SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K/A2
ANNUAL REPORT PURSUANT TO SECTION 13 or 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

For the Fiscal Year Ended December 31, 1998

CUMMINS ENGINE COMPANY, INC.

Commission File Number 1-4949
Incorporated in the State of Indiana   I.R.S. Employer Identification
No. 35-0257090

500 Jackson Street, Box 3005, Columbus, Indiana 47202-3005
(Principal Executive Office)
Telephone Number: (812) 377-5000

Securities 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 [x] 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. [x]

The aggregate market value of the voting stock held by non-affiliates was approximately $1.6 billion at January 29, 1999.

As of January 29, 1999, there were outstanding 42.0 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.

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

OVERVIEW

Net sales were a record $6.3 billion in 1998, 11 percent higher than in 1997, and 19 percent higher than in 1996. Nelson Industries, Inc., acquired in January 1998, and Cummins India Limited, which was first consolidated in the fourth quarter of 1997, added sales of $428 million. Without these additional sales, net sales for 1998 would have been $5.8 billion, an increase of 4 percent over 1997.

As disclosed in Notes 3 and 4 to the Consolidated Financial Statements, the Company recorded charges in 1998 totaling $217 million, comprised of $78 million for revised estimates of additional product coverage liability for both base and extended warranty programs, $114 million of costs associated with the Company's plan to restructure, consolidate and exit certain business activities and $25 million for a civil penalty resulting from an agreement reached with the U.S. Environmental Protection Agency and the Department of Justice regarding diesel engine emissions. Excluding these charges, earnings before interest and taxes were $282 million in 1998, compared to $312 million in 1997 and $232 million in 1996. Including the charges, the Company's net loss was $21 million or $(.55) per share in 1998. Net earnings in 1997 were $212 million or $5.48 per share and $160 million

or $4.01 per share in 1996.

To maintain Cummins' technological leadership, the Company has been in the process of upgrading or replacing engines across all product lines. This new product development program peaked in 1998 with a record six new engine introductions. While this investment in product development offers competitive advantages, it resulted in a temporary increase in product costs and a decrease in profitability in 1998.

RESULTS OF OPERATIONS

Net Sales:

In 1998, the Company achieved its seventh consecutive year of record sales, totaling $6.3 billion. Revenues from sales of engines were 55 percent of the Company's net sales in 1998, with engine revenues and unit shipments 8 percent and 9 percent higher, respectively, than in 1997. The Company shipped a record 403,300 engines in 1998, compared to 369,800 in 1997 and 332,300 in 1996 as follows:

Unit shipments	1998	1997	1996
Midrange engines	287,400	264,300	237,400
Heavy-duty engines	106,100	94,900	85,000
High-horsepower engines	9,800	10,600	9,900
	403,300	369,800	332,300

Revenues from non-engine products, which were 45 percent of net sales in 1998, were 16 percent higher than in 1997. The major changes within non-engine revenues were in filtration, with the sales of Nelson included from the date of acquisition by Cummins, and PowerCare (which includes new parts and remanufactured engines and parts). Sales of the remaining non-engine products, in the aggregate, were essentially level with 1997.

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

$ Millions	1998	1997	1996
Automotive markets	$2,928	$2,622	$2,447
Industrial markets	1,054	1,044	863
Engine Business	3,982	3,666	3,310
Power Generation Business	1,230	1,205	1,213
Filtration Business & Other	1,054	754	734
	$6,266	$5,625	$5,257

Cummins' engine business is the Company's largest business segment, producing engines and parts for sale to customers in both automotive and industrial markets. Engine business customers are each serviced through the Company's worldwide distributor network. The engines are used in trucks of all sizes, buses and recreational vehicles, as well as a variety of industrial applications including construction, mining, agriculture, marine, rail and military. Engine business revenues were $4.0 billion in 1998, a 9 percent increase over 1997 and 20 percent over 1996.

Sales of $2.9 billion in 1998 for automotive markets were 12 percent higher than in 1997 and 20 percent higher than in 1996. In 1998, heavy-duty truck engine revenues were 19 percent higher than in 1997 on a 20-percent increase in units. Within the North American heavy-duty truck market, unit shipments were up 20 percent over 1997, and Cummins continued to be the market leader with a 32-percent market share. In 1998, the Company began limited production of the Signature 600, a new electronic engine designed to capture a larger share of this market. International unit shipments for the heavy-duty market in 1998 were 20 percent higher than in 1997 due to continued strong demand in European and Mexican automotive markets.

Revenues from the sales of engines for medium-duty trucks in 1998 were 13 percent lower than in 1997 on a 12-percent decrease in units. In North America, the Company was affected by Ford's relocation of its production facilities, partially offset by increased sales in international markets, primarily Brazil.

For the bus and light commercial vehicle market, engine revenues in 1998 were 26 percent higher than in 1997, on a 22-percent increase in unit shipments. In January, Cummins jointly announced with DaimlerChrysler a new, fully electronic engine -- the ISB -- for the Dodge Ram pickup. The increase in 1998 was due primarily to record unit shipments to DaimlerChrysler for the Dodge Ram pickup, which were 26 percent higher than in 1997 and 37 percent higher than in 1996, and continued strong demand in bus markets.

In 1998, revenues from industrial markets were 1 percent higher than in 1997. Revenues from sales of engines decreased, while parts sales increased. Engine revenues in 1998 were 1 percent lower than in 1997 on an 8-percent increase in unit shipments. The variance between revenues and units resulted from lower heavy-duty and high-horsepower engine sales and a shift in product mix of midrange engine sales. The increased level of shipments was due to continued strong construction volumes in North America and Europe, partially offset by declines in worldwide agricultural markets. Sales of engines and parts into the marine market in 1998 were 6 percent lower than in 1997, due primarily to the economic turmoil in Asia. Sales into the mining market were 21 percent lower than the prior year. In 1998, Cummins announced an agreement with Komatsu, a joint venture partner, to develop a 3.3 liter engine targeted for the construction market, scheduled for release in the second half of 1999.

Revenues of $1.2 billion in 1998 for power generation were 2 percent higher than in 1997 and 1 percent higher than in 1996, with sales continuing to be impacted by the economic conditions in Asia and lower sales in Europe. Without the consolidation of Cummins India Limited, power generation sales would have decreased 4 percent from 1997. Sales of the Company's generator sets continued to reflect growth in North America, which offset declines in demand for generator sets in Asia. Engine sales to generator set assemblers were down 12 percent from the prior year and sales of alternators were down 11 percent, due primarily to lower demand in Asia and the Company's change in strategy, emphasizing sales of generator sets. Sales of small generator sets for recreational vehicles and other consumer markets remained strong in North America, increasing 12 percent from 1997.

Sales of $1.1 billion in 1998 for filtration and other were 40 percent higher than in 1997 and 44 percent higher than in 1996, with Nelson, acquired in January 1998, contributing sales of $311 million. International distributor sales increased 12 percent from 1997 due to the consolidation of Cummins India Limited in the fourth quarter of 1997.

Net sales by marketing territory for each of the last three years were:

$ Millions	1998	1997	1996
United States	$3,595	$3,123	$2,925
Asia/Australia	806	898	868
Europe/CIS	791	796	759
Mexico/Latin America	468	364	260
Canada	459	318	313
Africa/Middle East	147	126	132
	$6,266	$5,625	$5,257

In total, international markets accounted for 43 percent of the Company's revenues in 1998. Europe and the CIS, representing 13 percent of the Company's sales in 1998, were 1 percent lower than in 1997 and 4 percent higher than in 1996. Sales to Canada, representing 7 percent of sales in 1998, were 44 percent higher than in 1997 due to the acquisition of Nelson and the relocation of certain customer production facilities. Asian and Australian markets, in total, represented 13 percent of the Company's sales in 1998, as compared to 16 percent in 1997 and 17 percent in 1996. In Asia, sales to China were essentially flat compared to 1997, while revenues in Korea decreased 64 percent, Southeast Asia declined 47 percent and sales to Japan and India were 19 percent below 1997 levels, excluding the effect of Cummins India Limited consolidation.

Business in Mexico and Latin America, representing 8 percent of sales, was 29 percent higher than in 1997, but began to decline in the latter part of 1998. Sales to Latin America, including Brazil, represented 4 percent of the Company's sales in 1998 and were 28 percent higher than in 1997. Brazil individually accounted for 2 percent of sales in 1998. The recent economic events in Brazil have resulted in increased interest rates and devalued currencies in the region. Many of the Company's

customers are sensitive to interest rates, which will affect sales demand. The devaluation of local currencies also could have an impact on operations, as certain of the Company's transactions are based in Brazilian currency, and could result in currency gains or losses. Sales to Mexico, representing approximately 4 percent of the Company's sales in 1998, could also potentially be affected by the economic uncertainty in Brazil. These events could reasonably be expected to have an adverse effect on the Company's business, however, the extent cannot be estimated reasonably based upon presently available information.

Gross Margin:

As disclosed in Note 3 to the Consolidated Financial Statements, the Company recorded special charges of $92 million for product coverage costs and inventory write-downs. The product coverage special charges of $78 million include $43 million primarily attributable to base warranty costs and $35 million for extended warranty programs. The $43 million charge attributable to base warranty costs resulted from recent claim payment information which indicated engines in the field were experiencing higher warranty costs than expected due to some specific high-cost failures on certain engines. The estimate of base warranty liability was adjusted to reflect the impact of all this new information regarding the products' performance. The $35 million charge attributable to extended warranty costs was the result of the use of improved estimating techniques to determine the liability for these costs. The special charges recorded in 1998 also include $14 million for inventory write-downs associated with the Company's restructuring and exit activities. These write-downs reflect amounts of inventory rendered excess or unusable due to the closing or consolidation of facilities.

The Company's gross margin percentage before the product coverage and inventory special charges was 21.4 percent in 1998, compared to 22.8 percent in 1997 and 22.5 percent in 1996. The Company's gross margin percentage declined due to a temporary increase in product coverage costs from ISB and ISC engines and higher new product costs attributable to the production ramp-up of the ISB, ISC and Signature 600 engines. This decrease was partially offset by the benefit from higher volume and pricing. The acquisition of Nelson and consolidation of Cummins India Limited added $124 million. Gross margin percentage after the special charges was 19.9 percent. Product coverage costs, excluding the special charges, were 3.3 percent of net sales in 1998, compared to 2.6 percent in 1997 and 2.7 percent in 1996.

Operating Expenses:

Selling and administrative expenses were 12.5 percent of net sales in 1998, compared to 13.2 percent in 1997 and 13.8 percent in 1996. On the 11-percent sales increase in 1998, these expenses, which include volume-variable components, were up less than 6 percent in absolute dollars. Net benefits of the Company's cost reduction and restructuring actions were partially offset by increases in expenses associated with new product launches and information systems during 1998.

Research and engineering expenses were 4.1 percent of net sales in 1998, compared to 4.6 percent in 1997 and 4.8 percent in 1996. This is a result of a reduction in technical spending and certain product developments moving to the production stage.

The Company's losses from joint ventures and alliances were $30 million in 1998, compared to income of $10 million in 1997. The difference was due primarily to the consolidation of Cummins India Limited and losses at the Company's joint venture with Wartsila. Cummins Wartsila is being affected by lower sales, primarily due to decreased demand in Asia, and higher product coverage expenses.

In an effort to address the decline in the Company's business in Asia, to leverage overhead costs for all operations and to improve joint venture operating performance, the Company established a restructuring program in 1998. As a result of this program, the Company recorded a charge of $100 million for costs to reduce the worldwide workforce by approximately 1,100 people, as well as costs associated with streamlining certain majority-owned and international joint venture operations.

The charges for majority-owned operations included $38 million for severance and related costs associated with workforce reductions in the engine and power generation businesses, primarily for administrative positions. The costs of these reductions were based on amounts pursuant to benefit programs and contractual provisions or statutory requirements at the affected operations. Approximately one-half of these 1,100

employees left the Company prior to December 31, 1998. An asset impairment loss of $22 million, calculated according to the provisions of SFAS No. 121, was recorded primarily for engine manufacturing equipment to be disposed of upon the closure or consolidation of facilities or the outsource of production. The recovery value for the equipment to be disposed of was based on estimated liquidation value. The carrying value of assets held for disposal and the effect on earnings from suspending depreciation on such assets is immaterial. The equipment write-off of $22 million was for the following:

	$ Millions
N-14 engine component assets for which production is scheduled to be outsourced in the first half of 1999	$12
Brazilian engine operation assets for which production is planned to be discontinued by the end of 1999	4
Holset Germany operations assets to be disposed of by the end of 1998	3
Other facility closures and consolidations to be completed by the end of 1998	3

Facility consolidation and other costs of $17 million included lease termination and facility exit costs of $10 million, product support costs of $3 million, and litigation and other costs of $4 million. As the restructuring consists primarily of the closing or consolidation of smaller operations, the Company does not expect these actions to have a material effect on future revenues.

The charges for restructuring joint venture operations totaled $23 million, the majority of which relates to actions being taken at the Company's joint venture with Wartsila, which is part of the Company's power generation business. The charges included $11 million for employee severance and related benefits for approximately 1,200 people, $7 million for a tax asset impairment loss and $5 million for other facility and equipment-related charges.

Approximately $25 million, including $12 million of payments related to employee severance, has been charged to the restructuring liabilities as of December 31, 1998. Of the total charges associated with restructuring activities, cash outlays will approximate $60 million. The program is expected to be essentially complete by the end of 1999 and yield approximately $50 million in annual savings at completion. The annual savings of $50 million are expected to come from lower depreciation of approximately $2 million and reduced employee costs of approximately $48 million and relate to actions within the engine business totaling $33 million and actions within the power generation business of $17 million.

In 1998, the Company recorded a charge of $25 million for a civil penalty to be paid by the Company as a result of an agreement reached with the U.S. Environmental Protection Agency, the Department of Justice and the California Air Resources Board regarding diesel engine emissions. In addition to the civil penalty, the agreement provides a schedule for diesel engines to meet certain emission standards and requires manufacturers to continue to invest in environmental projects to further reduce oxides of nitrogen (NOx) emissions. The Company has developed extensive corporate action plans to comply with all aspects of the agreement. Additionally, three separate court actions have been filed as a result of allegations of the diesel emissions matter. The New York Supreme Court ruled in favor of the Company. This matter is now on appeal. A California State Court recently ruled in favor of the Company. A recent action was just filed in the U.S. District Court, the District of Columbia.

Year 2000:

The Company continues to address the impact of the Year 2000 issue on its businesses worldwide. This issue affects computer systems that have date-sensitive programs that may not properly recognize the year 2000. With respect to the Company, this issue affects not only computer systems but also machinery and equipment used in production that may contain embedded computer technology.

Following a review and assessment of information systems and technology used in its internal business operations and production, the Company inventoried and identified those systems and products that the Company believes may be vulnerable to Year 2000 failures and established a program to address Year 2000 issues. The Company's Year 2000 efforts are being carried out by the Company's Year 2000 Team under the leadership of the Director of Year 2000 Compliance. A Year

2000 program office has been established at each of the Company's facilities and is overseen by a Year 2000 coordinator. The Year 2000 Team maintains a reporting structure to ensure that progress is made and tracked on Year 2000 issues. In addition to internal resources, the Company has retained external resources to assist with the implementation of its Year 2000 program.

The Company's program consists of the remediation, replacement or retirement of affected systems. Remediation is the alteration of a non-compliant application to make it compliant, replacement is the substitution of a non-compliant application with a compliant upgrade or product and retirement is the discarding of non-compliant applications that have been determined to be dispensable.

The Company completed a substantial portion of its remediation efforts and testing in 1998, and expects to complete that process by the end of the second quarter of 1999.

The Year 2000 Team will remain in place through January 1, 2000, and beyond as needed. Their role is to ensure that compliance is maintained once it is attained. The Company maintains contact with its key suppliers to obtain information relating to the status of such suppliers with respect to Year 2000 issues, placing particular emphasis on determining the Year 2000 readiness of its critical suppliers.

The Company expects to incur total expenditures of approximately $45 million in connection with its Year 2000 program and remediation efforts. To date, the Company has incurred approximately $30 million in costs relating to its Year 2000 efforts.

There can be no assurances that the systems or products of third parties, which the Company relies upon, will be timely converted or that a failure by a third party, or a conversion that is incompatible with the Company's systems, would not have a material adverse effect on the Company. This is particularly true because the Company utilizes sole suppliers for certain products. The high level of skill and expertise required to develop certain components makes it impossible to change suppliers quickly. The failure of a sole supplier may lead to a delay in production.

The Company continues to develop contingency plans in the event that its operations are disrupted on January 1, 2000. Such contingency plans include the stockpiling of certain business critical inventory, and identifying alternative suppliers where possible.

The estimated time of completion of the Company's Year 2000 program and compliance efforts, and the expenses related to the Company's Year 2000 compliance efforts are based upon management's best estimates, which were based on assumptions of future events, including the availability of certain resources, third party modification plans and other factors. There can be no assurances that these results and estimates will be achieved, and the actual results could materially differ from those anticipated. Specific factors that might cause such material differences include, but are not limited to, the availability of personnel trained in this area and the ability to locate and correct all relevant computer codes.

Other:

Interest expense of $71 million was $45 million higher than in 1997 and $53 million higher than in 1996 due to the increased level of borrowings to support working capital on the higher sales level and to complete the acquisition of Nelson. Other income decreased $13 million in 1998 as compared to the year-ago period, primarily due to the Nelson goodwill amortization and lower royalty income.

Provision for Income Taxes:

The Company's effective income tax rate normally is below the 35% U.S. federal corporate tax rate. The lower tax rate is a result of tax benefits on export sales and tax credits on research expenses. These benefits in 1998 were more than offset by the unfavorable tax effects of nondeductible losses in foreign joint ventures and nondeductible EPA penalty and goodwill amortization. The combined effect was a 1998 income tax provision of $4 million.

CASH FLOW AND FINANCIAL CONDITION

Key elements of cash flows were:

$ Millions	1998	1997	1996

Net cash used in operating and investing activities	$(481)	$(154)	$ (66)
Net cash from financing activities	471	96	110
Effect of exchange rate changes on cash	(1)	(1)	4
Net change in cash	$ (11)	$ (59)	$ 48

During 1998, net cash used for operating and investing activities was $481 million. The higher level of net cash requirements in 1998 was due primarily to the acquisition of Nelson, planned capital expenditures ($271 million in 1998, compared to $405 million in 1997 and $304 million in 1996) for investments in new products and for working capital. Net working capital as a percent of sales was 12.8 percent in 1998, compared to 11.6 percent in 1997. Investments in joint ventures and alliances of $22 million reflected the net effect of capital contributions and cash generated by certain joint ventures.

Net cash provided from financing activities was $471 million in 1998. As disclosed in Note 6, the Company issued $765 million face amount of notes and debentures under a $1 billion registration statement filed with the Securities and Exchange Commission in December 1997. Net proceeds were used to finance the acquisition of Nelson and pay down other indebtedness outstanding at December 31, 1997. Based on the Company's projected cash flow from operations and existing credit facilities, management believes that sufficient liquidity is available to meet anticipated capital and dividend requirements in the foreseeable future.

Market Risk:

The Company is exposed to financial risk resulting from volatility in foreign exchange rates, interest rates and commodity prices. This risk is closely monitored and managed through the use of financial derivative contracts. As clearly stated in the Company's policies and procedures, financial derivatives are used expressly for hedging purposes, and under no circumstances are they used for speculating or for trading. Transactions are entered into only with banking institutions with strong credit ratings, and thus the credit risk associated with these contracts is considered immaterial. Hedging program results and status are reported to senior management on a monthly and quarterly basis.

The following section describes the Company's risk exposures and provides results of sensitivity analyses performed on December 31, 1998. The sensitivity tests assumed instantaneous, parallel shifts in foreign currency exchange rates, commodity prices and interest rate yield curves.

A. Foreign Exchange Rates

Due to its international business presence, the Company transacts extensively in foreign currencies. As a result, corporate earnings experience some volatility related to movements in exchange rates. In order to exploit the benefits of global diversification and naturally offsetting currency positions, foreign exchange balance sheet exposures are aggregated and hedged at the corporate level through the use of foreign exchange forward contracts. The objective of the foreign exchange hedging program is to reduce earnings volatility resulting from the translation of net foreign exchange balance sheet positions. A hypothetical, instantaneous 10% adverse movement in foreign exchange rates would decrease earnings by approximately $4 million in the current reporting period. The sensitivity analysis ignores the impact of foreign exchange movements on Cummins' competitive position as well as the remoteness of the likelihood that all foreign currencies will move in tandem against the U.S. dollar. The analysis also ignores the offsetting impact on income of the revaluation of the underlying balance sheet exposures.

B. Interest Rates

The Company currently has in place an interest rate swap that effectively converts fixed-rate debt into floating-rate debt. The objective of the swap is to lower the cost of borrowed funds. A sensitivity analysis assumed a hypothetical, instantaneous, 100 basis-point parallel shift in the floating interest rate yield curve, after which rates remained fixed at the new, higher level for a one-year period. This change in the yield curve would correspond to a $2 million increase in interest expense for the one-year period. This sensitivity analysis does not account for the change in the Company's

competitive environment indirectly related to changes in interest rates and the potential managerial response taken in response to these changes.

C. Commodity Prices

The Company is exposed to fluctuations in commodity prices through the purchase of raw materials as well as contractual agreements with component suppliers. Given the historically volatile nature of commodity prices, this exposure can significantly impact product costs. The Company uses commodity swap agreements to partially hedge exposures to changes in copper and aluminum prices. Given a hypothetical, instantaneous 10% depreciation of the underlying commodity price, with prices then remaining fixed for a 12-month period, the Company would experience a loss of approximately $3 million for the annual reporting period. This amount excludes the offsetting impact of decreases in commodity costs.

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 10 for a list of the financial statements filed as a part of this report.

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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 this 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 meets periodically 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, 1998 and 1997, and the related consolidated statements of earnings, cash flows and shareholders' investment for each of the three years in the period ended December 31, 1998. 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, 1998 and 1997, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1998, in conformity with generally accepted accounting principles.

Arthur Andersen LLP

Chicago, Illinois,
January 26, 1999.

CUMMINS ENGINE COMPANY, INC.
CONSOLIDATED STATEMENT OF EARNINGS

Millions, except per share amounts	1998	1997	1996
Net sales	$6,266	$5,625	$5,257
Cost of goods sold	4,925	4,345	4,072
Special charges	92	-	-
Gross profit	1,249	1,280	1,185

Selling & administrative expenses	787	744	725
Research & engineering expenses	255	260	252
Net expense (income) from joint ventures and alliances	30	(10)	-
Interest expense	71	26	18
Other income, net	(13)	(26)	(24)
Restructuring and other non-recurring charges	125	-	-
Earnings (loss) before income taxes	(6)	286	214
Provision for income taxes	4	74	54
Minority interest	11	-	-
Net earnings (loss)	$ (21)	$ 212	$ 160
Basic earnings (loss) per share	$(.55)	$5.55	$4.02
Diluted earnings (loss) per share	(.55)	5.48	4.01

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, 1998	1997
Assets		
Current assets:		
Cash and cash equivalents	$ 38	$ 49
Receivables	833	771
Inventories	731	677
Other current assets	274	213
	1,876	1,710
Investments and other assets:		
Investments in joint ventures and alliances	136	204
Other assets	144	142
	280	346
Property, plant and equipment:		
Land and buildings	590	495
Machinery, equipment and fixtures	2,320	2,079
Construction in process	185	392
	3,095	2,966
Less accumulated depreciation	1,424	1,434
	1,671	1,532
Goodwill, net of amortization of $17 and $5	384	12
Other intangibles, deferred taxes and deferred charges	331	165
Total assets	$4,542	$3,765
Liabilities and shareholders' investment		
Current liabilities:		
Loans payable	$ 64	$ 90
Current maturities of long-term debt	26	42
Accounts payable	340	386
Accrued salaries and wages	99	87
Accrued product coverage & marketing expenses	209	120
Income taxes payable	13	18
Other accrued expenses	320	312
	1,071	1,055
Long-term debt	1,137	522
Other liabilities	1,000	713
Minority interest	62	53

Shareholders' investment:		
Common stock, $2.50 par value, 48.1 shares issued	120	120
Additional contributed capital	1,121	1,119
Retained earnings	648	715
Accumulated other comprehensive income	(167)	(70)
Common stock in treasury,at cost,6.1 & 6.0 shares	(240)	(245)
Common stock held in trust for employee benefit plans, 3.6 and 3.7 shares	(172)	(175)
Unearned compensation	(38)	(42)
	1,272	1,422
Total liabilities & shareholders' investment	$4,542	$3,765

The accompanying notes are an integral part of this statement.

CUMMINS ENGINE COMPANY, INC.
CONSOLIDATED STATEMENT OF CASH FLOWS

Millions	1998	1997	1996
Cash flows from operating activities:			
Net earnings (loss)	$ (21)	$ 212	$ 160
Adjustments to reconcile net earnings (loss) to net cash from operating activities:			
Depreciation and amortization	199	158	149
Restructuring actions	110	(24)	(42)
Equity in (earnings) losses of joint ventures and alliances	38	(1)	11
Receivables	(10)	(80)	(56)
Inventories	(26)	(65)	(62)
Accounts payable and accrued expenses	56	(18)	28
Deferred income taxes	(65)	22	17
Other	(10)	(4)	(12)
Total adjustments	292	(12)	33
	271	200	193
Cash flows from investing activities:			
Property, plant and equipment:			
Additions	(271)	(405)	(304)
Disposals	7	21	26
Investments in joint ventures and alliances	(22)	(47)	(5)
Acquisitions and dispositions of business activities	(468)	76	10
Other	2	1	14
	(752)	(354)	(259)
Net cash used in operating and investing activities	(481)	(154)	(66)
Cash flows from financing activities:			
Proceeds from borrowings	711	281	200
Payments on borrowings	(161)	(50)	(47)
Net (payments) borrowings under credit agreements	(30)	(12)	32
Repurchases of common stock	(14)	(75)	(34)
Dividend payments	(46)	(45)	(40)
Other	11	(3)	(1)
	471	96	110
Effect of exchange rate changes on cash	(1)	(1)	4
Net change in cash and cash equivalents	(11)	(59)	48
Cash & cash equivalents at beginning of year	49	108	60
Cash & cash equivalents at end of year	$ 38	$ 49	$108

Cash payments during the year for:			
Interest	$ 56	$ 21	$ 16
Income taxes	73	42	40

The accompanying notes are an integral part of this statement.

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

Millions, except per share amounts	1998		1997		1996	
Common stock:						
Balance at beginning of year	$ 120		$ 110		$ 110	
Issued to trust for employee benefit plans	-		9		-	
Other	-		1		-	
Balance at end of year	120		120		110	
Additional contributed capital:						
Balance at beginning of year	1,119		929		926	
Issued to trust for employee benefit plans	-		171		-	
Other	2		19		3	
Balance at end of year	1,121		1,119		929	
Retained earnings:						
Balance at beginning of year	715		548		428	
Net earnings (loss)	(21)	$(21)	212	$212	160	$160
Cash dividends	(46)		(45)		(40)	
Balance at end of year	648		715		548	
Accumulated other comprehensive income:						
Balance at beginning of year	(70)		(60)		(95)	
Foreign currency translation adjustments		(43)		(21)		26
Minimum pension liability adjustments		(54)		12		9
Unrealized losses on securities		-		(1)		-
Other comprehensive income	(97)	(97)	(10)	(10)	35	35
Comprehensive income		$(118)		$202		$195
Balance at end of year	(167)		(70)		(60)	
Common stock in treasury:						
Balance at beginning of year	(245)		(169)		(135)	
Repurchased	(14)		(76)		(34)	
Issued	19		-		-	
Balance at end of year	(240)		(245)		(169)	
Common stock held in trust for employee benefit plans:						
Balance at beginning of year	(175)		-		-	
Issued	-		(180)		-	
Shares allocated to benefit plans	3		5		-	
Balance at end of year	(172)		(175)		-	
Unearned compensation:						
Balance at beginning of year	(42)		(46)		(51)	
Shares allocated to participants	4		4		5	
Balance at end of year	(38)		(42)		(46)	
Shareholders' investment	$1,272		$1,422		$1,312	

Shares of stock			
Common stock, $2.50 par value, 150.0 shares authorized			
Balance at beginning of year	48.1	43.9	43.9
Shares issued	-	4.2	-
Balance at end of year	48.1	48.1	43.9
Common stock in treasury			
Balance at beginning of year	6.0	4.5	3.7
Shares repurchased	.4	1.5	.8
Shares issued	(.3)	-	-
Balance at end of year	6.1	6.0	4.5
Common stock held in trust for employee benefit plans			
Balance at beginning of year	3.7	-	-
Shares issued	-	3.8	-
Shares allocated to benefit plans	(.1)	(.1)	-
Balance at end of year	3.6	3.7	-

The accompanying notes are an integral part of this statement.

CUMMINS ENGINE COMPANY, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. ACCOUNTING POLICIES:

Principles of Consolidation: The consolidated financial statements include all significant majority-owned subsidiaries. Affiliated companies in which Cummins does not have a controlling interest, or for which control is expected to be temporary, are accounted for using the equity method. Use of estimates and assumptions as determined by management is required in the preparation of consolidated financial statements in conformity with generally accepted accounting principles. Actual results could differ from these estimates and assumptions.

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. 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.

Foreign Currency: Assets and liabilities of foreign entities, where the local currency is the functional currency, have been translated at year-end exchange rates, and income and expenses have been translated to US dollars at average-period rates. Adjustments resulting from translation have been recorded in shareholders' investment and are included in net earnings only upon sale or liquidation of the underlying foreign investment.

For foreign entities where the US dollar is the functional currency, including those operating in highly inflationary economies, inventory, property, plant and equipment balances and related income statement accounts have been translated using historical exchange rates. The resulting gains and losses have been credited or charged to net earnings.

Derivative Instruments: The Company makes use of derivative instruments in its foreign exchange, commodity price and interest rate hedging programs. Derivatives currently in use are commodity and interest rate swaps, as well as foreign currency forward contracts. These contracts are used strictly for hedging, and not for speculative purposes. Refer to Note 8 for more information on derivative financial instruments.

The Company enters into commodity swaps to offset the Company's exposure to price volatility for certain raw materials used in the manufacturing process. As the Company has the discretion to settle these transactions either in cash or by taking physical delivery, these

contracts are not considered financial instruments for accounting purposes. These commodity swaps are accounted for as hedges.

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

Research & development expenditures, net of contract reimbursements, are expensed when incurred and were $228 million in 1998, $250 million in 1997 and $235 million in 1996.

Maintenance and repair costs are charged to earnings as incurred.

Cash Equivalents: Cash equivalents include all highly liquid investments with an original maturity of three months or less at time of purchase.

Inventories: Inventories are generally stated at cost or net realizable value. Approximately 25 percent of domestic inventories (primarily heavy-duty and high-horsepower engines and engine parts) are valued using the last-in, first-out (LIFO) cost method. Inventories at December 31 were as follows:

$ Millions	1998	1997
Finished products	$400	$351
Work-in-process and raw materials	387	388
Inventories at FIFO cost	787	739
Excess of FIFO over LIFO	(56)	(62)
	$731	$677

Property, Plant and Equipment: Property, plant and equipment are stated at cost. A modified units-of-production method, which is based upon units produced subject to a minimum level, is used to depreciate substantially all engine production equipment. The straight-line depreciation method is used for all other equipment. The estimated depreciable lives range from 20 to 40 years for buildings and 3 to 20 years for machinery, equipment and fixtures.

Software: Internal and external software costs (excluding research, reengineering and training) are capitalized and amortized generally over 5 years. Effective January 1, 1998, the Company adopted SOP 98-1 on accounting for internal use software costs. Internal software costs capitalized in 1998 in accordance with this new rule were $9 million. Capitalized software, net of amortization, was $75 million at December 31, 1998 and $32 million at December 31, 1997.

Earnings Per Share: Effective January 1, 1997, the Company adopted SFAS No. 128, a new accounting rule on calculating earnings per share. Under the new rule, basic earnings per share of common stock are computed by dividing net earnings by the weighted-average number of shares outstanding for the period. Diluted earnings per share are computed by dividing net earnings by the weighted-average number of shares, assuming the exercise of stock options when the effect of their exercise is dilutive. Shares of stock held by the employee benefits trust are not included in outstanding shares for EPS until distributed from the trust. Years prior to 1997 have been restated to reflect this new rule.

Millions, except per share amounts	Net Earnings (Loss)	Weighted Average Shares	Per share
1998			
Basic	$(21)	38.5	$(.55)
Options	-	-	
Diluted	$(21)	38.5	$(.55)
1997			
Basic	$212	38.2	$5.55
Options	-	.5	
Diluted	$212	38.7	$5.48

1996

Basic	$160	39.8	$4.02
Options	-	.1	
Diluted	$160	39.9	$4.01

NOTE 2. ACQUISITION: In January 1998, the Company completed the acquisition of the stock of Nelson Industries, Inc., for $453 million. Nelson, a filtration and exhaust systems manufacturer, was consolidated from the date of its acquisition. On a pro forma basis, if the Company had acquired Nelson on January 1, 1997, consolidated net sales for 1997 would have been $5.9 billion and consolidated earnings would not have been materially different. In accordance with APB Opinion No. 16, Nelson's net assets were recorded at fair value at the date of acquisition. The purchase price in excess of net assets will be amortized over 40 years.

NOTE 3. SPECIAL CHARGES: In 1998, the Company recorded special charges of $92 million for product coverage costs and inventory write-downs. The product coverage special charges of $78 million included $43 million primarily attributable to the recent experience of higher-than-anticipated base warranty costs to repair certain automotive engines manufactured in previous years, and $35 million related to a revised estimate of product coverage cost liability primarily for extended warranty programs. The Company believed it was necessary to make these special charges to accrue for such product coverage costs expected to be incurred in the future on these engines currently in the field. The special charges also included $14 million for inventory write-downs associated with the Company's restructuring and exit activities. These write-downs relate to amounts of inventory rendered excess or unusable due to the closing or consolidation of facilities. The Company has committed to these facility closures and consolidations as part of a plan to reduce costs and improve operating performance.

NOTE 4. RESTRUCTURING AND OTHER NON-RECURRING CHARGES: In 1998, the Company recorded charges of $125 million, comprised of $100 million for costs to reduce the worldwide workforce, as well as costs associated with streamlining certain majority-owned and international joint venture operations and $25 million for a civil penalty to be paid by the Company as a result of an agreement reached with the U.S. Environmental Protection Agency (EPA), the Department of Justice (DOJ) and the California Air Resources Board (CARB) regarding diesel engine emissions.

The major components of these charges are as follows:

$ Millions	
Restructuring of majority-owned operations:	
Workforce reductions	$ 38
Asset impairment loss	22
Facility consolidations and other	17
	77
Restructuring of joint venture operations:	
Workforce reductions	11
Tax asset impairment loss	7
Facility and equipment-related costs	5
	23
EPA penalty	25
Total	$125

The restructuring program was undertaken to address the decline in the Company's business in Asia, to leverage overhead costs for all operations and to improve joint venture operating performance.

The charges for majority-owned operations include $38 million for severance and related costs associated with workforce reductions of approximately 1,100 people. These reductions are in the engine and power generation businesses and are primarily for administrative positions. Costs for workforce reductions were based on amounts pursuant to benefit programs and contractual provisions or statutory requirements at the affected operations. Approximately one-half of these employees left the Company prior to December 31, 1998.

The asset impairment loss, calculated according to the provisions of SFAS 121, was recorded primarily for engine manufacturing equipment to be disposed of upon the closure or consolidation of facilities or the outsource of production. The recovery value for the equipment to be disposed of was based on estimated liquidation value. The carrying value of assets held for disposal and the effect on earnings from suspending depreciation on such assets is immaterial.

Facility consolidation and other costs of $17 million include lease termination and facility exit costs of $10 million, product support costs of $3 million and litigation and other costs of $4 million. As the restructuring consists primarily of the closing or consolidation of smaller operations, the Company does not expect these actions to have a material effect on future revenues.

The charges for restructuring joint venture operations totaled $23 million, the majority of which relates to actions being taken at the Company's joint venture with Wartsila, which is part of the Company's power generation business. The charges include $11 million for employee severance and related benefits for approximately 1,200 people, $7 million for a tax asset impairment loss and $5 million for other facility and equipment-related charges.

Approximately $25 million, primarily related to employee severance, has been charged to the restructuring liabilities as of December 31, 1998. Of the total charges associated with restructuring activities, cash outlays will approximate $60 million. The program is expected to be essentially complete by the end of 1999 and yield approximately $50 million in annual savings at completion.

In addition to the civil penalty, the agreement with the EPA/DOJ/CARB provides a schedule for diesel engines to meet certain emission standards and requires manufacturers to continue to invest in environmental projects to further reduce oxides of nitrogen (NOx) emissions. The Company has developed extensive corporate action plans to comply with all aspects of the agreement. Additionally, three separate court actions have been filed as a result of allegations of the diesel emissions matter. The New York Supreme Court ruled in favor of the Company. This matter is now on appeal. A California State Court recently ruled in favor of the Company. A recent action was just filed in the U.S. District Court, the District of Columbia.

NOTE 5. INVESTMENTS IN JOINT VENTURES AND ALLIANCES: Investments in joint ventures and alliances at December 31 were as follows:

$ Millions	1998	1997
Consolidated Diesel	$ 39	$ 32
Tata Cummins	22	16
Komatsu alliances	17	10
Chongqing Cummins	15	16
Behr America, Inc.	14	14
Dong Feng	8	7
Cummins Wartsila	(6)	88
Other	27	21
	$136	$204

Summary balance sheet information for the joint ventures and alliances was as follows:

$ Millions	December 31, 1998	1997
Current assets	$527	$447
Noncurrent assets	613	533
Current liabilities	(406)	(258)
Noncurrent liabilities	(455)	(305)
Net assets	$279	$417
Cummins' share	$136	$204

The Company has guaranteed $79 million in outstanding debt of the Cummins Wartsila joint venture as of December 31, 1998.

In connection with various joint venture agreements, Cummins is required to purchase products from the joint ventures in amounts to provide for the recovery of specified costs of the ventures. Under

the agreement with Consolidated Diesel, Cummins' purchases were $535 million in 1998 and $538 million in 1997.

NOTE 6. LONG-TERM DEBT: Long-term debt at December 31 was:

$ Millions	1998	1997
7.125% debentures due 2028	$249	$ -
6.45% notes due 2005	224	-
Commercial paper	142	242
5.65% debentures due 2098, net of unamortized discount of $40 (effective interest rate 7.48%)	125	-
6.25% notes due 2003	125	-
6.75% debentures due 2027	120	120
8.2% notes through 2003	79	96
Guaranteed notes of ESOP Trust due 2010	63	65
10.35%-10.65% medium-term notes through 1998	-	14
Other	36	27
Total	1,163	564
Current maturities	(26)	(42)
Long-term debt	$1,137	$522

Maturities of long-term debt for the five years subsequent to December 31, 1998 are $26 million, $26 million, $25 million, $27 million and $141 million. At both December 31, 1998 and 1997, the weighted-average interest rate on loans payable and current maturities of long-term debt approximated 7 percent.

The Company maintains a $500 million revolving credit agreement, maturing in 2003, under which there were no outstanding borrowings at December 31, 1998 or 1997. The revolving credit agreement supports the Company's commercial paper borrowings. In February 1998, the Company issued $765 million face amount of notes and debentures under a $1 billion Registration Statement filed with the Securities and Exchange Commission in 1997. Net proceeds were used to finance the acquisition of Nelson and pay down other indebtedness outstanding at December 31, 1997. The Company also has other domestic and international credit lines with approximately $193 million available at December 31, 1998.

In 1997, the Company issued $120 million of 6.75 percent debentures that mature in 2027. Holders have a one-time option in 2007 to redeem the debentures and Cummins has a recall right after ten years.

The Company has guaranteed the outstanding borrowings of its ESOP Trust. The notes were refinanced in July 1998. 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. Cash contributions and dividends to the Trust approximated $10 million in each year. The unearned compensation, which is reflected as a reduction to shareholders' investment, represents the historical cost of the shares of common stock that have not yet been allocated by the Trust to participants.

NOTE 7. OTHER LIABILITIES: Other liabilities at December 31 included the following:

$ Millions	1998	1997
Accrued retirement & post-employment benefits	$720	$487
Accrued product coverage & marketing expenses	156	111
Accrued compensation	38	34
Deferred income taxes	17	25
Other	69	56
	$1,000	$713

NOTE 8. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT: The Company is exposed to financial risk resulting from volatility in foreign exchange rates and interest rates. This risk is closely monitored and managed through the use of financial derivative contracts. As clearly stated in the Company's policies and procedures, financial derivatives are used expressly for hedging purposes, and under no circumstances are they used for speculating or trading. Transactions are entered into only with banking institutions with strong credit ratings, and thus the credit risk associated with these contracts is considered immaterial. Hedging program results and status are reported to senior management on a periodic basis.

Foreign Exchange Rates
Due to its international business presence, the Company uses foreign exchange forward contracts to manage its exposure to exchange rate volatility. Foreign exchange balance sheet exposures are aggregated and hedged at the corporate level. Maturities on these instruments generally fall within the one-month and six-month range. The objective of the hedging program is to reduce earnings volatility resulting from the translation of net foreign exchange balance sheet positions. The total notional amount of these forward contracts outstanding at December 31, 1998, and December 31, 1997, were $174 million and $257 million, respectively.

Interest Rates
The Company manages its exposure to interest rate fluctuations through the use of interest rate swaps. Currently the Company has in place one interest rate swap that effectively converts fixed-rate debt into floating-rate debt. The objective of this swap is to lower the cost of borrowed funds. The contract was established during October 1998 with a notional value of $225 million. There were no interest rate swap contracts outstanding at December 31, 1997.

Fair Value of Financial Instruments
Based on borrowing rates currently available to the Company for bank loans with similar terms and average maturities, the fair value of total debt, including current maturities, at December 31, 1998, approximated $1,214 million. The carrying value at that date was $1,227 million. At December 31, 1997, the fair and carrying values of total debt, including current maturities, were $664 and $654 million, respectively. The carrying values of all other receivables and liabilities approximated fair values.

NOTE 9. INCOME TAXES: The provision for income taxes was as follows:

$ Millions	1998	1997	1996
Current:			
U.S. Federal and state	$16	$16	$22
Foreign	41	32	15
	57	48	37
Deferred:			
U.S. Federal and state	(34)	26	-
Foreign	(19)	-	17
	(53)	26	17
	$ 4	$74	$54

The Company expects to realize all of its tax assets, including the use of all carryforwards, before any expiration.

Significant components of net deferred tax assets related to the following tax effects of differences between financial and tax reporting at December 31:

$ Millions	1998	1997
Employee benefit plans	$300	$266
Product coverage & marketing expenses	106	64
Restructuring charges	14	9
US plant & equipment	(176)	(139)
Net foreign taxable differences, primarily plant and equipment	6	(23)
US Federal carryforward benefits:		
General business tax credits, expiring 2009 to 2013	43	31
Minimum tax credits, no expiration	12	10
Other net differences	12	13
	$317	$231
Balance Sheet Classification		
Current assets	$203	$129
Noncurrent assets	131	127
Noncurrent liabilities	(17)	(25)
	$317	$231

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

$ Millions	1998	1997	1996
Earnings (loss) before income taxes:			
US	$(21)	$205	$134
Foreign	15	81	80
	$ (6)	$286	$214
Tax at 35 percent US statutory rate	$ (2)	$100	$ 75
Nondeductible EPA penalty	9	-	-
Nondeductible goodwill amortization	3	-	-
Research tax credits	(10)	(11)	(6)
Foreign sales corporation benefits	(9)	(11)	(11)
Differences in rates and taxability of foreign subsidiaries	15	(3)	-
All other, net	(2)	(1)	(4)
	$ 4	$ 74	$(54)

NOTE 10. RETIREMENT PLANS: The Company has various contributory and noncontributory pension plans covering substantially all employees. Cummins common stock represented 9 percent of pension plan assets at December 31, 1998.

Cummins also provides various health care and life insurance benefits to eligible retirees and their dependents but reserves the right to change benefits covered under these plans. The plans are contributory with retirees' contributions adjusted annually, and they 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.

The projected benefit obligation, accumulated benefit obligation and fair value of plan assets for plans with accumulated benefit obligations in excess of plan assets were $1,296 million, $1,251 million, and $999 million, respectively as of December 31, 1998, and $418 million, $381 million, and $339 million, respectively, as of December 31, 1997. The assumed long-term rate of compensation increase for salaried plans was 4.25% in 1998 and 5.00% in 1997. Other significant assumptions for the Company's principal plans were:

	Pension Benefits		Other Benefits	
	1998	1997	1998	1997
Weighted-average discount rate	6.5%	7.5%	6.5%	7.5%
Long-term rate of return on plan assets	10.0%	10.0%		

For measurement purposes a 7% annual increase in health care costs was assumed for 1999, decreasing gradually to 4.25% in ten years and remaining constant thereafter.

Increasing the health care cost trend rate by one percent would increase the obligation by $42 million and annual expense by $3 million. Decreasing the health care cost trend rate by one percent would decrease the obligation by $38 million and annual expense by $3 million.

The Company's net periodic benefit cost under these plans was as follows:

	Pension Benefits			Other Benefits		
$ Millions	1998	1997	1996	1998	1997	1996
Service cost	$ 47	$ 41	$ 45	$ 8	$ 8	$ 9
Interest cost	123	115	104	40	41	36
Expected return on plan assets	(153)	(134)	(116)	-	-	-
Amortization of transition asset	(4)	(9)	(9)	-	-	-
Other	12	13	16	4	9	10
	$ 25	$ 26	$ 40	$ 52	$ 58	$ 55

$ Millions	Pension Benefits 1998	1997	Other Benefits 1998	1997
Change in benefit obligation:				
Benefit obligation at beginning of year	$1,693	$1,491	$ 596	$ 545
Service cost	47	41	8	8
Interest cost	123	115	44	41
Plan participants' contributions	7	6	1	1
Amendments	2	4	-	-
Experience (gain) loss	161	128	20	26
Benefits paid	(123)	(96)	(29)	(25)
Other	(3)	4	-	-
Benefit obligation at end of year	$1,907	$1,693	$ 640	$ 596
Change in plan assets:				
Fair value of plan assets at beginning of year	$1,905	$1,555	$ -	$ -
Actual return on plan assets	(129)	414	-	-
Employer contribution	34	23	28	24
Plan participants' contributions	7	6	1	1
Benefits paid	(123)	(96)	(29)	(25)
Other	(2)	3	-	-
Fair value of plan assets at end of year	$1,692	$1,905	$ -	$ -
Funded status	$ (215)	$ 212	$ (640)	$ (596)
Unrecognized:				
Experience (gain) loss (a)	172	(269)	80	62
Prior service cost (b)	55	63	(11)	(12)
Transition asset (c)	(7)	(11)	-	-
Net amount recognized	$ 5	$ (5)	$ (571)	$ (546)
Amounts recognized in the statement of financial position:				
Prepaid benefit cost	$ 50	$ 9	$ -	$ -
Accrued benefit liability	(232)	(14)	(571)	(546)
Intangible asset	104	-	-	-
Accumulated other comprehensive income	83	-	-	-
Net amount recognized	$ 5	$ (5)	$ (571)	$ (546)

(a) The net deferred gain (loss) resulting from investments, other experience and changes in assumptions.
(b) The prior service effect of plan amendments deferred for recognition over remaining service.
(c) The balance of the initial difference between assets and obligations deferred for recognition over a 15-year period.

NOTE 11. COMMON STOCK: The Company increased its quarterly common stock dividend from 25 cents per share to 27.5 cents, effective with the dividend payment in June 1997.

In 1998, the Company repurchased 0.4 million shares on the open market at an aggregate purchase price of $14 million. In 1997, the Company repurchased 1.3 million shares from Ford Motor Company and another 0.2 million shares on the open market at an aggregate purchase price of $75 million. The Company repurchased 0.8 million shares on the open market at an aggregate purchase price of $34 million in 1996. All of the acquired shares are held as common stock in treasury.

In 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 stock held by this trust are not used in the calculation of earnings per share until allocated to a benefit plan.

NOTE 12. 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.

NOTE 13. 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, 1998, there were no shares of common stock available for grant and 1,234,875 options exercisable under the plans.

The Company accounts for stock options in accordance with APB Opinion No. 25 and related interpretations. No compensation expense has been recognized for stock options since the options have exercise prices equal to the market price of the Company's common stock at the date of grant.

Number of Shares	Options	Weighted-average exercise price
1,183,275	Dec. 31, 1995	38.45
394,150	Granted	40.13
(47,475)	Exercised	32.43
(19,800	Cancelled	41.00
1,510,150	Dec. 31, 1996	38.88
766,500	Granted	60.61
(294,025)	Exercised	35.85
(61,775)	Cancelled	42.66
1,920,850	Dec. 31, 1997	46.08
703,660	Granted	45.34
(54,075)	Exercised	36.36
(27,425)	Cancelled	53.80
2,543,010	Dec. 31, 1998	48.08

Options outstanding at December 31, 1998, have exercise prices between $15.94 and $79.81 and a weighted-average remaining life of 8 years. The weighted-average fair value of options granted was $18.61 per share in 1998 and $14.94 per share in 1997. The fair value of each option was estimated on the date of grant using a risk-free interest rate of 5.6 percent in 1998 and 6.4 percent in 1997, current annual dividends, expected lives of 10 years and expected volatility of 34 percent. A fair-value method of accounting for awards subsequent to January 1, 1996, would have had no material effect on results of operations.

NOTE 14. COMPREHENSIVE INCOME: Effective January 1, 1998, the Company adopted SFAS No. 130, a new accounting rule which requires companies to report comprehensive income. Comprehensive income includes net income and all other nonowner changes in equity during a period.

The tax effect on other comprehensive income is as follows:

	Foreign Currency Translation Adjustments	Unrealized Losses on Securities	Minimum Pension Liability Adjustments	Total Other Compre-hensive Income
1998				
Pre-tax amount	$(44)	$(1)	$(83)	$(128)
Tax (expense) benefit	1	1	29	31
Net amount	$(43)	$ -	$(54)	$ (97)
1997				
Pre-tax amount	$(21)	$(1)	$ 12	$ (10)
Tax (expense) benefit	-	-	-	-
Net amount	$(21)	$(1)	$ 12	$ (10)
1996				
Pre-tax amount	$ 26	$ -	$ 9	$ 35

Tax (expense) benefit	-	-	-	-
Net amount	$ 26	$ -	$ 9	$ 35

The components of accumulated other comprehensive income are as follows:

	Foreign Currency Translation Adjustments	Unrealized Losses on Securities	Minimum Pension Liability Adjustments	Accumulated Other Comprehensive Income
Balance at 12/31/95	$ (73)	$ -	$(22)	$ (95)
Change in 1996	26	-	9	35
Balance at 12/31/96	(47)	-	(13)	(60)
Change in 1997	(21)	(1)	12	(10)
Balance at 12/31/97	(68)	(1)	(1)	(70)
Change in 1998	(43)	-	(54)	(97)
Balance at 12/31/98	$(111)	$(1)	$(55)	$(167)

NOTE 15. SEGMENTS OF THE BUSINESS: Effective for 1998 annual reporting, the Company adopted SFAS No. 131 on segment reporting. Under the provisions of the new standard, Cummins has three reportable segments: Engine, Power Generation, and Filtration and Other. The engine segment produces engines and parts for sale to customers in automotive and industrial markets. The engines are used in trucks of all sizes, buses and recreational vehicles, as well as various industrial applications including construction, mining, agriculture, marine, rail and military. The power generation segment is the Company's power systems supplier, selling engines, generator sets and alternators. The filtration and other segment includes sales of filtration products and exhaust systems, turbochargers and company-owned distributors.

The Company's reportable segments are organized according to products and the markets they each serve. This business structure was designed to focus efforts on providing enhanced service to a wide range of customers.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies except that the Company evaluates performance based on earnings before interest and income taxes and on net assets, and, therefore, no allocation of debt-related items and income taxes is made to the individual segments.

Operating segment information is as follows:

1998	Engine	Power Generation	Filtration and Other	Total
Net sales	$3,982	$1,230	$1,054	$6,266
Depreciation & amortization	120	40	39	199
Income (expense) from joint ventures and alliances	(4)	(25)	(1)	(30)
Earnings before interest, income taxes and special charges	136	25	121	282
Special charges	165	50	2	217
Earnings (loss) before interest & income taxes	(29)	(25)	119	65
Net assets	946	511	803	2,260
Investment in joint ventures and alliances	132	3	1	136
Capital expenditures	172	67	32	271
Additions to goodwill	12	2	370	384
1997				
Net sales	$3,666	$1,205	$ 754	$5,625
Depreciation & amortization	102	34	22	158
Income (expense) from joint ventures and alliances	12	(2)	-	10
Earnings (loss) before interest and income taxes	207	(2)	107	312

Net assets	1,074	531	312	1,917
Investment in joint ventures and alliances	133	65	6	204
Capital expenditures	304	79	22	405
1996				
Net sales	$3,310	$1,213	$ 734	$5,257
Depreciation & amortization	97	31	21	149
Income (expense) from joint ventures and alliances	(2)	2	-	-
Earnings before interest and income taxes	160	14	58	232
Net assets	784	459	249	1,492
Investment in joint ventures and alliances	114	89	4	207
Capital expenditures	242	44	18	304

Reconciliation to Consolidated Financial Statements:

	1998	1997	1996
Earnings before interest & income taxes for reportable segments	$ 65	$ 312	$ 232
Interest expense	71	26	18
Income tax expense	4	74	54
Minority interest	11	-	-
Net earnings (loss)	$ (21)	$ 212	$ 160
Net assets for reportable segments	$2,260	$1,917	$1,492
Liabilities deducted in arriving at net assets	1,926	1,583	1,586
Deferred tax assets not allocated to segments	334	256	284
Debt-related costs not allocated to segments	22	9	7
Total assets	$4,542	$3,765	$3,369

Summary geographic information is listed below:

$ Millions	US	UK	Canada	Other	Total
1998					
Net sales (a)	$3,595	$ 389	$ 459	$1,823	$6,266
Long-lived assets	$1,470	$ 209	$ -	$ 272	$1,951
1997					
Net sales (a)	$3,123	$ 384	$ 318	$1,800	$5,625
Long-lived assets	$1,360	$ 251	$ -	$ 267	$1,878
1996					
Net sales (a)	$2,925	$ 348	$ 313	$1,671	$5,257
Long-lived assets	$1,201	$ 200	$ -	$ 211	$1,612

(a) Net sales are attributed to countries based on location of customer.

Revenues from the Company's largest customer represent approximately $1.1 billion of the Company's net sales in 1998. These sales are included in the engine and filtration and other segments.

NOTE 16. GUARANTEES, COMMITMENTS AND OTHER CONTINGENCIES: At December 31, 1998, the Company had the following minimum rental commitments for noncancelable operating leases: $41 million in 1999, $38 million in 2000, $30 million in 2001, $25 million in 2002, $21 million in 2003 and $46 million thereafter. Rental expense under these leases approximated $70 million in 1998, $60 million in 1997 and $55 million in 1996.

Commitments under outstanding letters of credit, guarantees and contingencies at December 31, 1998, approximated $195 million.

Cummins and its subsidiaries are defendants in a number of pending legal actions, including actions related 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 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 that 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 17. QUARTERLY FINANCIAL DATA (unaudited):

$ Millions, except per share amounts	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Full Year
1998					
Net sales	$1,500	$1,635	$1,525	$1,606	$6,266
Gross profit	297	369	258	325	1,249
Net earnings (loss)	7	53	(110)	29	(21)
Basic earnings (loss) per share	$ .18	$ 1.39	$(2.86)	$ .75	$ (.55)
Diluted earnings (loss) per share	.18	1.38	(2.86)	.75	(.55)
1997					
Net sales	$1,304	$1,396	$1,366	$1,559	$5,625
Gross profit	286	324	309	361	1,280
Net earnings	41	53	54	64	212
Basic earnings per share	$ 1.07	$ 1.40	$ 1.41	$ 1.69	$ 5.55
Diluted earnings per share	1.06	1.38	1.38	1.66	5.48

Earnings per share for the first three quarters of 1997 have been restated to reflect the adoption of SFAS No. 128 as disclosed in Note 1.

NOTE 18. ADDITIONAL INFORMATION:

Long-Lived Assets: The Company evaluates the carrying value of its long-lived assets for impairment whenever adverse events or changes in circumstances indicate that the carrying value of an asset may be impaired. In accordance with SFAS 121, if the quoted market price or if not available, the undiscounted cash flows are not sufficient to support the recorded asset value, an impairment loss is recorded to reduce the carrying value of the asset to the amount of expected discounted cash flows. This same policy is followed for goodwill.

Foreign Currency Gains and Losses: Total foreign currency remeasurement and transaction losses included in earnings were $5 million in 1998, $1 million in 1997 and $2 million in 1996.

Foreign Exchange Forward Contracts: The notional amounts of foreign exchange forward contracts outstanding at December 31 were as follows:

	Millions	
Currency	1998	1997
British Pound	$ 86	$ 90
French Franc	23	-
German Mark	19	27
Australian Dollar	13	103
Canadian Dollar	11	12
Hong Kong Dollar	8	-
Other	14	9
	$174	$241

Employee Stock Plans: A fair-value method of accounting for awards subsequent to January 1, 1996, would have resulted in an increase in compensation expense of $8 million, net of tax ($.20 per share) in 1998, $6 million, net of tax ($.14 per share) in 1997 and $2 million, net of tax ($.05 per share) in 1996.

Investment in Joint Ventures and Alliances: Additional summary financial information for joint ventures and alliances was as follows:

$Millions	Year Ended December 31 1998	1997	1996

Net sales	$1,245	$1,307	$1,328
Gross profit	25	111	84
Net earnings (loss)	(105)	5	3
Cummins' share	(52)	2	2

Other Income: The major components of Other Income, Net include the following:

$ Millions	1998	1997	1996
Goodwill amortization	$ 12	$ 2	$ 2
Interest income	(9)	(5)	(11)
Gain on sale of businesses	(7)	(13)	(8)
Rental income	(6)	(3)	-
Royalty income	(5)	(12)	(6)
Foreign currency losses	5	1	2
Gain on sale of building	-	-	(8)
Distribution system support	-	-	7
Other	(3)	4	(2)
Total	$(13)	$(26)	$(24)

Restructuring and Other Non-Recurring Charges: Activity in the major components of these charges was as follows:

$ Millions	Original Provision	Charges 1998	Balance Dec. 31, 1998
Restructuring of majority-owned operations:			
Workforce reductions	$ 38	$(12)	$ 26
Asset impairment loss	22	-	22
Facility consolidations and other	17	(8)	9
	77	(20)	57
Restructuring of joint venture operations:			
Workforce reductions	11	-	11
Tax asset impairment loss	7	-	7
Facility and equipment-related costs	5	-	5
	23	-	23
Inventory write-downs associated with exit activities	14	(5)	9
Total	$114	$(25)	$ 89

The remaining one-half of the employees to be severed related to these actions are expected to be terminated at various dates during 1999.

The tax asset impairment loss relates to a write-down of the investment in the Cummins Wartsila joint venture in an amount equal to certain deferred taxes previously recorded for losses of the joint venture. The Company had been adjusting the investment in the joint venture to reflect deferred taxes associated with net operating losses for the venture. Upon review of the restructuring plan and future operating results, it was determined that certain of the associated deferred tax assets for this joint venture are less likely to be recoverable.

EXHIBIT 23

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, 333-2165, 333-31573, 333-42687 and 333-67391.

ARTHUR ANDERSEN LLP

Chicago, Illinois
November 3, 1999.