | (34) | (69) | (5) |
| Dividend payments | (40) | (40) | (26) |
| Other | (1) | 4 | (2) |
| Net cash provided from (used for) financing activities | <u>110</u> | <u>(121)</u> | <u>(50)</u> |
| Effect of exchange rate changes on cash | 4 | 1 | 5 |
| Net change in cash and cash equivalents | <u>48</u> | <u>(87)</u> | <u>70</u> |
| Cash & cash equivalents at beginning of year | 60 | 147 | 77 |
| Cash & cash equivalents at end of year | <u>\$108</u> | <u>\$ 60</u> | <u>\$147</u> |
| Cash payments during the year for: | | | |
| Interest | \$ 16 | \$ 13 | \$ 19 |
| Income taxes | 40 | 59 | 43 |

The accompanying notes are an integral part of this statement.

CUMMINS ENGINE COMPANY, INC.
CONSOLIDATED STATEMENT OF SHAREHOLDERS' INVESTMENT

| Millions, Except per Share Amounts | 1996 | 1995 | 1994 |
|--------------------------------------------------------------------|------------|------------|------------|
| Convertible preference stock, no par value, 1.0 shares authorized: | | | |
| Beginning balance (.2 shares) | \$ - | \$ - | \$ 112 |
| Converted to common stock or redeemed (.2 shares) | - | - | (112) |
| Ending balance | <u>-</u> | <u>-</u> | <u>-</u> |
| Common stock, \$2.50 par value, 150.0 shares authorized: | | | |
| Beginning balance (43.9, 43.8 & 40.6 shares) | 110 | 109 | 101 |
| Conversion of preference stock & debt (2.9 shares) | - | - | 7 |
| Other (.1 and .3 shares) | - | 1 | 1 |
| Ending balance (43.9, 43.9 & 43.8 shares) | <u>110</u> | <u>110</u> | <u>109</u> |
| Additional contributed capital: | | | |
| Beginning balance | 926 | 927 | 823 |
| Conversion of preference stock and debt | - | - | 104 |
| Other | 3 | (1) | - |
| Ending balance | <u>929</u> | <u>926</u> | <u>927</u> |
| Retained earnings: | | | |
| Beginning balance | 406 | 232 | 4 |
| Net earnings for the year | 160 | 224 | 253 |
| Cash dividends declared | (40) | (40) | (26) |
| Additional minimum liability for pensions | 9 | (10) | 1 |
| Ending balance | <u>535</u> | <u>406</u> | <u>232</u> |

| | | | |
|-------------------------------------------|----------------|----------------|----------------|
| Common stock in treasury: | | | |
| Beginning balance (3.7, 2.2 & 2.1 shares) | (135) | (72) | (67) |
| Stock repurchased (.8, 1.6 and .1 shares) | (34) | (69) | (5) |
| Stock issued (.1 shares) | - | 6 | - |
| Ending balance (4.5, 3.7 & 2.2 shares) | <u>(169)</u> | <u>(135)</u> | <u>(72)</u> |
| Unearned compensation: | | | |
| Beginning balance | (51) | (55) | (59) |
| Shares allocated to participants | 5 | 4 | 4 |
| Ending balance | <u>(46)</u> | <u>(51)</u> | <u>(55)</u> |
| Cumulative translation adjustments: | | | |
| Beginning balance | (73) | (69) | (93) |
| Adjustments | 26 | (4) | 24 |
| Ending balance | <u>(47)</u> | <u>(73)</u> | <u>(69)</u> |
| Shareholders' investment | <u>\$1,312</u> | <u>\$1,183</u> | <u>\$1,072</u> |

The accompanying notes are an integral part of this statement.

CUMMINS ENGINE COMPANY, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in Millions, Unless Otherwise Stated)

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Principles of Consolidation: The consolidated financial statements include the accounts of Cummins Engine Company, Inc., and its majority-owned subsidiaries. Affiliated companies in which Cummins does not have a controlling interest are accounted for using the equity method.

The statements and notes have been prepared in conformity with generally accepted accounting principles and include some amounts which are estimates based upon currently available information and management's judgment of current conditions and circumstances.

Revenue Recognition: The Company recognizes revenues on the sale of its products, net of estimated costs of returns, allowances and sales incentives, when the products are shipped to customers.

Product Coverage Programs: Estimated costs of commitments for product coverage programs are charged to earnings at the time the Company sells its products.

Foreign Currency: The Company uses the local currency as the functional currency for its manufacturing operations outside the United States, except those in Brazil and Mexico for which it uses the US dollar. At operations which use the local currency as the functional currency, results are translated into US dollars using average exchange rates for the year, while assets and liabilities are translated into US dollars using year-end exchange rates. The resulting translation adjustments are recorded as a separate component of shareholders' investment; gains and losses from foreign currency transactions are included in net earnings. At the Company's operations in Brazil and Mexico, cash and certain other monetary assets and liabilities (such as receivables and payables) and revenues and expenses are translated into US dollars using current exchange rates. Inventories and nonmonetary assets, such as fixed assets, are translated into US dollars using historical exchange rates. The resulting translation adjustments and gains and losses from foreign currency transactions are reflected in net earnings.

Research & Development: Expenditures for research and development of new products, as well as engineering expenditures during early production and ongoing efforts to improve existing products, are charged to earnings as incurred, net of contract reimbursements. Research and development costs approximated \$235 in 1996, \$230 in 1995 and \$200 in 1994.

Cash Equivalents: Cash equivalents are investments that are readily convertible to known amounts of cash and have original maturities of three months or less.

Inventories: The Company accounts for approximately 25 percent of its inventories using the last-in, first-out (LIFO) cost method. These LIFO inventories include substantially all of the Company's US heavy-

duty and high-horsepower engine and engine parts inventories. All other inventories are valued at the lower of first-in, first-out (FIFO) cost or net realizable value.

| Inventories | December 31, | |
|---------------------------------|--------------|--------------|
| | 1996 | 1995 |
| Finished products | \$334 | \$283 |
| Work-in-process & raw materials | 319 | 292 |
| Inventories at FIFO cost | <u>653</u> | <u>575</u> |
| Excess of FIFO over LIFO | (66) | (62) |
| Inventories | <u>\$587</u> | <u>\$513</u> |

Property, Plant and Equipment: The Company depreciates substantially all engine production equipment using a modified units-of-production method, which is based upon units produced subject to a minimum level. Depreciation of all other equipment is computed using the straight-line method for financial reporting purposes. The estimated service lives to compute depreciation range from 20 to 40 years for buildings and 3 to 20 years for machinery, equipment and fixtures. Where appropriate, the Company uses accelerated depreciation methods for tax purposes. Maintenance and repair costs are charged to earnings as incurred.

Earnings Per Share: Primary earnings per share are computed by subtracting preference stock dividend requirements from net earnings and dividing that amount by the weighted-average number of common shares outstanding during each year. Fully diluted earnings per share are computed by dividing net earnings by the weighted-average number of shares outstanding, assuming the exercise of stock options and the conversion of debt and preference stock to common stock.

NOTE 2. RESTRUCTURING CHARGES: Results of operations in 1995 included restructuring charges of \$118 (\$77 after taxes) for costs to reduce the worldwide work force through a series of actions, including voluntary and involuntary separations, retirements and plant consolidations. Facility consolidations included closing or restructuring selected operations in Europe, Brazil and North America. The components of the restructuring charges were:

| | |
|-----------------------------|--------------|
| Work force reductions | \$ 82 |
| Asset write downs..... | 32 |
| Other | 4 |
| Total | <u>\$118</u> |

Estimated costs for work force reductions were based on amounts pursuant to benefit programs and contractual provisions or statutory requirements at the affected operations. Approximately \$53 has been charged to the liabilities as of December 31, 1996.

NOTE 3. OPERATING LEASES: Certain of the Company's manufacturing plants, warehouses and offices are leased facilities. The Company also leases manufacturing and office equipment. Most of these leases require fixed rental payments, expire over the next ten years and can be renewed or replaced with similar leases. Rental expense under these leases approximated \$55 in each of the last three years. Future minimum payments for leases with original terms of more than one year are \$32 in 1997, \$28 in 1998, \$22 in 1999, \$18 in 2000, \$15 in 2001 and \$59 thereafter.

NOTE 4. INVESTMENTS IN JOINT VENTURES AND ALLIANCES:

| | December 31, | |
|---------------------|--------------|--------------|
| | 1996 | 1995 |
| Cummins Wartsila | \$ 59 | \$ 31 |
| Consolidated Diesel | 38 | 96 |
| Kirloskar Cummins | 36 | 27 |
| Chongqing Cummins | 16 | 15 |
| Tata Cummins | 13 | 13 |
| Behr America | 12 | 12 |
| Cummins Komatsu | 9 | 3 |
| Other | 24 | 14 |
| Carrying value | <u>\$207</u> | <u>\$211</u> |

Summary financial information for these 50-percent or less owned joint ventures and alliances:

| Earnings Data | 1996 | 1995 | 1994 |
|---------------|------|------|------|
|---------------|------|------|------|

| | | | |
|------------------------|---------|--------------|--------|
| Net sales | \$1,328 | \$1,091 | \$ 914 |
| Earnings | 2 | 6 | 15 |
| Cummins' share | - | (2) | 4 |
| | | | |
| | | December 31, | |
| Balance Sheet Data | | 1996 | 1995 |
| | | | |
| Current assets | | \$458 | \$330 |
| Noncurrent assets | | 478 | 340 |
| Current liabilities | | (305) | (231) |
| Noncurrent liabilities | | (248) | (63) |
| | | | |
| Net assets | | \$383 | \$376 |
| | | | |
| Cummins' share | | \$207 | \$211 |

In connection with various joint venture agreements, the Company is required to purchase engine products in amounts to provide for the recovery of specified costs of the joint venture. Under the agreement with Consolidated Diesel, Cummins purchases approximated \$540 in 1996 and 1995, with future minimum purchases of \$6 in 1997 and 1998, \$9 in 1999, \$10 in 2000 and 2001 and \$85 thereafter. The Company's carrying value of Consolidated Diesel at December 31, 1995 included temporary financing of \$50 that was repaid to Cummins in 1996.

NOTE 5. LONG-TERM DEBT:

| | | | |
|-----------------------------------------------|--|--------------|-------|
| | | December 31, | |
| Long-term Debt | | 1996 | 1995 |
| | | | |
| 8.2% notes, due 2003 | | \$108 | \$ - |
| Commercial paper | | 90 | - |
| 10.35%-10.65% medium-term notes, through 1998 | | 35 | 73 |
| Guaranteed notes of ESOP Trust, due 1998 | | 67 | 68 |
| Other | | 22 | 18 |
| | | | |
| Total indebtedness | | 322 | 159 |
| Less current maturities | | 39 | 42 |
| | | | |
| Long-term debt | | \$283 | \$117 |

Aggregate maturities of long-term debt for the five years subsequent to December 31, 1996 are \$39, \$101, \$19, \$18 and \$20. At December 31, 1996 and 1995, the weighted-average interest rate on loans payable and current maturities of long-term debt was 7 percent and 8 percent, respectively.

In 1996, a subsidiary of the Company issued 8.2 percent notes, which resulted in net proceeds of \$100.

The Company maintains a revolving credit agreement, under which there were no outstanding borrowings at December 31, 1996 or 1995. In 1996, the agreement was amended, increasing the available amount from \$300 to \$400 and extending the term to 2001. The revolving credit agreement supported commercial paper borrowings at December 31, 1996. The commercial paper initially was issued as replacement financing for an arrangement whereby the Company sold up to \$110 receivables without recourse. The agreement for the sale of receivables expired in the second quarter of 1996 and was not renewed by the Company. The Company also maintains other domestic and international credit lines with approximately \$90 available at December 31, 1996.

The Company has guaranteed the outstanding borrowings of its ESOP Trust. Cash contributions to the Trust, together with the dividends accumulated on the common stock held by the Trust, are used to pay interest and principal due on the notes. Cash contributions and dividends to the ESOP Trust and the Company's compensation expense approximated \$10 in each year. The unearned compensation, which is reflected as a reduction to shareholders' investment, represents the historical cost of the ESOP Trust's shares of common stock that have not yet been allocated to participants.

In February 1997, the Company issued \$120 of 6.75 percent debentures that mature in 2027. Holders have a 1-time option in 2007 to redeem the debentures. The Company also has a recall right after ten years.

NOTE 6. OTHER LIABILITIES:

| | | | |
|-----------------------------------------------|--|--------------|-------|
| | | December 31, | |
| Other Liabilities | | 1996 | 1995 |
| | | | |
| Accrued retirement & post-employment benefits | | \$530 | \$533 |
| Accrued product coverage & marketing expenses | | 112 | 86 |
| Deferred taxes | | 28 | 21 |

| | | |
|----------------------|--------------|--------------|
| Accrued compensation | 28 | 21 |
| Other | 55 | 42 |
| Other liabilities | <u>\$753</u> | <u>\$703</u> |

NOTE 7. INCOME TAXES:

| Tax Provision | 1996 | 1995 | 1994 |
|------------------------|-------------|----------------|-------------|
| Current: | | | |
| US Federal and state | \$22 | \$ 30 | \$29 |
| Foreign | 15 | 23 | 19 |
| | <u>37</u> | <u>53</u> | <u>48</u> |
| Deferred: | | | |
| US Federal and state | - | (93) | (9) |
| Foreign | 17 | (7) | 2 |
| | <u>17</u> | <u>(100)</u> | <u>(7)</u> |
| Tax provision (credit) | <u>\$54</u> | <u>\$(47)</u> | <u>\$41</u> |

The Company expects to realize all of its tax assets, including the use of all carryforwards before any expiration. A valuation allowance previously maintained against tax carryforward benefits was released to earnings as a reduction of income tax expense in the amount of \$68 in 1995 and \$32 in 1994. Tax benefits of \$35 also were recorded as a reduction to income tax expense in 1995 for changes in the treatment of foreign tax credits and foreign sales corporation benefits for prior years.

Significant components of the Company's net deferred tax assets relate to the following tax effects of differences between financial and tax reporting:

| | December 31, | |
|----------------------------------------------------------------|--------------|--------------|
| Net Deferred Tax Assets | 1996 | 1995 |
| US accrued employee benefits | \$247 | \$236 |
| US accrued product coverage & marketing expenses | 72 | 73 |
| Restructuring charges | 10 | 25 |
| US plant & equipment | (125) | (124) |
| Other net US differences | 21 | 7 |
| Net foreign taxable differences, primarily plant and equipment | (23) | (7) |
| US Federal carryforward benefits: | | |
| General business tax credits, expiring 2000 to 2010 | 45 | 58 |
| Minimum tax credits, no expiration | 9 | 11 |
| Net deferred tax assets | <u>\$256</u> | <u>\$279</u> |
| Balance Sheet Classification | | |
| Current assets | \$131 | \$164 |
| Noncurrent assets | 153 | 136 |
| Noncurrent liabilities | (28) | (21) |
| Net deferred tax assets | <u>\$256</u> | <u>\$279</u> |

Earnings before income taxes and differences between the effective tax rate and US Federal income tax rates were:

| | 1996 | 1995 | 1994 |
|-------------------------------------------------------------------------------------------------|--------------|--------------|--------------|
| Earnings before income taxes: | | | |
| US | \$134 | \$135 | \$181 |
| International | 80 | 42 | 113 |
| | <u>\$214</u> | <u>\$177</u> | <u>\$294</u> |
| Tax at 35 percent US statutory rate | \$ 75 | \$ 62 | \$103 |
| Adjustment to beginning-of-year valuation allowance | - | (68) | (32) |
| Change in treatment of foreign tax credit and foreign sales corporation benefits of prior years | - | (35) | - |
| Research tax credits | (6) | (6) | (9) |
| Current-year foreign sales corporation benefits | (11) | (5) | - |
| Differences in rates and taxability of foreign subsidiaries | - | - | (18) |

| | | | |
|------------------------|--------------|----------------|--------------|
| All other, net | (4) | 5 | (3) |
| Tax provision (credit) | <u>\$ 54</u> | <u>\$ (47)</u> | <u>\$ 41</u> |

NOTE 8. RETIREMENT PLANS: The Company has various contributory and noncontributory pension plans covering substantially all employees. Benefits for salaried plans generally are based upon annual compensation, and benefits under the hourly plans generally are based upon various monthly amounts for each year of service. The Company has a non-qualified excess benefit plan that provides certain employees with defined retirement benefits in excess of qualified plan limits imposed by US tax law. In addition, the Company has a plan that provides officers and other key employees with term life insurance during active employment and supplemental retirement benefits.

| Pension Cost | 1996 | 1995 | 1994 |
|-------------------------------|--------------|--------------|--------------|
| Service cost | <u>\$ 45</u> | <u>\$ 40</u> | <u>\$ 42</u> |
| Interest cost | 104 | 99 | 89 |
| Asset return: | | | |
| Actual | (155) | (214) | (26) |
| Deferred | 39 | 110) | (79) |
| Transition asset amortization | (9) | (9) | (9) |
| Other | 16 | 14 | 12 |
| Pension cost | <u>\$ 40</u> | <u>\$ 40</u> | <u>\$ 29</u> |

| Funded Status | December 31 | |
|----------------------|-------------------|-------------------|
| | 1996 | 1995 |
| Benefit obligation: | | |
| Vested | \$ (1,286) | \$ (1,139) |
| Accumulated | \$ (1,410) | \$ (1,332) |
| Projected | <u>\$ (1,491)</u> | <u>\$ (1,467)</u> |
| Plan assets | 1,555 | 1,367 |
| Funded status | 64 | (100) |
| Unrecognized: | | |
| Experience gain | (114) | (26) |
| Prior service cost | 70 | 106 |
| Transition asset | (21) | (29) |
| Additional liability | (35) | (63) |
| Accrued liability | <u>\$ (36)</u> | <u>\$ (112)</u> |

The projected benefit obligation for under-funded plans was \$694 at December 31, 1996 and \$688 at December 31, 1995, of which \$109 and \$168, respectively, was recorded as a liability. The projected benefit obligation for the Company's principal plans was determined using a weighted-average discount rate of 7.75 percent in 1996 and 7 percent in 1995. The long-term rate of return on assets was assumed to be 9.25 percent in 1996 and 10 percent in 1995. The assumed long-term rate of compensation increase for salaried plans approximated expected inflation in both 1996 and 1995.

It is the Company's policy to make contributions to plans sufficient to meet the funding requirements of applicable laws and regulations, plus such additional amounts as deemed to be appropriate. Plan assets consisted principally of equity securities and corporate and fixed-income Government obligations. Cummins common stock represented 6 percent of plan assets at December 31, 1996.

While the Company provides certain health care and life insurance benefits to eligible retirees and their dependents, it reserves the right to change benefits covered under these plans. The plans are contributory, with retirees' contributions adjusted annually, and contain other cost-sharing features, such as deductibles, coinsurance and spousal contributions. The general policy is to fund benefits as claims and premiums are incurred.

| Health Care Cost | 1996 | 1995 | 1994 |
|------------------|--------------|--------------|--------------|
| Service cost | <u>\$ 9</u> | <u>\$ 8</u> | <u>\$ 10</u> |
| Interest cost | 36 | 38 | 33 |
| Other | 10 | 7 | 10 |
| Total | <u>\$ 55</u> | <u>\$ 53</u> | <u>\$ 53</u> |

| Accrued Liability | December 31, | |
|--------------------|--------------|-------|
| | 1996 | 1995 |
| Obligation for: | | |
| Retirees | \$273 | \$238 |
| Eligible to retire | 145 | 125 |
| Others | 127 | 163 |
| Unrecognized: | | |
| Prior service cost | 4 | (10) |
| Experience loss | (38) | (40) |
| Accrued liability | \$511 | \$476 |

The weighted-average discount rate used to determine the accumulated benefit obligation was 7.75 percent in 1996 and 7 percent in 1995. The weighted-average trend rate for medical benefits was 8.9 percent, grading down to an ultimate rate of 5.5 percent by 2006. The health care cost trend rate assumption could have a significant effect on the determination of the obligation. For example, increasing the rate by one percent would increase the accumulated benefit obligation by \$31 and net cost by \$3.

NOTE 9. COMMON STOCK REPURCHASES: In 1994, the Board of Directors authorized repurchase by the Company of up to 2.5 million shares of its common stock. During 1996, the Company completed this program with the repurchase of .8 million shares of stock on the open market at an aggregate purchase price of \$34, or average price of \$41.35 per share. The Company repurchased 1.6 million shares at an aggregate purchase price of \$69, or average price of \$43.57 per share, in 1995 and .1 million shares at an aggregate purchase price of \$5, or average price of \$42.47 per share, in 1994. All of the acquired shares are held as common stock in treasury.

In January 1997, the Company announced that it will issue 3.75 million shares of its common stock to an employee benefits trust to fund obligations of employee benefit and compensation plans, principally retirement savings plans. Shares of the common stock held by this trust will not be used in the calculation of the Company's earnings per share until distributed from the trust and allocated to a benefit plan. The Company also announced in January 1997 repurchase of 1.3 million shares of its common stock from Ford Motor Company and that the Board of Directors has authorized the repurchase of an additional 1.7 million shares in the open market.

NOTE 10. SHAREHOLDERS' RIGHTS PLAN: The Company has a Shareholders' Rights Plan which it first adopted in 1986. The Rights Plan provides that each share of the Company's common stock has associated with it a stock purchase right. The Rights Plan becomes operative when a person or entity acquires 15 percent of the Company's common stock or commences a tender offer to purchase 20 percent or more of the Company's common stock without the approval of the Board of Directors. In the event a person or entity acquires 15 percent of the Company's common stock, each right, except for the acquiring person's rights, can be exercised to purchase \$400 worth of common stock for \$200. In addition, for a period of 10 days after such acquisition, the Board of Directors can exchange such right for a new right which permits the holders to purchase one share of the Company's common stock for \$1 per share. If a person or entity commences a tender offer to purchase 20 percent or more of the Company's common stock, unless the Board of Directors redeems the rights within 10 days of the event, each right can be exercised to purchase one share for \$200. The plan also allows holders of the rights to purchase shares of the acquiring person's stock at a discount if the Company is acquired or 50 percent of the assets or earnings power of the Company is transferred to an acquiring person.

NOTE 11. EMPLOYEE STOCK PLANS: Under the Company's stock incentive and option plans, officers and other eligible employees may be awarded stock options, stock appreciation rights and restricted stock. Under the provisions of the stock incentive plan, up to one percent of the Company's outstanding shares of common stock at the end of the preceding year is available for issuance under the plan each year. At December 31, 1996, there were 174,741 shares of common stock available for grant and 792,075 options exercisable under the plans.

| Options | Number of Shares | Weighted-average Exercise Price |
|-------------------|------------------|---------------------------------|
| December 31, 1993 | 525,070 | \$32.54 |
| Granted | 349,927 | 43.05 |
| Exercised | (10,200) | 27.44 |
| December 31, 1994 | 864,797 | 37.49 |

| | | |
|-------------------|------------------|-------|
| Granted | 360,625 | 39.98 |
| Exercised | (22,520) | 30.83 |
| Cancelled | (19,627) | 41.03 |
| December 31, 1995 | <u>1,183,275</u> | 38.45 |
| Granted | 394,150 | 40.13 |
| Exercised | (47,475) | 32.43 |
| Cancelled | (19,800) | 41.00 |
| December 31, 1996 | <u>1,510,150</u> | 38.88 |

Options outstanding at December 31, 1996 have exercise prices between \$15.94 and \$53.25 and a weighted-average remaining life of 5 years. The weighted-average fair value of options granted was \$11.36 per share in 1996 and \$10.41 per share in 1995. The fair value of each option was estimated on the date of grant using a risk-free interest rate of 6.7 percent in 1996 and 5.7 percent in 1995, current annual dividends, expected lives of 10 years and expected volatility of 27 percent. If the Company had used a fair-value method of accounting for awards subsequent to January 1, 1995, net earnings would have been reduced less than \$2 in 1996.

NOTE 12. SEGMENTS OF THE BUSINESS: The Company operates in a single industry segment -- designing, manufacturing and marketing diesel engines and related products. The Company's key markets for engines are automotive (heavy-duty trucks, midrange trucks, bus and light commercial vehicles), power generation and industrial. Manufacturing, marketing and technical operations are maintained in major areas of the world. Summary financial information is listed below for each geographic area. Earnings for each area may not be a meaningful representation of each area's contribution to consolidated operating results because of significant sales of products between and among the Company's various domestic and international operations.

| | US | Europe | All Other | Corporate Items | Combined |
|-------------------------------------|---------------|---------------|--------------|-----------------|---------------|
| 1996 | | | | | |
| Net sales: | | | | | |
| To customers in the area | \$2904 | \$ 770 | \$619 | \$ - | \$4293 |
| To customers outside the area | 581 | 363 | 20 | - | 964 |
| Intergeographic transfers | 415 | 180 | 129 | (724) | - |
| Total | <u>\$3900</u> | <u>\$1313</u> | <u>\$768</u> | <u>\$(724)</u> | <u>\$5257</u> |
| Earnings before income taxes | \$ 111 | \$ 75 | \$ 22 | \$ 6 | \$ 214 |
| Identifiable assets | \$2069 | \$ 624 | \$517 | \$ 159 | \$3369 |
| 1995 | | | | | |
| Net sales: | | | | | |
| To customers in the area | \$3010 | \$ 772 | \$524 | \$ - | \$4306 |
| To customers outside the area | 587 | 342 | 10 | - | 939 |
| Intergeographic transfers | 367 | 186 | 126 | (679) | - |
| Total | <u>\$3964</u> | <u>\$1300</u> | <u>\$660</u> | <u>\$(679)</u> | <u>\$5245</u> |
| Earnings (loss) before income taxes | \$ 178 | \$ 113 | \$ 24 | \$(138) | \$ 177 |
| Identifiable assets | \$1853 | \$ 598 | \$483 | \$ 122 | \$3056 |
| 1994 | | | | | |
| Net sales: | | | | | |
| To customers in the area | \$2708 | \$ 657 | \$538 | \$ - | \$3903 |
| To customers outside the area | 594 | 234 | 6 | - | 834 |
| Intergeographic transfers | 410 | 159 | 114 | (683) | - |
| Total | <u>\$3712</u> | <u>\$1050</u> | <u>\$658</u> | <u>\$(683)</u> | <u>\$4737</u> |
| Earnings (loss) before income taxes | \$ 177 | \$ 87 | \$ 44 | \$(14) | \$ 294 |
| Identifiable assets | \$1618 | \$ 499 | \$412 | \$ 177 | \$2706 |

Total sales for each geographic area are classified by manufacturing source and include sales to customers within and outside the area and intergeographic transfers. Transfer prices for sales between the Company's various operating units generally are at arm's length, based upon business conditions, distribution costs and other costs which are expected to be incurred in producing and marketing products. Corporate items include interest and other income and expense. Identifiable assets are those resources associated with the operations in each area. Corporate assets are principally cash and investments.

The Company generally sells its products on open account under credit terms customary to the region of distribution. The Company performs

ongoing credit evaluations of its customers and generally does not require collateral to secure its customers' receivables.

Net sales by marketing territory:

| Net Sales | 1996 | 1995 | 1994 |
|----------------------------|---------|---------|---------|
| United States | \$2,925 | \$3,018 | \$2,712 |
| Asia, Far East & Australia | 868 | 723 | 626 |
| Europe | 759 | 783 | 671 |
| Canada | 313 | 384 | 330 |
| Mexico & South America | 260 | 233 | 318 |
| Africa & Middle East | 132 | 104 | 80 |
| Net sales | \$5,257 | \$5,245 | \$4,737 |

NOTE 13. GUARANTEES, COMMITMENTS AND OTHER CONTINGENCIES: Accounts receivable that have been sold with recourse amounted to \$25 at December 31, 1996. Commitments under outstanding letters of credit, guarantees and contingencies approximated \$185. Based on borrowing rates currently available to the Company for bank loans with similar terms and average maturities, the fair value of total indebtedness of \$322 at December 31, 1996 was approximately \$335. The carrying values of all other receivables and liabilities approximated fair values at December 31, 1996.

The Company enters into forward exchange contracts to hedge the effects of fluctuating currency rates on certain assets and liabilities, such as accounts receivable and payable, that are denominated in other than the functional currencies of entities. The contracts typically provide for the exchange of different currencies at specified future dates and rates. The gain or loss due to the difference between the forward exchange rates of the contracts and current rates offsets in whole or in part the loss or gain on the assets or liabilities being hedged. The Company had \$214 of contracts outstanding at December 31, 1996, which mature in 1997 and are denominated in a variety of foreign currencies where the Company does business.

Commodity swap contracts at December 31, 1996 amounted to \$35 and have the effect of fixing the Company's cost of certain future material purchases. These contracts mature through 1998. Gains or losses on the contracts are reflected in earnings concurrently with the hedged items.

Cummins and its subsidiaries are defendants in a number of pending legal actions, including actions relating to use and performance of the Company's products. The Company carries product liability insurance covering significant claims for damages involving personal injury and property damage. In the event the Company is determined to be liable for damages in connection with such actions and proceedings, the unreserved and uninsured portion of such liability is not expected to be material. The Company also has been identified as a potentially responsible party at several waste disposal sites under US and related state environmental statutes and regulations. The Company denies liability with respect to many of these legal actions and environmental proceedings and vigorously is defending such actions or proceedings. The Company has established reserves which it believes are adequate for its expected future liability in such actions and proceedings where the nature and extent of such liability can be estimated reasonably based upon presently available information.

NOTE 14. QUARTERLY FINANCIAL DATA (unaudited):

| | First Quarter | Second Quarter | Third Quarter | Fourth Quarter | Full Year |
|--------------------|------------------|-------------------|------------------|-------------------|--------------|
| 1996 | | | | | |
| Net sales | \$1,316 | \$1,316 | \$1,264 | \$1,361 | \$5,257 |
| Gross profit | 316 | 300 | 270 | 299 | 1,185 |
| Net earnings | 49 | 44 | 26 | 41 | 160 |
| Earnings per share | \$ 1.21 | \$ 1.10 | \$.67 | \$ 1.03 | \$ 4.01 |
| 1995 | | | | | |
| Net sales | \$1,334 | \$1,361 | \$1,219 | \$1,331 | \$5,245 |
| Gross profit | 343 | 340 | 277 | 311 | 1,271 |
| Net earnings | 67 | 69 | 46 | 42 | 224 |
| Earnings per share | \$ 1.63 | \$ 1.69 | \$ 1.14 | \$ 1.05 | \$ 5.52 |

Included in net earnings in the fourth quarter of 1995 was a restructuring charge of \$116 (\$76 after taxes). There also was a tax credit of \$68. Net earnings for 1995 included restructuring charges of \$118 (\$77 after taxes.)

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CUMMINS ENGINE COMPANY, INC.

| | | |
|-----------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------|--|
| By /s/K. M. Patel <hr style="width: 100%;"/> K. M. Patel Vice President and Chief Financial Officer (Principal Financial Officer) | By /s/John McLachlan <hr style="width: 100%;"/> John McLachlan Vice President - Corporate Controller (Principal Accounting Officer) | |
|-----------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------|--|

Date: March 1, 1997

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

| Signatures | Title | Date |
|----------------------------------------------------------|-------------------------------------------------------------------------------------------------------------|--------|
| * <hr style="width: 100%;"/> (James A. Henderson) | Director & Chairman of the Board of Directors & Chief Executive Officer (Principal Executive Officer) | 3/1/97 |
| * <hr style="width: 100%;"/> (Theodore M. Solso) | Director and President & Chief Operating Officer | 3/1/97 |
| * <hr style="width: 100%;"/> (Harold Brown) | Director | 3/1/97 |
| * <hr style="width: 100%;"/> (Robert J. Darnall) | Director | 3/1/97 |
| * <hr style="width: 100%;"/> (W. Y. Elisha) | Director | 3/1/97 |
| * <hr style="width: 100%;"/> (Hanna H. Gray) | Director | 3/1/97 |
| * <hr style="width: 100%;"/> (J. Irwin Miller) | Director | 3/1/97 |
| * <hr style="width: 100%;"/> (William I. Miller) | Director | 3/1/97 |
| * <hr style="width: 100%;"/> (Donald S. Perkins) | Director | 3/1/97 |
| * <hr style="width: 100%;"/> (William D. Ruckelshaus) | Director | 3/1/97 |
| * <hr style="width: 100%;"/> (H. B. Schacht) | Director | 3/1/97 |
| * <hr style="width: 100%;"/> (F. A. Thomas) | Director | 3/1/97 |
| * <hr style="width: 100%;"/> (J. Lawrence Wilson) | Director | 3/1/97 |

By /s/Mark R. Gerstle

Mark R. Gerstle
Attorney-in-fact

CUMMINS ENGINE COMPANY, INC.
EXHIBIT INDEX

- 3(a) Restated Articles of Incorporation of Cummins Engine Company, Inc., as amended (incorporated by reference to Quarterly Report on Form 10-Q for the quarter ended April 3, 1994, by reference to Quarterly Report on Form 10-Q for the quarter ended October 1, 1989 and by reference to Form 8-K dated July 26, 1990).
- 3(b) By-laws of Cummins Engine Company, Inc., as amended and restated effective as of August 12, 1994 (incorporated by reference to Quarterly Report on Form 10-Q for the quarter ended October 2, 1994).
- 4(a) Amended and Restated Credit Agreement (incorporated by reference to Quarterly Report on Form 10-Q for the quarter ended June 30, 1996).
- 4(b) Rights Agreement, as amended (incorporated by reference to Annual Report on Form 10-K for the year ended December 31, 1989, by reference to Form 8-K dated July 26, 1990, by reference to Form 8 dated November 6, 1990, by reference to Form 8-A/A dated November 1, 1993, and by reference to Form 8-A/A dated January 12, 1994 and by reference to Form 8-A/A dated July 15, 1996).
- 10(a) Target Bonus Plan (filed herewith).
- 10(b) Deferred Compensation Plan (incorporated by reference to Annual Report on Form 10-K for the year ended December 31, 1994).
- 10(c) Key Employee Stock Investment Plan, as amended (incorporated by reference to Quarterly Report on Form 10-Q for the quarter ended July 3, 1994).
- 10(d) Supplemental Life Insurance and Deferred Income Plan (filed herewith).
- 10(e) Financial Counseling Program, (incorporated by reference to Quarterly Report on Form 10-Q for the quarter ended July 3, 1994).
- 10(f) 1986 Stock Option Plan (incorporated by reference to Quarterly Report on Form 10-Q for the quarter ended March 30, 1986).
- 10(g) Deferred Compensation Plan for Non-Employee Directors, as amended, effective as of April 15, 1994 (incorporated by reference to Annual Report on Form 10-K for the year ended December 31, 1994).
- 10(h) Key Executive Compensation Protection Plan (incorporated by reference to Quarterly Report on Form 10-Q for the quarter ended October 2, 1994).
- 10(i) Excess Benefit Retirement Plan, (incorporated by reference to Quarterly Report on Form 10-Q for the quarter ended October 2, 1994).
- 10(j) Restated Sponsors Agreement between Case Corporation and Cummins Engine Company, Inc., dated December 7, 1990, together with the Restated Partnership Agreement between Case Engine Holding Company, Inc., and Cummins Engine Holding Company, Inc., dated December 7, 1990 (incorporated by reference to Annual Report on Form 10-K for the year ended December 31, 1990).
- 10(k) Retirement Plan for Non-Employee Directors of Cummins Engine Company, Inc., effective September 1989 (incorporated by reference to Quarterly Report on Form 10-Q for the quarter ended April 2, 1995).

- 10(l) Stock Unit Appreciation Plan effective October 1990 (incorporated by reference to Quarterly Report on Form 10-Q for the quarter ended April 2, 1995).
- 10(m) Three Year Performance Plan effective December 1992 (incorporated by reference to Quarterly Report on Form 10-Q for the quarter ended April 2, 1995).
- 10(n) Consulting arrangement with Harold Brown (incorporated by reference to the description thereof provided in the Company's definitive Proxy Statement).
- 10(o) 1992 Stock Incentive Plan (incorporated by reference to Annual Report on Form 10-K for the year ended December 31, 1995).
- 10(p) Restricted Stock Plan for Non-Employee Directors (incorporated by reference to Quarterly Report on Form 10-Q for the quarter ended April 3, 1994).
- 10(q) Executive Retention Plan (incorporated by reference to Annual Report on Form 10-K for the year ended December 31, 1995).
- 10(r) Performance Share Plan, as amended January 1989 (incorporated by reference to Quarterly Report on Form 10-Q for the quarter ended April 2, 1995).
- 10(s) Senior Executive Bonus Plan (filed herewith).
- 10(t) Senior Executive Three Year Performance Plan (incorporated by reference to Quarterly Report on Form 10-Q for the quarter ended April 2, 1995).
- 10(u) Guarantees of Perpetual Loan Facility of Cummins Finance Limited dated January 31, 1996 with the Toronto Dominion Bank, The Bank of New York and Societe Generale (incorporated by reference to Quarterly Report on Form 10-Q for the quarter ended June 30, 1996).
- 11 Schedule of Computation of Per Share Earnings for each of the Three Years Ended December 31, 1996 (filed herewith).
- 21 Subsidiaries of the Registrant (filed herewith).
- 23 Consent of Arthur Andersen LLP (filed herewith).
- 24 Powers of Attorney (filed herewith).
- 27 Financial Data Schedule (filed herewith).

CUMMINS ENGINE COMPANY, INC.
SENIOR EXECUTIVE BONUS PLAN

(Amended as of December 10, 1996)

1. Purpose. The Senior Executive Bonus Plan is designed to: (i) reinforce the financial objectives of the Company in the minds of senior executives; (ii) attain and maintain a leadership position for the Company in its method of compensating its senior executives consistent with the relative size of the Company, the industry in which the Company competes and the relative performance of its senior executives; (iii) recognize the performance of the Company as a whole, maximizing the contributions of the Company's various businesses; and (iv) reward both team and individual performance. The Plan is an incentive plan providing compensation that varies with the financial results of the Company.

2. Philosophy. Bonus payments should relate to the importance of the executive's position in influencing Company performance, the financial performance of the Company during a quarter and the performance of the individual during that quarter. Bonus payments should encourage and promote outstanding decisions and efforts by senior executives for the benefit of the Company.

3. Definitions.

- a) "Base Salary" means the salary paid to a Participant during a Quarter, exclusive of allowances, incentive pay, reimbursed expenses, fringe benefits and other similar forms of payment.
- b) "Compensation Committee" or "Committee" means the Compensation Committee of the Board of Directors of the Company.
- c) "Company" means Cummins Engine Company, Inc.
- d) "Participant" means the Company's Chief Executive Officer and other executive officers designated by the Compensation Committee.
- e) "Performance Measure" means the Company's return on equity, return on sales, net income, sales growth, return on assets, total shareholder return or a combination thereof.
- f) "Plan" means the Senior Executive Bonus Plan described herein.
- g) "Plan Year" means the Company's fiscal year, provided however, that the first Plan Year includes only three Quarters beginning April 3, 1995.
- h) "Quarter" means a fiscal quarter of the Company.
- i) "Target Bonus" means an incentive bonus amount described in Section 7 of the Plan.
- j) "Target Bonus Percentage" means a percentage of the Participant's Base Salary intended to be paid as a Target Bonus under the Plan.

4. Eligibility. The Compensation Committee shall designate the Participants each Plan Year and establish the Target Bonus Percentage applicable to each Participant. The Committee shall have the power to change the Target Bonus Percentage of a Participant or remove one or more Participants from the Plan, provided, however, that the percentage shall not be increased following the commencement of any period for which a Target Bonus may be earned.

5. Target Bonus Percentage. On or before the 20th day of each Quarter during which a Target Bonus may be earned, each Participant will be informed of his or her applicable Target Bonus Percentage. The Target Bonus Percentage assigned to each Participant by the Committee shall be based on various criteria applicable to the Participant including, but not limited to: (i) the scope and breadth of the Participant's management position; (ii) opportunity for independent thought and action; (iii) effect on the Company's financial performance; (iv) role in decision-making; (v) working relationships within the Company; and (vi) the level of compensation prevailing in the industry in which the Company competes.

6. Bonus Payout Schedule. On or before the 20th day of each Plan Year, a Bonus Payout Schedule will be calculated by the Committee and communicated to Participants. The Bonus Payout Schedule will specify the Performance Measure and the performance level against the measure during the Quarter required to achieve each payout factor ("Bonus Factor"). In addition to specifying the Performance Measure, the Committee may, in its discretion, specify that up to 20 percent of the determination of each Bonus Factor also be based upon achieving certain other financial or nonfinancial goals and objectives. The "Target Performance" is that performance which provides a 1.0 bonus factor.

7. Target Bonus. A Target Bonus is calculated for each Participant by multiplying Base Salary times the Target Bonus Percentage designated for the Participant.

8. Earned Bonus. Performance during the Quarter in excess of the Target Performance or performance less than the Target Performance will result in an increased or diminished bonus, respectively, from the Target Bonus communicated to the Participant. The "Earned Bonus" will be calculated by multiplying the Target Bonus Percentage times the Participant's Base Salary times the Bonus Factor associated with the actual performance for that Quarter as specified in the Bonus Payout Schedule in effect for the Plan Year containing the Quarter. In no event may a Participant receive an Earned Bonus for any Quarter in excess of \$750,000.

9. Change in Accounting Standards. For purposes of determining the Bonus Factor, the Company's actual performance under the Performance Measure will exclude extraordinary charges and credits which result from a change in accounting standards of the Company.

10. Adjustment for Individual Performance. The Earned Bonus will be the bonus paid, except in unusual circumstances where poor individual performance justifies a reduced bonus.

11. Termination of Employment. During any Quarter that a Participant's employment is voluntarily or involuntarily terminated, including termination due to death, disability or retirement, the amount of the Earned Bonus for that Quarter will be paid to the Participant or his or her legal representative or estate, whichever is applicable.

12. Bonus Distribution Date. Any Earned Bonus will be distributed as soon as practicable following the determination of actual performance and written certification by the Compensation Committee that the performance level with respect to a bonus payable to the Participant has been met. In general, the Earned Bonus will be distributed approximately six (6) weeks following the end of the Quarter in which earned, provided, however, payments under the Plan may be deferred pursuant to the Company's Deferred Compensation Plan.

13. Administration. The Plan shall be administered by the Compensation Committee. No member of the Committee shall be eligible to receive a bonus under this Plan while serving on the Committee. The Committee shall have authority to interpret the Plan and to establish, amend and rescind rules and regulations for the administration of the Plan, and all such interpretations, rules and regulations shall be conclusive and binding on all persons. Notwithstanding any other provision of the Plan to the contrary, the Committee may impose such conditions on participation in and bonuses under the Plan as it deems appropriate.

14. Effective Date. The Plan shall be effective for Quarters beginning April 3, 1995, subject to its approval by the Company's shareholders.

15. Amendment and Termination. The Board of Directors may at any time amend, modify, alter or terminate this Plan.

16. Governing Law. This Plan and all determinations made and actions taken pursuant hereto shall be governed by the laws of the State of Indiana and construed accordingly.

17. Miscellaneous. There shall be no bonus pool or cumulative bonus pool. This Plan is based upon the number of Participants, the Target Bonus Percentages, the Bonus Factors and the Base Salaries of the Participants.

CUMMINS ENGINE COMPANY, INC.
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EXHIBIT 11

CUMMINS ENGINE COMPANY, INC.
 SCHEDULE OF COMPUTATION OF PER SHARE EARNINGS
 FOR EACH OF THE THREE YEARS ENDED DECEMBER 31, 1996

| Millions, Except per Share Data | Weighted Average Shares | Net Earnings | Calculated Per Share |
|-----------------------------------------------------|-------------------------------|-----------------|-------------------------|
| <hr/> | | | |
| 1996 | | | |
| <hr/> | | | |
| Earnings available for common stock shareholders | 39.7 | \$160 | \$4.02 |
| Options | .1 | - | |
| | <hr/> | <hr/> | |
| Primary and fully diluted earnings per share | 39.8 | \$160 | \$4.01 |
| | <hr/> | <hr/> | |
| 1995 | | | |
| <hr/> | | | |
| Earnings available for common stock shareholders | 40.6 | \$224 | \$5.53 |
| Options | .1 | - | |
| | <hr/> | <hr/> | |
| Primary and fully diluted earnings per share | 40.7 | \$224 | \$5.52 |
| | <hr/> | <hr/> | |
| 1994 | | | |
| <hr/> | | | |
| Earnings available for common stock shareholders | 41.2 | \$253 | \$6.14 |
| Options | .2 | - | |
| | <hr/> | <hr/> | |
| Primary and fully diluted earnings per share | 41.4 | \$253 | \$6.11 |
| | <hr/> | <hr/> | |

CUMMINS ENGINE COMPANY, INC.

SUBSIDIARIES OF THE REGISTRANT

| Subsidiary/Joint Venture | State or Country of Incorporation |
|----------------------------------------------|-----------------------------------|
| A. E. Goetze, Inc. -- Flowery Branch, LLC | Delaware |
| A. F. Shane Company | Pennsylvania |
| Aggregatebau GmbH | Germany |
| Agreba Aggregatebau GmbH & Co. KG | Germany |
| Agreba Beteiligungs GmbH | Germany |
| Atlas Crankshaft Corporation | Ohio |
| Autofield Engineers Private Limited | India |
| Auto Diesels Power Plant Limited | United Kingdom |
| Behr America, Inc. | Delaware |
| Behr Climate Systems, Inc. | New Jersey |
| Behr Gmgh | |
| Behr Heat Transfer Systems, Inc. | Delaware |
| Cadec Systems, Inc. | Indiana |
| Cal Disposition, Inc. | California |
| C. E. Sonora S.A. de C.V. | Mexico |
| C. G. Newage Electrical, Ltd. | India |
| Chongqing Cummins Engine Company, Ltd. | China |
| CNE S/A Industrial | Brazil |
| Combustion Technologies, Inc. | Indiana |
| Consolidated Diesel Company | North Carolina |
| Consolidated Diesel, Inc. | Delaware |
| Consolidated Diesel of North Carolina, Inc. | North Carolina |
| Cummins Americas, Inc. | Indiana |
| Cummins Australia Pty. Limited | Australia |
| Cummins Brasil, S.A. Ltda. | Brazil |
| Cummins British Columbia | Canada |
| Cummins Corporation | Indiana |
| Cummins de Colombia, S.A. | Colombia |
| Cummins Diesel Deutschland GmbH | Germany |
| Cummins Diesel Export Limited | Barbados |
| Cummins Diesel of Canada Limited | Canada |
| Cummins Diesel International Limited | Barbados |
| Cummins Diesel Italia S.P.A. | Italy |
| Cummins Diesel (Japan) Ltd. | Japan |
| Cummins Diesel Limited | Canada |
| Cummins Diesel N.V. | Belgium |
| Cummins Diesel Sales Corporation | Indiana |
| Cummins Diesel Sales & Service Co., Ltd. | Korea |
| Cummins Diesel Sales & Service, Ltd. (India) | India |
| Cummins Engine (Beijing) Co., Ltd. | China |
| Cummins Engine Company Limited | New Zealand |
| Cummins Engine Company Limited | United Kingdom |
| Cummins Engine H.K. Limited | Hong Kong |
| Cummins Engine Holding Company, Inc. | Indiana |
| Cummins Engine (Singapore) Pte. Ltd. | Singapore |
| Cummins Engine Venture Corporation | Indiana |
| Cummins Financial, Inc. | Delaware |
| Cummins Finance Limited | United Kingdom |
| Cummins Funding Corporation | Delaware |
| Cummins France EURL | France |
| Cummins Great Lakes, Inc. | Indiana |
| Cummins India Holdings Limited | India |
| Cummins International Finance Corporation | Delaware |
| Cummins KH-12, Inc. | Delaware |
| Cummins Komatsu Engine Company | Indiana |
| Cummins Korea, Ltd. | Korea |
| Cummins Mexicana, S.A. de C.V. | Mexico |
| Cummins Military Systems Company | Delaware |
| Cummins Nordeste, S.A. | Brazil |
| Cummins Power Generation, Inc. | Indiana |
| Cummins Professional Training Center, Inc. | Delaware |
| Cummins Research Limited Partnership | United States |
| Cummins S.A. de C.V. | Mexico |
| Cummins Ten Holdings Inc. | |
| Cummins U.K. Limited | United Kingdom |
| Cummins Venture Corporation | Delaware |
| Cummins Wartsila Engine Company, G.E.I.E. | France |
| Cummins Wartsila Engine Company, S.A.S. | France |
| Cummins Zimbabwe Pvt. Ltd. | Zimbabwe |
| Dampers Iberica, S.A. | Spain |
| Dampers, S.A. | France |

| | |
|-------------------------------------------------------|-----------------|
| Diesel Credit Services | United Kingdom |
| Diesel ReCon de Mexico, S.A. de C.V. | Mexico |
| Diesel ReCon Industria e Comercio Ltda. | Brazil |
| Dongfeng Cummins Engine Company Ltd. | China |
| Empresas Cummins S.A. de C.V. | Mexico |
| Enceratec, Inc. | Maryland |
| Engine Systems Limited | Pakistan |
| European Engine Alliance EEIG | |
| Fleetguard Commercial S.A. de C.V. | Mexico |
| Fleetguard Filtration Systems, India Pvt. Ltd. | India |
| Fleetguard GmbH | Germany |
| Fleetguard, Inc. | Indiana |
| Fleetguard Mexico S.A. de C.V. | Mexico |
| Fleetguard SNC | France |
| Getrag Precision Gear Company, LLC | Delaware |
| Hodek Engineering Co. Ltd. | India |
| Holset Brasil Equipamentos Automotores Ltda. | Brazil |
| Holset Engineering Company, Inc. | Indiana |
| Holset Engineering Company Limited | United Kingdom |
| Holset Korea Ltd. | Korea |
| Holset SNC | France |
| HPI Company | Indiana |
| Hyperbar USA, Inc. | Indiana |
| Industria e Comercio Cummins Ltda. | Brazil |
| Integrated Distribution Systems, Inc. | Delaware |
| KamDizel | Russia |
| K.B.B. GmbH | Germany |
| Kirloskar-Cummins Limited | India |
| Komatsu Cummins Engine Co., Ltd. | Japan |
| Komatsu, Ltd. | |
| Kompressorenban Bannewitz GmbH | Germany |
| Kuss Corporation | Ohio |
| Kuss SNC | France |
| Logstrup Modular Systems PTE, Limited | Singapore |
| Lubricant Consultants, Inc. | New Jersey |
| Markon Engineering Company Ltd. | United Kingdom |
| MHTC Corporation | Delaware |
| Motores Cummins Diesel do Brazil, Ltda. | Brazil |
| Muenchworks Limited | Canada |
| NAP Accoustics South East Asia PTE, Limited | Singapore |
| Newage Engineers Pty. Ltd. | Australia |
| Newage Equipment Ltd. | Canada |
| Newage (Far East) Pte. Ltd. | Singapore |
| Newage International Limited | United Kingdom |
| Newage Italia S.R.L. | Italy |
| Newage Ltd. (UK) | United Kingdom |
| Newage Ltd. (US) | Pennsylvania |
| Newage Machine Tools Limited | United Kingdom |
| Newage Norge | Norway |
| Newage Pension Trustees Limited | |
| Newage Staff Pension Trustees Limited | |
| No. 379 Taurus Ventures Ltd. | Canada |
| Northwest Dieselguard Limited | Canada |
| Nu-Plant Service Limited | United Kingdom |
| Ona Corporation | Alabama |
| Onan Australia Pty. Limited | Australia |
| Onan Canada Limited | Canada |
| Onan Corporation | Delaware |
| Onan Foreign Holdings, Ltd. | Delaware |
| Onan FSC Limited | Jamaica |
| Onan International B.V. | The Netherlands |
| Onan International Limited | United Kingdom |
| Onan New York, Inc. | New York |
| Pacific World Trade, Inc. | Indiana |
| Park Avenue Limited Partnership | United States |
| Petbow Custom Generators Limited | United Kingdom |
| Petbow Far East PTE, Limited | Singapore |
| Petbow Limited | United Kingdom |
| Petbow Pacific Limited | Hong Kong |
| Petbow Power Projects Limited | United Kingdom |
| Petbow S.A. | France |
| Petbow Welding Products Limited | United Kingdom |
| PGI Manufacturing Limited | United Kingdom |
| PGI (UK Holdings) Limited | United Kingdom |
| PGI (Overseas Holdings) B.V. | The Netherlands |
| Poona Couplings, Ltd. | India |
| Power Generation International Limited | United Kingdom |
| Power Group International (Overseas Holdings) Limited | United Kingdom |
| Precise Power Corporation | Florida |
| PT Newage Engineers Indonesia | Indonesia |
| Shanghai Fleetguard Filter Co., Ltd. | China |
| Stamford Iberica | Spain |
| Tata Cummins Ltd. | India |
| TATA Holset Private Limited | India |
| TATA Engineering Locomotive Company Limited | |

| | |
|-----------------------------------------|----------|
| TATA Exports Limited | |
| TATA Industries Limited | |
| Techniparts S.A. | France |
| Turbo Europa, B.V. | Holland |
| Wabco Compressor Manufacturing Company | Delaware |
| Wuxi Electrical & Machinery Group | |
| Wuxi Engine Works | |
| Wuxi Holset Engineering Company Limited | China |
| Wuxi Newage Alternators Ltd. | |
| 124747 Canada Limited | Canada |
| 14-15 Corporation | Nevada |

CONSENT OF INDEPENDENT PUBLIC ACCOUNTANTS

As independent public accountants, we hereby consent to the incorporation of our report, included in this Form 10-K, into the Company's previously filed Registration Statement File Nos. 2-32091, 2-53247, 2-58696, 33-2161, 33-8842, 33-31095, 33-37690, 33-46096, 33-46097, 33-46098, 33-50665, 33-56115 and 333-2165.

ARTHUR ANDERSEN LLP

Chicago, Illinois
March 3, 1997.

CUMMINS ENGINE COMPANY, INC.
POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that the undersigned hereby constitutes and appoints Mark R. Gerstle with full power to act without the other as his true and lawful attorney-in-fact and agent, with full and several powers of substitution and resubstitution for him in his name, place and stead, in any and all capacities, to sign the Annual Report on Form 10-K of Cummins Engine Company, Inc. ("the Company") for the Company's fiscal year ended December 31, 1996 and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing requisite and necessary to be done in and about the premises, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents or any of them, or their or his substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

Dated: March 1, 1997

/s/James A. Henderson

James A. Henderson
Director & Chairman of the
Board and Chief Executive
Officer

CUMMINS ENGINE COMPANY, INC.
POWER OF ATTORNEY

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Dated: March 1, 1997

/s/Theodore M. Solso

Theodore M. Solso
Director & President and
Chief Operating Officer

CUMMINS ENGINE COMPANY, INC.
POWER OF ATTORNEY

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Dated: March 1, 1997

/s/Harold Brown

Harold Brown
Director

CUMMINS ENGINE COMPANY, INC.
POWER OF ATTORNEY

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Dated: March 1, 1997

/s/Robert J. Darnall

Robert J. Darnall
Director

CUMMINS ENGINE COMPANY, INC.
POWER OF ATTORNEY

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Dated: March 1, 1997

/s/W. Y. Elisha

W. Y. Elisha
Director
CUMMINS ENGINE COMPANY, INC.
POWER OF ATTORNEY

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Dated: March 1, 1997

/s/Hanna H. Gray

Hanna H. Gray
Director
CUMMINS ENGINE COMPANY, INC.
POWER OF ATTORNEY

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Dated: March 1, 1997

/s/J. Irwin Miller

J. Irwin Miller
Director
CUMMINS ENGINE COMPANY, INC.
POWER OF ATTORNEY

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Dated: March 1, 1997

/s/William I. Miller

William I. Miller
Director

CUMMINS ENGINE COMPANY, INC.
POWER OF ATTORNEY

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Dated: March 1, 1997

/s/Donald S. Perkins

Donald S. Perkins
Director

CUMMINS ENGINE COMPANY, INC.
POWER OF ATTORNEY

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Dated: March 1, 1997

/s/William D. Ruckelshaus

William D. Ruckelshaus
Director

CUMMINS ENGINE COMPANY, INC.

POWER OF ATTORNEY

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Dated: March 1, 1997

/s/H. B. Schacht

H. B. Schacht
Director

CUMMINS ENGINE COMPANY, INC.
POWER OF ATTORNEY

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Dated: March 1, 1997

/s/F. A. Thomas

F. A. Thomas
Director

CUMMINS ENGINE COMPANY, INC.
POWER OF ATTORNEY

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Dated: March 1, 1997

/s/J. Lawrence Wilson

J. Lawrence Wilson
Director

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