

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

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 29, 1996 Commission File Number 1-4949

Indiana

35-0257090

(State or Other Jurisdiction of
Incorporation or Organization)

(IRS Employer Identification No.)

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 29, 1996, the number of shares outstanding of the registrant's only class of common stock was 39.5 million.

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CUMMINS ENGINE COMPANY, INC.
CONSOLIDATED STATEMENT OF EARNINGS
FOR THE THIRD QUARTER AND NINE MONTHS ENDED
SEPTEMBER 29, 1996 AND OCTOBER 1, 1995

Unaudited

Millions, Except per Share Amounts	Third Quarter		Nine Months	
	1996	1995	1996	1995
Net sales	\$1,264	\$1,219	\$3,896	\$3,914
Cost of goods sold	994	942	3,010	2,954
Gross profit	270	277	886	960
Selling & administrative expenses	177	154	537	518
Research & engineering expenses	60	61	188	194
Net expense of joint ventures and alliances	1	2	6	-
Interest expense	5	3	13	10
Other (income) expense, net	(4)	-	(22)	4
Restructuring charge	-	2	-	2
Earnings before income taxes	31	55	164	232
Provision for income taxes	5	9	45	50
Net earnings	\$ 26	\$ 46	\$ 119	\$ 182
Earnings per share	\$.67	\$ 1.14	\$ 2.99	\$ 4.47
Cash dividends declared per share	.25	.25	.75	.75

CUMMINS ENGINE COMPANY, INC.
CONSOLIDATED STATEMENT OF FINANCIAL POSITION

Unaudited

Millions, Except per Share Amounts	9/29/96	12/31/95
Assets		
Current assets:		
Cash and cash equivalents	\$ 79	\$ 60
Receivables	728	597
Inventories	621	513
Other current assets	220	218
	1,648	1,388
Investments and other assets	286	326
Property, plant and equipment less accumulated depreciation of \$1,352 & \$1,327	1,163	1,148
Intangibles, deferred taxes and deferred charges	204	194
Total assets	\$3,301	\$3,056
Liabilities and shareholders' investment		
Current liabilities:		
Loans payable	\$ 19	\$ 60
Current maturities of long-term debt	50	42
Accounts payable	390	376
Other current liabilities	585	575

	1,044	1,053
Long-term debt	<u>259</u>	<u>117</u>
Other liabilities	<u>747</u>	<u>703</u>
Shareholders' investment:		
Common stock, \$2.50 par value, 44.0 and 43.9 shares issued	110	110
Additional contributed capital	929	926
Retained earnings	495	406
Common stock in treasury, at cost, 4.5 & 3.7 shares	(169)	(135)
Unearned compensation	(46)	(51)
Cumulative translation adjustments	(68)	(73)
	<u>1,251</u>	<u>1,183</u>
Total liabilities & shareholders' investment	<u>\$3,301</u>	<u>\$3,056</u>

CUMMINS ENGINE COMPANY, INC.
CONSOLIDATED STATEMENT OF CASH FLOWS

Unaudited

Millions	Nine Months Ended 9/29/96	10/1/95
Cash flows from operating activities:		
Net earnings	\$ 119	\$ 182
Adjustments to reconcile net earnings to net cash from operating activities:		
Depreciation and amortization	111	106
Restructuring actions	(36)	2
Accounts receivable	(125)	(74)
Inventories	(106)	(49)
Accounts payable and accrued expenses	77	27
Income taxes payable	11	2
Other	(5)	10
Total adjustments	<u>(73)</u>	<u>24</u>
Net cash provided by operating activities	<u>46</u>	<u>206</u>
Cash flows from investing activities:		
Property, plant and equipment:		
Additions	(151)	(130)
Disposals	30	3
Joint venture investments	32	(85)
Disposition of business activities	13	-
Other	8	(1)
Net cash used in investing activities	<u>(68)</u>	<u>(213)</u>
Net cash flows used for operating and investing activities	<u>(22)</u>	<u>(7)</u>
Cash flows from financing activities:		
Proceeds from borrowings	160	-
Payments on borrowings	(14)	(8)
Net borrowings under credit agreements	(41)	42
Dividend payments	(30)	(30)
Repurchases of common stock	(34)	(69)
Other	(1)	1
Net cash provided from (used for) financing activities	<u>40</u>	<u>(64)</u>
Effect of exchange rate changes on cash	1	1
Net change in cash and cash equivalents	<u>19</u>	<u>(70)</u>
Cash & cash equivalents at beginning of year	60	147
Cash & cash equivalents at the end of quarter	<u>\$ 79</u>	<u>\$ 77</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Unaudited

Note 1. Accounting Policies: The Consolidated Financial Statements for the interim periods ended September 29, 1996 and October 1, 1995 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. In the first nine months of 1995, the Company recognized approximately \$31 million related to a reduction in its valuation allowance for tax benefit carryforwards.

Note 3. Long-term Debt: The Company maintains a revolving credit agreement, under which there were no outstanding borrowings at September 29, 1996. In the second quarter of 1996, the agreement was amended, increasing the available amount to \$400 million and extending the term to 2001. The revolving credit agreement supported commercial paper borrowings of \$50 million at September 29, 1996. The commercial paper borrowings were issued as replacement financing for an arrangement whereby the Company sold up to \$110 million receivables without recourse. The agreement for the sale of receivables expired in the second quarter and was not renewed by the Company. In the first quarter of 1996, a subsidiary of the Company issued 8.2 percent notes, which resulted in net proceeds of \$100 million.

Note 4. Stock Repurchase Program: In October 1994, the Board of Directors authorized repurchase by the Company of up to 2,500,000 shares of its common stock. During the first nine months of 1996, the Company completed this program with the repurchase of 821,500 shares on the open market at an aggregate purchase price of \$34 million, or average price of \$41.35 per share. The Company repurchased 1,575,400 shares at an aggregate purchase price of \$69 million, or average price of \$43.57 per share, in 1995 and 103,100 shares at an aggregate purchase price of \$5 million, or average price of \$42.47 per share, in 1994.

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 includes the exercise of certain stock options granted to employees, was 39.6 million in the third quarter of 1996 and 40.0 million in the first nine months of 1996. The weighted-average number of shares was 40.4 million in the third quarter of 1995 and 40.8 million in the first nine months of 1995.

CUMMINS ENGINE COMPANY, INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS
OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

OVERVIEW

The Company's net sales of \$1.3 billion in the third quarter of 1996 were \$45 million, or 4 percent, higher than the third quarter of 1995. The Company traditionally experiences a seasonal decline in its automotive markets in the third quarter. In addition, in the third quarter of 1996, Cummins experienced the decline in the North American heavy-duty truck market that was anticipated for the second half of 1996. Sales to power generation and certain industrial markets were strong, however, offsetting the decline in sales to automotive markets.

The Company shipped 249,400 engines in the first nine months of 1996 as indicated in the following table:

	Third Quarter		Nine Months	
Engine Shipments	1996	1995	1996	1995

Midrange engines	52,500	49,000	176,100	167,500
Heavy-duty engines	19,700	25,000	66,200	82,400
High-horsepower engines	2,700	2,300	7,100	7,000
Total	<u>74,900</u>	<u>76,300</u>	<u>249,400</u>	<u>256,900</u>

The Company's net earnings were \$26 million, or 67 cents per share, in the third quarter of 1996 compared to \$46 million, or \$1.14 per share, in the third quarter of 1995. For the first nine months of 1996, net earnings were \$119 million, or \$2.99 per share, compared to \$182 million, or \$4.47 per share, in the first nine months of 1995. Although sales exceeded the 1995 level, the Company's results were affected by several factors, including the decline in heavy-duty production that resulted in lower fixed cost absorption, a shift in sales to lower margin power generation products and higher than anticipated costs to implement the restructuring actions.

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	
	1996	1995	1996	1995
Net sales	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>
Cost of goods sold	78.6	77.3	77.3	75.5
Gross profit	<u>21.4</u>	<u>22.7</u>	<u>22.7</u>	<u>24.5</u>
Selling and administrative expenses	14.0	12.6	13.8	13.2
Research and engineering expenses	4.7	5.0	4.8	5.0
Net expense of joint ventures & alliances	.1	.2	.2	-
Interest expense	.4	.2	.3	.3
Other (income) expense, net	(.3)	-	(.6)	.1
Restructuring charge	-	.2	-	-
Earnings before income taxes	<u>2.5</u>	<u>4.5</u>	<u>4.2</u>	<u>5.9</u>
Provision for income taxes	.4	.7	1.1	1.3
Net earnings	<u>2.1</u>	<u>3.8</u>	<u>3.1</u>	<u>4.6</u>

Net Sales

Sales for each of the Company's markets for the comparative reporting periods were:

Dollars in Millions	Third Quarter		Nine Months	
	1996	1995	1996	1995
Heavy-duty truck	\$ 274	\$ 361	\$ 929	\$1,155
Midrange truck	131	143	445	446
Bus and light commercial vehicles	166	139	562	502
Power generation	348	269	918	824
Industrial products	183	149	540	499
Marine	29	23	91	69
Fleetguard and Holset	133	135	411	419
Net sales	<u>\$1,264</u>	<u>\$1,219</u>	<u>\$3,896</u>	<u>\$3,914</u>

Sales of \$274 million to the heavy-duty truck market were 24 percent lower than the third quarter of 1995. The North American heavy-duty truck market is experiencing the decline anticipated for the second half of 1996. The latest estimates for 1996 project a market size approximately 25 percent below 1995. This lower market size has been the cause for the Company's drop in engine shipments in 1996. International engine shipments were 4 percent lower compared to the third quarter of 1995, due primarily to lower demand from European markets.

Midrange truck engine sales of \$131 million in the third quarter of 1996 were 8 percent lower than the third quarter of 1995. In North America, engine shipments were 14 percent lower than the third quarter of 1995, due to an overall decrease in demand for medium-duty trucks. Shipments for international markets have been higher in 1996 due to demand in Mexico.

Sales for the bus and light commercial vehicles market were 19 percent higher than the third quarter of 1995 and 12 percent higher than the first nine months of 1995 due to the high level of sales of midrange engines to Chrysler.

Sales of \$348 million to the power generation market were \$79 million higher, a 29-percent increase compared to the third quarter of 1995. The increase was all in international markets, due primarily to strong demand in China, India and Southeast Asia. Power generation, however, continues to be affected by price competition in international markets and a shift in sales to lower margin products. For the first nine months of 1996, sales were 11 percent higher than the same period of 1995.

Sales to industrial markets, which traditionally are affected by a seasonal decline in the third quarter, were 23 percent higher, compared to the third quarter of 1995. The increase was due to strong sales of engines for construction equipment in international markets. Sales in the first nine months of 1996 were \$540 million, 8 percent higher than the first nine months of 1995.

In the third quarter and first nine months of 1996, sales of filtration products and turbochargers were slightly lower than the prior year's respective periods.

Gross Profit

In the third quarter of 1996, the Company's gross profit percentage was 21.4 percent of net sales, compared to 22.7 percent in the third quarter of 1995. In the first nine months of 1996, the Company's gross profit percentage was 22.7 percent of net sales, compared to 24.5 percent in the first nine months of 1995.

The reduction in gross profit in 1996 was due to several factors, the most significant of which was the decline in heavy-duty production that resulted in lower fixed cost absorption. Gross profit in 1996 also was affected by lower demand for midrange engines for medium-duty trucks, price competition and higher sales of lower margin power generation products and expenses associated with restructuring actions. While the restructuring actions are proceeding, expenses associated with implementation of certain of these actions have been higher than anticipated. In the third quarter and first nine months of 1996, product coverage expense was 2.9 percent and 2.8 percent of net sales, respectively, compared to 2.6 percent and 2.5 percent of net sales in the comparative periods of 1995.

Operating Expenses

Selling and administrative expenses of \$177 million, 14.0 percent of net sales, in the third quarter and \$537 million, 13.8 percent of net sales, in the first nine months of 1996 reflected expenditures associated with the restructuring actions and marketing programs that offset a decrease in administrative expenses.

In the third quarter and first nine months of 1996, research and engineering expenses of \$60 million and \$188 million, respectively, were slightly lower than the prior year's levels.

Net expense of joint ventures and alliances was associated with product development and start-up costs of the joint venture with Wartsila.

Interest and Other Income and Expense

Interest expense in the third quarter and first nine months of 1996 was slightly higher than the comparable periods of 1995 due to the increase in long-term debt.

Other income and expense includes a variety of items, such as foreign currency gains and losses, royalties, interest income, and gains and losses associated with fixed asset dispositions. In the first nine months of 1996 other income of \$22 million was generated primarily from capital gains associated with various asset disposals.

Provision For Income Taxes

The estimated effective tax rate for 1996 is 26 percent. This is lower than the US federal statutory rate of 35 percent, primarily because of export sales, lower state taxes and the effect of reinstatement of the research credit. Tax provisions in the Small Business Job Protection Act that was signed into law in August 1996 included reinstatement of the research credit for an 11-month period, beginning July 1, 1996. In the

first nine months of 1995, the Company recognized approximately \$31 million related to a reduction in its valuation allowance for tax benefit carryforwards.

CASH FLOW AND FINANCIAL CONDITION

Key elements of the Consolidated Statement of Cash Flows were:

Dollars in Millions	First Nine Months	
	1996	1995
Net cash provided by operating activities	\$ 46	\$206
Net cash used in investing activities	(68)	(213)
Net cash flows used for operating and investing activities	(22)	(7)
Net cash provided from (used for) financing activities	40	(64)
Effect of exchange rate changes on cash	1	1
Net change in cash and cash equivalents	\$ 19	\$(70)

During the first nine months of 1996, cash flows used for operating and investing activities were \$22 million compared to \$7 million in the first nine months of 1995. In the second quarter of 1996, an agreement for the sale of up to \$110 million of accounts receivable was not renewed by the Company, which resulted in an increase in receivables and a lower level of net cash flows provided by operating activities. Investing activities required \$151 million for capital expenditures in the first nine months of 1996.

Net cash provided from financing activities was \$40 million in the first nine months of 1996. Total indebtedness was \$328 million at September 29, 1996 compared to \$219 million at December 31, 1995. As disclosed more fully in Note 3 to the Consolidated Financial Statements, the Company amended its revolving credit agreement in the second quarter of 1996 to increase the available amount to \$400 million and extend the term to 2001. There were no outstanding borrowings under the agreement at September 29, 1996. Commercial paper borrowings of \$50 million were outstanding at September 29, 1996. In the first quarter of 1996, a subsidiary of the Company issued 8.2 percent notes, which resulted in net proceeds of \$100 million.

As disclosed in Note 4 to the Consolidated Financial Statements, the Company repurchased on the open market 821,500 shares of its common stock at an average price of \$41.35 per share in the first nine months of 1996.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings:

On July 8, 1996, the United States District Court for the Southern District of Indiana entered an order approving the settlement of Warkel v. Cummins Engine Company, et.al.

Item 5. Other Information:

Certain information contained in this Form 10-Q is forward-looking and involves risks and uncertainties, including general economic and competitive conditions that could significantly affect expected results.

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

- (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 1996.

Signatures

the registrant has duly caused this report to be signed on its behalf
by the undersigned thereunto duly authorized.

CUMMINS ENGINE COMPANY, INC.

By: /s/John McLachlan

John McLachlan
Vice President - Corporate Controller
(Chief Accounting Officer)

October 30, 1996

CUMMINS ENGINE COMPANY, INC.

INDEX TO EXHIBITS

- 11 Schedule of Computation of Per Share Earnings for the Third
Quarter and Nine Months Ended September 29, 1996 and
October 1, 1995 (filed herewith)
- 27 Financial Data Schedule (filed herewith)

CUMMINS ENGINE COMPANY, INC.

EXHIBIT 11

SCHEDULE OF COMPUTATION OF PER SHARE EARNINGS
FOR THE THIRD QUARTER AND NINE MONTHS ENDED
SEPTEMBER 29, 1996 AND OCTOBER 1, 1995

Millions, Except per Share Amounts	Third Quarter		Nine Months	
	Weighted Average Shares	Net Earnings	Weighted Average Shares	Net Earnings
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		\$.67		\$2.99
1995				
Shares outstanding & net earnings	40.3	\$ 46	40.7	\$182
Options	.1	-	.1	-
Used in the determination of earnings per share	40.4	\$ 46	40.8	\$182
Primary and fully diluted earnings per share		\$1.14		\$4.47

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