

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d)  
of the Securities Exchange Act of 1934

CUMMINS ENGINE COMPANY, INC.

For the Quarter Ended September 28, 1997      Commission File Number 1-4949

Indiana      35-0257090  
(State or Other Jurisdiction of      (IRS Employer Identification No.)  
Incorporation or Organization)

500 Jackson Street, Box 3005,  
Columbus, Indiana      47202-3005  
(Address of Principal Executive Offices)      (Zip Code)

812-377-5000  
(Registrant's Telephone Number)

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 proceeding 12 months and (2) has been subject to such filing requirements for the past 90 days:

Yes   
No

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date:

As of September 28, 1997, the number of shares outstanding of the registrant's only class of common stock was 41.9 million.

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CUMMINS ENGINE COMPANY, INC.  
CONSOLIDATED STATEMENT OF EARNINGS  
FOR THE THIRD QUARTER AND NINE MONTHS ENDED  
SEPTEMBER 28, 1997 AND SEPTEMBER 29, 1996

Unaudited

Millions, Except per Share Amounts	Third Quarter		Nine Months	
	1997	1996	1997	1996
Net sales	\$1,366	\$1,264	\$4,066	\$3,896
Cost of goods sold	1,057	994	3,147	3,010
Gross profit	309	270	919	886
Selling & administrative expenses	181	177	545	537
Research & engineering expenses	64	60	189	188
Net (income) expense from joint ventures and alliances	(3)	1	(12)	6
Interest expense	5	5	17	13
Other income, net	(7)	(4)	(19)	(22)
Earnings before income taxes	69	31	199	164
Provision for income taxes	15	5	51	45
Net earnings	\$ 54	\$ 26	\$ 148	\$ 119
Earnings per share	\$ 1.40	\$ .67	\$ 3.85	\$ 2.99
Cash dividends declared per share	.275	.25	.80	.75

CUMMINS ENGINE COMPANY, INC.  
CONSOLIDATED STATEMENT OF FINANCIAL POSITION

Unaudited

Millions, Except per Share Amounts	9/28/97	12/31/96
Assets		
Current assets:		
Cash and cash equivalents	\$ 61	\$ 108
Receivables	814	669
Inventories	634	587
Other current assets	200	189
	1,709	1,553
Investments and other assets	336	326
Property, plant and equipment less accumulated depreciation of \$1,388 & \$1,375	1,424	1,286
Intangibles, deferred taxes and deferred charges	210	204
Total assets	\$3,679	\$3,369
Liabilities and shareholders' investment		
Current liabilities:		
Loans payable	\$ 34	\$ 93
Current maturities of long-term debt	45	39
Accounts payable	402	380
Other current liabilities	560	509
	1,041	1,021
Long-term debt	538	283
Other liabilities	758	753

Shareholders' investment:		
Common stock, \$2.50 par value, 47.8 and 43.9 shares issued	119	110
Additional contributed capital	1,099	929
Retained earnings	649	535
Common stock in treasury, at cost, 5.9 & 4.5 shares	(236)	(169)
Common stock held in trust for employee benefit plans, 3.7 shares	(177)	-
Unearned compensation (ESOP)	( 42)	(46)
Cumulative translation adjustments	( 70)	(47)
	<u>1,342</u>	<u>1,312</u>
Total liabilities & shareholders' investment	<u>\$3,679</u>	<u>\$3,369</u>

CUMMINS ENGINE COMPANY, INC.  
CONSOLIDATED STATEMENT OF CASH FLOWS

Unaudited

Millions	Nine Months Ended 9/28/97	9/29/96
Cash flows from operating activities:		
Net earnings	\$ 148	\$ 119
Adjustments to reconcile net earnings to net cash from operating activities:		
Depreciation and amortization	118	111
Restructuring actions	( 15)	( 36)
Accounts receivable	(174)	(125)
Inventories	( 63)	(106)
Accounts payable and accrued expenses	62	77
Income taxes payable	11	11
Other	( 5)	( 5)
Total adjustments	<u>( 66)</u>	<u>(73)</u>
Net cash provided by operating activities	<u>82</u>	<u>46</u>
Cash flows from investing activities:		
Property, plant and equipment:		
Additions	(298)	(151)
Disposals	14	30
Investments in joint ventures & alliances	(10)	32
Disposition of business activities	79	13
Other	(13)	8
Net cash used in investing activities	<u>(228)</u>	<u>( 68)</u>
Net cash flows used for operating and investing activities	<u>(146)</u>	<u>( 22)</u>
Cash flows from financing activities:		
Proceeds from borrowings	281	160
Payments on borrowings	( 17)	( 14)
Net payments under credit agreements	( 57)	( 41)
Repurchase of common stock	( 66)	( 34)
Dividend payments	( 34)	( 30)
Other	( 7)	( 1)
Net cash provided from financing activities	<u>100</u>	<u>40</u>
Effect of exchange rate changes on cash	( 1)	1
Net change in cash and cash equivalents	<u>(47)</u>	<u>19</u>
Cash & cash equivalents at beginning of year	108	60
Cash & cash equivalents at the end of quarter	<u>\$ 61</u>	<u>\$ 79</u>

CUMMINS ENGINE COMPANY, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Accounting Policies: The Consolidated Financial Statements for the interim periods ended September 28, 1997 and September 29, 1996 have been prepared in accordance with the accounting policies described in the Company's Annual Report to Shareholders and Form 10-K. Management believes the statements include all adjustments of a normal recurring nature necessary to present fairly the results of operations for the interim periods. Inventory values at interim reporting dates are based upon estimates of the annual adjustments for taking physical inventory and for the change in cost of LIFO inventories.

Note 2. Income Taxes: Income tax expense is reported during the interim reporting periods on the basis of the estimated annual effective tax rate for the taxable jurisdictions in which the Company operates.

Note 3. Long-term Debt: In February 1997, the Company issued \$120 million of 6.75 percent debentures that mature in 2027. Net proceeds were used principally to repay commercial paper indebtedness incurred to repurchase shares of common stock. Holders of the debentures have a 1-time option in 2007 to redeem the debentures. The Company also has a recall right after ten years.

In July 1997, the Company filed a Shelf Registration Statement with the Securities and Exchange Commission in the amount of \$250 million to issue from time to time debt securities, preferred stock, preference stock, common stock or warrants at prices and on terms to be determined at the time of sale.

Note 4. Common Stock: In January 1997, the Company issued 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 are not 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 repurchased 1.3 million shares of its common stock from Ford Motor Company in January 1997 and was authorized by the Board of Directors to repurchase an additional 1.7 million shares from time to time in the open market. In the third quarter of 1997, the Company repurchased 110,000 shares of common stock for \$9 million, or \$78.71 average price per share.

In April 1997, the Company announced an increase in its quarterly common stock dividend from 25 cents per share to 27.5 cents, effective with the dividend payment in June 1997.

Note 5. Earnings per Share: Earnings per share of common stock are computed by dividing net earnings by the weighted-average number of common shares outstanding during the period. The weighted-average number of shares, which excludes shares of stock held by the employee benefits trust until distributed and allocated to a benefit plan, was 38.5 million in the third quarter of 1997 and 38.4 million for the nine-month period of 1997. The weighted-average number of shares was 39.6 million in the third quarter of 1996 and 40.0 million shares in the first nine months of 1996. The Financial Accounting Standards Board has released a new accounting rule on the calculation of earnings per share that is effective at year-end 1997. This rule, which does not permit early adoption, is not expected to have a material effect on the Company's reported earnings per share.

CUMMINS ENGINE COMPANY, INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS,  
CASH FLOW AND FINANCIAL CONDITION

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#### OVERVIEW

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The Company's revenues of \$1.37 billion were a third-quarter record, 8 percent higher than the year-ago quarter and only 2 percent lower than Cummins' quarterly record in the second quarter of 1997. The increase was primarily due to strong sales to industrial markets and improvements in North American truck markets. For the first nine months, the Company's sales were \$4.1 billion, 4 percent higher than the first nine months of 1996.

Net earnings were \$54 million, or \$1.40 per share, in the third quarter of 1997, more than double the third quarter of 1996. This was the third consecutive quarter of higher earnings and the second consecutive

quarter in which the Company's net earnings have exceeded the year-ago quarter. For the first nine months of 1997, net earnings were \$148 million, or \$3.85 per share, compared to \$119 million, or \$2.99 per share, in the first nine months of 1996.

#### RESULTS OF OPERATIONS

The percentage relationships between net sales and other elements of the Company's Consolidated Statement of Earnings for the comparative reporting periods were:

Percent of Net Sales	Third Quarter		Nine Months	
	1997	1996	1997	1996
Net sales	100.0	100.0	100.0	100.0
Cost of goods sold	77.4	78.6	77.4	77.3
Gross profit	22.6	21.4	22.6	22.7
Selling and administrative expenses	13.2	14.0	13.4	13.8
Research and engineering expenses	4.7	4.7	4.6	4.8
Net (income) expense from joint ventures and alliances	(.2)	.1	(.3)	.2
Interest expense	.3	.4	.4	.3
Other income, net	(.5)	(.3)	(.4)	(.6)
Earnings before income taxes	5.1	2.5	4.9	4.2
Provision for income taxes	1.1	.4	1.3	1.1
Net earnings	4.0	2.1	3.6	3.1

#### Net Sales

The Company's sales are diversified across geographic regions and with a broad set of markets. Sales for each of the Company's markets for the comparative reporting periods were:

Dollars in Millions	Third Quarter		Nine Months	
	1997	1996	1997	1996
Automotive	\$ 646	\$ 569	\$1,870	\$1,868
Power generation	289	314	866	874
Industrial	245	203	765	614
Filtration, turbochargers and company-owned distributors	186	178	565	540
Net sales	\$1,366	\$1,264	\$4,066	\$3,896

Revenues from sales of engines, which generally represent 55 to 60 percent of the Company's net sales, were approximately 16 percent higher than in the third quarter of 1996. Sales of other products, which make up the remainder of Cummins' revenues, were essentially level with the third quarter of 1996.

Engine shipments were 21 percent higher than the third quarter of 1996, reflecting a shift from heavy-duty to midrange engines for industrial markets. Year-to-date, the Company has shipped over 265,000 engines, with almost 30 percent of these outside the United States.

Engine Shipments	Third Quarter		Nine Months	
	1997	1996	1997	1996
Midrange	64,800	52,500	190,600	176,100
Heavy-duty	23,400	19,700	67,100	66,200
High-horsepower	2,600	2,700	7,500	7,100
Total	90,800	74,900	265,200	249,400

Engine revenues and unit shipments for the heavy-duty truck market were approximately 25 percent higher than the third quarter of 1996 due to the improvement in the North American market and to stronger demand in Mexico in 1997. For the medium-duty truck market, engine revenues and shipments were approximately 35 percent higher than the third quarter of 1996 due to a higher level of shipments to Ford. In the bus and light commercial vehicle market, engine revenues and shipments were approximately 15 percent higher than the same period of 1996. In the third quarter of 1997, the Company shipped 16,600 engines to Chrysler,

a 14-percent increase over the third quarter of 1996. Demand in North American bus markets also remained strong in the third quarter of 1997, 16 percent higher than the third quarter of 1996.

Engine shipments for industrial markets in the third quarter of 1997 were 22 percent higher, continuing to reflect strong demand for construction equipment in North America and for international agricultural markets. However, engine revenues for industrial markets were only 14 percent higher due to the shift from heavy-duty to midrange engines for these markets.

A decline in sales of gensets and an 18-percent decrease in power gen sales for recreational vehicles in North America were offset by increased sales of engine kits, filtration and other products. Sales of both alternators and service parts were essentially level with the third quarter of 1996.

#### Gross Profit

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In the third quarter and first nine months of 1997, the Company's gross profit percentage was 22.6 percent of net sales compared to 21.4 percent in the third quarter of 1996 and 22.7 percent in the first nine months of 1996. In the third quarter of 1997, the Company benefited from higher volume absorption and lower costs, including a reduction in product coverage, which was 2.4 percent of net sales, compared to 2.9 percent in the third quarter of 1996. In the first nine months of 1997, product coverage expense was 2.6 percent of net sales, compared to 2.8 percent in the first nine months of 1996.

#### Operating Expenses

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Selling and administrative expenses of \$181 million in the third quarter of 1997 and \$545 million in the first nine months were 13.2 percent and 13.4 percent of net sales, respectively, compared to 14.0 percent and 13.8 percent of net sales in the same periods of 1996. The increase in absolute dollars in 1997 was primarily due to expenditures for new product launches, software and systems development, and volume-related marketing programs.

Net income from joint ventures and alliances was \$3 million in the third quarter and \$12 million in the first nine months of 1997. The increase in income over 1996 was due to the net effect of higher earnings and royalties from Kirloskar Cummins (KCL) and the joint ventures with Komatsu and lower start-up losses at the Company's joint venture with Wartsila. In the fourth quarter of 1997, the Company will consolidate the results of KCL, which has been renamed Cummins India Limited as a result of Cummins' increase in ownership to 51 percent.

#### Interest and Other Income and Expense

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Interest expense of \$17 million in the first nine months of 1997 was higher than 1996 due to a higher level of debt in 1997. In the third quarter of 1997, the increase in other income of \$3 million over third-quarter 1996 was due primarily to foreign currency translation. In the third quarter of 1997, the Company had a net gain of \$2 million compared to a net loss of \$1 million in the third quarter of 1996.

#### Provision For Income Taxes

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In the third quarter, the estimated effective tax rate (ETR) for 1997 was reduced to 26 percent for the year as a result of the recent tax legislation, which reinstated the research tax credit that had expired May 31. For the quarter, the Company's tax rate was 22 percent to reflect the year-to-date adjustment to the lower ETR. In the third quarter of 1996, the Company had a similar full-year adjustment that resulted in an ETR of 15 percent in that quarter.

#### CASH FLOW AND FINANCIAL CONDITION

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Key elements of the Consolidated Statement of Cash Flows were:

Dollars in Millions	First Nine Months	
	1997	1996
Net cash provided by operating activities	\$ 82	\$ 46
Net cash used for investing activities	(228)	( 68)
Net cash flows used for operating and investing activities	(146)	(22)
Net cash provided from financing activities	100	40

Effect of exchange rate changes on cash	( 1)	1
Net change in cash and cash equivalents	<u>\$( 47)</u>	<u>\$ 19</u>
	_____	_____
	_____	_____

During the first nine months of 1997, the Company generated cash flows from operating activities of \$82 million, compared to \$46 million in the first nine months of 1996. Investing activities required net cash resources of \$228 million in 1997, due to a higher level of capital expenditures for previously announced investments for new products. In the first nine months of 1997, capital expenditures were \$298 million compared to \$151 million in the first nine months of 1996. At the end of the second quarter of 1997, the Company sold its vibration attenuation business to Simpson Industries for approximately \$74 million. The sale of this business was a continuation of the Company's restructuring program announced previously. The sale and the associated restructuring actions had no material effect on reported results.

Net cash provided from financing activities was \$100 million in the first nine months of 1997. As disclosed in Note 3 to the Consolidated Financial Statements, the Company issued \$120 million in debentures under its shelf registration statement in February 1997.

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 the third quarter of 1997, the Company repurchased 110,000 shares of common stock for \$9 million. In January 1997, the Company issued 3.75 million shares of its common stock to an employee benefits trust. Shares held by this trust are not used in the calculation of the Company's earnings per share until distributed from the trust.

In April 1997, the Company announced a 10-percent increase in its quarterly common stock dividend from 25 cents per share to 27.5 cents, effective with the dividend payment in June 1997.

#### FORWARD-LOOKING STATEMENTS

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The Company has included certain forward-looking statements in this Management's Discussion and Analysis of Results of Operations, Cash Flow and Financial Condition. These statements are based on current expectations, estimates and projections about the industries in which the Company operates, management's beliefs and various assumptions made by management which are difficult to predict. Among the factors that could affect the outcome of the statements are general industry and market conditions and growth rates. Therefore, actual outcomes and their impact on the Company may differ materially from what is expressed or forecasted. The Company undertakes no obligation to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

#### PART II. OTHER INFORMATION

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##### Item 6. Exhibits and Reports on Form 8-K:

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- (a) See the Index to Exhibits on page 12 for a list of exhibits filed herewith.
- (b) The Company was not required to file a Form 8-K during the third quarter of 1997.

Signatures

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

By: /s/Rick J. Mills

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Rick J. Mills  
Vice President - Corporate Controller  
(Chief Accounting Officer)

November 7, 1997

CUMMINS ENGINE COMPANY, INC.

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INDEX TO EXHIBITS  
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- 11 Schedule of Computation of Per Share Earnings for the Third  
Quarter and Nine Months Ended September 28, 1997 and  
September 29, 1996 (filed herewith)
- 27 Financial Data Schedule (filed herewith)



## CUMMINS ENGINE COMPANY, INC.

SCHEDULE OF COMPUTATION OF PER SHARE EARNINGS  
 FOR THE THIRD QUARTER AND NINE MONTHS ENDED  
 SEPTEMBER 28, 1997 AND SEPTEMBER 29, 1996

Millions, Except per Share Amounts	Third Quarter		Nine Months	
	Weighted Average Shares	Net Earnings	Weighted Average Shares	Net Earnings
1997				
Shares outstanding & net earnings	38.3	\$ 54	38.3	\$148
Options	.2	-	.1	-
Used in the determination of earnings per share	38.5	\$ 54	38.4	\$148
Primary and fully diluted earnings per share		\$1.40		\$3.85
1996				
Shares outstanding & net earnings	39.6	\$ 26	40.0	\$119
Options	-	-	-	-
Used in the determination of earnings per share	39.6	\$ 26	40.0	\$119
Primary and fully diluted earnings per share		\$0.67		\$2.99

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