

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

CUMMINS ENGINE COMPANY, INC.

For the Quarter Ended March 28, 1999 Commission File Number 1-4949

Indiana

35-0257090

(State or Other Jurisdiction of
Incorporation or Organization)

(I.R.S. 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 March 28, 1999, the number of shares outstanding of the registrant's only class of common stock was 42.2 million.

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CUMMINS ENGINE COMPANY, INC.
CONSOLIDATED STATEMENT OF EARNINGS
Unaudited

Millions, except per share amounts	First Quarter Ended	
	3/28/99	3/29/98
Net sales	\$1,505	\$1,500
Cost of goods sold	1,204	1,160
Special charge	-	43
Gross profit	<u>301</u>	<u>297</u>
Selling & administrative expenses	178	202
Research & engineering expenses	54	67
Net expense from joint ventures & alliances	7	4
Interest expense	19	17
Other expense (income), net	7	(7)
Earnings before income taxes	<u>36</u>	<u>14</u>
Provision for income taxes	10	4
Minority interest	2	3
Net earnings	<u>\$ 24</u>	<u>\$ 7</u>
Basic earnings per share	\$.63	\$.18
Diluted earnings per share	.63	.18
Cash dividends declared per share	.275	.275

CUMMINS ENGINE COMPANY, INC.
CONSOLIDATED STATEMENT OF FINANCIAL POSITION
Unaudited

Millions, except per share amounts	3/28/99	12/31/98
Assets		
Current assets:		
Cash and cash equivalents	\$ 45	\$ 38
Receivables	962	833
Inventories	733	731
Other current assets	283	274
	<u>2,023</u>	<u>1,876</u>
Investments and other assets	294	280
Property, plant & equipment less accumulated depreciation of \$1,464 and \$1,424	1,655	1,671
Goodwill, net of amortization of \$20 and \$17	380	384
Other intangibles, deferred taxes & deferred charges	339	331
Total assets	<u>\$4,691</u>	<u>\$4,542</u>
Liabilities and shareholders' investment		
Current liabilities:		
Loans payable	\$ 21	\$ 64
Current maturities of long-term debt	27	26
Accounts payable	381	340
Other current liabilities	684	641
	<u>1,113</u>	<u>1,071</u>
Long-term debt	<u>1,213</u>	<u>1,137</u>
Other liabilities	<u>1,003</u>	<u>1,000</u>
Minority interest	<u>67</u>	<u>62</u>
Shareholders' investment:		
Common stock, \$2.50 par value, 48.3 and 48.1		

shares issued	121	120
Additional contributed capital	1,126	1,121
Retained earnings	660	648
Accumulated other comprehensive income	(166)	(167)
Common stock in treasury, at cost, 6.1 shares	(240)	(240)
Common stock held in trust for employee benefit plans, 3.6 shares	(171)	(172)
Unearned compensation (ESOP)	(35)	(38)
	<u>1,295</u>	<u>1,272</u>
Total liabilities & shareholders' investment	<u>\$4,691</u>	<u>\$4,542</u>

CUMMINS ENGINE COMPANY, INC.
CONSOLIDATED STATEMENT OF CASH FLOWS
Unaudited

Millions	First Quarter Ended	
	3/28/99	3/29/98
Cash flows from operating activities:		
Net earnings	\$ 24	\$ 7
Adjustments to reconcile net earnings to net cash from operating activities:		
Depreciation and amortization	56	47
Restructuring actions	(5)	(6)
Accounts receivable	(130)	(113)
Inventories	(2)	(54)
Accounts payable and accrued expenses	95	120
Income taxes payable	(5)	(7)
Equity in losses of joint ventures and alliances	11	7
Other	(12)	20
Total adjustments	<u>8</u>	<u>14</u>
Net cash provided by operating activities	<u>32</u>	<u>21</u>
Cash flows from investing activities:		
Property, plant and equipment:		
Additions	(37)	(83)
Disposals	4	2
Investments in joint ventures and alliances	(19)	(20)
Acquisition and disposition of businesses	7	(453)
Other	(1)	-
Net cash used in investing activities	<u>(46)</u>	<u>(554)</u>
Net cash flows used for operating and investing activities	<u>(14)</u>	<u>(533)</u>
Cash flows from financing activities:		
Proceeds from borrowings	88	710
Payments on borrowings	(11)	(103)
Net payments under credit agreements	(43)	(62)
Dividend payments	(12)	(12)
Other	(1)	(1)
Net cash provided from financing activities	<u>21</u>	<u>532</u>
Net change in cash and cash equivalents	7	(1)
Cash & cash equivalents at beginning of the year	38	49
Cash & cash equivalents at the end of the quarter	<u>\$ 45</u>	<u>\$ 48</u>

CUMMINS ENGINE COMPANY, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Unaudited

Note 1. Accounting Policies: The Consolidated Financial Statements for the interim periods ended March 28, 1999 and March 29, 1998 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. Acquisition: In January 1998, Cummins 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. 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 Charge: In the first quarter of 1998, the Company recorded a special charge for product coverage expense primarily attributable to the recent experience of higher-than-anticipated costs to repair certain automotive engines manufactured in previous years. The Company believes it was necessary to make a special charge of \$43 million pre-tax to accrue for such product coverage costs expected to be incurred in the future on these engines currently in the field.

Note 4. Income Taxes: Income tax expense is reported during the interim reporting periods on the basis of the estimated annual effective tax rate for the taxable jurisdictions in which the Company operates.

Note 5. Long-term Debt: In February 1998, the Company issued \$765 million face amount of notes and debentures. Net proceeds were used to finance the acquisition of Nelson and pay down other indebtedness outstanding at December 31, 1997.

Note 6. Earnings per Share: Basic earnings per share of common stock are computed by dividing net earnings by the weighted-average number of common shares outstanding during 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. Shares of stock held by the employee benefits trust are not included in outstanding shares for EPS until distributed from the trust.

Millions, except per share amounts	Net Earnings	Weighted Average Shares	Per-Share Amount
1999			
Basic	\$24	38.5	\$.63
Options	-	-	
Diluted	\$24	38.5	\$.63
1998			
Basic	\$ 7	38.5	\$.18
Options	-	.4	
Diluted	\$ 7	38.9	\$.18

Note 7. Comprehensive Income: Comprehensive income, which includes net income and all other nonowner changes in equity during a period, is as follows:

Millions	First Quarter Ended	
	March 28, 1999	March 29, 1998
Net income	\$ 24	\$ 7
Unrealized gain on securities	1	-
Translation loss	-	(19)
Comprehensive income	\$ 25	\$(12)

Note 8. Segment Information: Operating segment information is as follows:

Millions	Engine	Power Generation	Filtration And Other	Total
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Quarter Ended March 28, 1999

Net sales	\$1,000	\$251	\$254	\$1,505
Earnings before interest and income taxes	27	2	26	55
Net assets	976	523	799	2,298

Quarter Ended March 29, 1998

Net sales	\$ 953	\$291	\$256	\$1,500
Earnings before interest, income taxes & special charges	48	2	24	74
Special charges	43	-	-	43
Earnings before interest and income taxes	5	2	24	31
Net assets	1,170	540	814	2,524

Reconciliation to Consolidated Financial Statements:

Millions	First Quarter Ended	
	3/28/99	3/29/98
Earnings before interest and income taxes for reportable segments	\$ 55	\$ 31
Interest expense	19	17
Income tax expense	10	4
Minority interest	2	3
Net earnings	\$ 24	\$ 7
Net assets for reportable segments	\$2,298	\$2,524
Liabilities deducted in arriving at net assets	2,037	1,693
Deferred tax assets not allocated to segments	334	257
Debt-related costs not allocated to segments	22	22
Total assets	\$4,691	\$4,496

CUMMINS ENGINE COMPANY, INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS,
CASH FLOW AND FINANCIAL CONDITION

Overview

Net sales were \$1.5 billion in the first quarter of 1999, essentially flat with the first quarter of 1998. Earnings before interest and taxes in the first quarter of 1999 were \$55 million or 3.7 percent of sales. Net earnings were \$24 million or 63 cents per share compared to \$7 million or 18 cents per share in the first quarter of 1998. Excluding the special charge for product coverage costs, net earnings in the first quarter of 1998 were \$37 million or 96 cents per share.

Results of Operations

Net Sales:

Revenues from sales of engines were 58 percent of the Company's net sales in the first quarter of 1999, with engine revenues 6 percent higher than first-quarter 1998 and unit shipments 10 percent higher. This variance reflected a shift from heavy-duty and high-horsepower engines to more mid-range engines in certain industrial markets and a mix shift within the Company's medium-duty truck sales to lower unit revenue engines.

Unit Shipments	First Quarter	
	1999	1998
Midrange Engines	73,700	65,000
Heavy-duty Engines	26,800	26,900
High-horsepower Engines	2,000	2,200
	102,500	94,100

Revenues from non-engine products, which were 42 percent of net sales

in the first quarter of 1999, were 6 percent lower than the first quarter of 1998. This decrease was primarily due to the continued softening of the power generation business in Asia.

The Company's sales for each of its key businesses during the comparative first quarters were:

\$ Millions	First Quarter	
	1999	1998
Automotive markets	\$ 760	\$ 684
Industrial markets	240	269
Engine Business	1,000	953
Power Generation Business	251	291
Filtration Business and Other	254	256
	<u>\$1,505</u>	<u>\$1,500</u>

In the first quarter of 1999, engine business revenues of \$1 billion increased 5 percent as compared to the first quarter of 1998, primarily due to the strength of the North American automotive market.

Sales of \$760 million in the first quarter of 1999 for automotive markets were 11 percent higher than the first quarter of 1998. Heavy-duty truck revenues increased 8 percent from the first quarter of 1998 due to the strong market in North America, partially offset by reduced demand in Mexican and European automotive markets.

Medium-duty truck revenues increased 14 percent from the first quarter of 1998 due to higher sales of engines combined with lower kits and parts sales. Revenues from the sales of engines for medium-duty trucks in the first quarter of 1999 were 26 percent higher than the prior year's quarter on a 43-percent increase in units. This variance reflected a mix shift towards engines with a lower selling price and margin.

Revenues of the bus and light commercial vehicle market were 15 percent higher than the first quarter of 1998. In the first quarter of 1999, Cummins shipped 25,300 engines to DaimlerChrysler, 14 percent higher than the first-quarter 1998 level. Bus and recreational vehicle volumes increased 27 percent from the year-ago quarter due to growth in sales of midrange engines in North America.

Sales to industrial markets were 11 percent lower than the first quarter of 1998, due to decreased volume and a shift in product mix. Engine revenues for this market were down 13 percent on a 9-percent decrease in units. Construction equipment business remained relatively flat compared to first quarter 1998, while agricultural equipment demand declined 51 percent from the prior year's quarter. Sales to marine markets increased 9 percent from first quarter 1998, with a shift to more mid-range engines in recreational applications. Mining market sales decreased 12 percent as compared to the first quarter of 1998, reflecting lower high-horsepower engine volumes.

In the first quarter of 1999, sales for the Company's power generation business decreased 14 percent compared to first quarter 1998. Sales of the Company's generator sets were 18 percent below first quarter last year due to declines in Latin America, which offset increased sales in North America. Engine sales to generator set assemblers were down 15 percent and sales of alternators decreased 24 percent from the first quarter of 1998 due to lower Asian demand. However, generator set sales for the recreational vehicle market in North America continued to be strong, with revenues 11 percent above the year-ago quarter.

Filtration business and other sales were \$254 million in the first quarter of 1999, essentially flat with the first quarter of 1998. Within the filtration business, the Company was impacted by reduced demand in agricultural and mining markets, offset by market gains in Europe, South Africa and Australia.

In total, international markets represented 36 percent of the Company's revenues in the first quarter of 1999. The Company experienced declines in most of the international markets in which it participates. Sales to Europe and the CIS, representing 12 percent of the Company's sales in the first quarter of 1999, were 6 percent lower than the prior year's quarter. Business in Mexico, Brazil and Latin America represented 5 percent of sales in the first quarter of 1999, with revenues 40 percent below the year-ago levels. Asia and Australian markets, in total, represented 11 percent of sales in the first quarter of 1999 as compared to 14 percent in the prior year's quarter. Sales to Canada, representing 6 percent of sales in the first quarter of 1999, were 23 percent lower than the first quarter of 1998.

Gross Margin:

The Company's gross margin percentage was 20.0 percent in the first quarter of 1999, compared to 19.8 percent in the prior year's quarter. Gross margin percentage before the special charge for product coverage costs was 22.7 percent in the first quarter of 1998. The decreased margin in 1999 was due to higher product coverage costs, increased costs related to new products, a change in product mix and the effect of the devaluation of the Brazilian Real.

Operating Expenses:

Selling and administrative expenses as a percent of sales were 11.8 percent in the first quarter of 1999, compared to 13.4 percent in the first quarter of 1998, a decrease of \$24 million in absolute dollars. This improvement is primarily a result of the Company's cost reduction initiatives. Research and engineering expenses declined from 4.5 percent of sales in the first quarter of 1998 to 3.5 percent in the first quarter of 1999, primarily due to new products moving into production and some delay in the start-up of new programs.

The Company is continuing the restructuring plan implemented in the third quarter of 1998. During the first quarter of 1999, \$12 million was charged against the liabilities associated with these actions. The Company does not anticipate any material changes in the original charges recorded for these actions.

The Company's losses from joint ventures and alliances were \$7 million in the first quarter of 1999, compared to \$4 million in the first quarter of 1998. This difference resulted from higher losses at the Company's joint venture with Wartsila where business continues to be affected by decreased demand in Asia.

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.

The Company's Year 2000 efforts are being carried out by the Company's Year 2000 Program Office under the leadership of the Director of the Year 2000 Program. The Year 2000 effort is being implemented at each of the Company's facilities and is overseen by a Year 2000 coordinator. In addition to internal resources, the Company continues to retain external resources to assist with its Year 2000 program.

The Company's Year 2000 program involves: 1) mainframe (legacy systems); 2) distributed computing (includes manufacturing and warehousing systems, end user computing, facility systems, laboratory equipment, technical infrastructure and remote business systems); 3) products; 4) suppliers; 5) business readiness and contingency planning and 6) communication. The general phases of the program are: a) inventory; b) analyze and prioritize; c) determine compliance; d) remediate, replace or retire and e) test, implement, audit and maintain.

The Company completed the inventorying, analyzing and prioritizing phase of its mainframe and distributed computing in 1998. Substantial portions of the Company's remediation and implementation efforts were conducted in 1998, and the Company is on track to complete that process by the end of the second quarter of 1999. Testing began in 1998 and will continue through 1999. The Company's Year 2000 Program Office continues to monitor the progress and compliance of its facilities through audits and reports by the Year 2000 coordinators. The Company's goal is to be Year 2000 ready by June 30, 1999. The Company will use its best efforts to ensure that any Year 2000 item not completed by that date would be completed well before the end of 1999.

During the first quarter, the Company announced that its commercial products met the Company's Year 2000 compliance standards. For the convenience of its customers, the Company continues to maintain a Year 2000 Internet website at www.cummins.com/custasis/y2k.html. The Company's product compliance information is also included on that website.

The greatest area of potential risk is the supply chain. This is particularly true because the Company utilizes sole suppliers for certain critical components used in the manufacture of the Company's products. The high level of skill and expertise required to develop

certain components makes it impractical to change such suppliers quickly. The failure of a sole supplier may lead to a delay in production and/or business interruption. To mitigate this, the Company continues its efforts to review the Year 2000 readiness of key suppliers through a formal program of prioritization and communication using questionnaires and/or personal follow up, as appropriate. To further the Company's efforts with suppliers, the Company continues to be a member of the Automotive Industry Action Group (AIAG).

There can be no assurances that the systems or products of third parties relied upon by the Company, such as suppliers, vendors or significant customers, will be timely converted or that a failure by such third parties or a conversion that is incompatible with the Company's systems, would not have a material adverse effect on the Company. Other undiscovered factors related to the Year 2000 issue may also have potential for an adverse effect on the Company. Such adverse effect may include an adverse effect on the Company's revenues.

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 \$35 million in costs relating to its Year 2000 efforts.

The Company believes that its "reasonably likely worst case scenarios" involve the failure of third parties with whom the Company does business to address Year 2000 issues. As a result, in the following months, the Company intends to focus on business readiness and contingency planning to address possible external Year 2000 problems. A significant part of this effort will be the evaluation of the risk to the Company's operations from external sources, and the development of strategies to manage those risks. The Company's efforts in this regard include identifying alternate suppliers, vendors and procedures where possible, conducting employee training and developing communication plans. The Company's contingency planning also covers the identification and evaluation of risk areas at the Company's international locations.

The Company believes that it is taking full advantage of its internal resources and all necessary external resources to understand, identify and correct all Year 2000 issues within its control. The Company is also taking steps to minimize the impact of its exposure to Year 2000 risks outside its control.

The estimated time of completion and success 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 trained personnel, the ability to locate and correct all relevant computer code and failure by third parties.

Other:

Interest expense was \$19 million in the first quarter of 1999, compared to \$17 million in the prior year's quarter. Other income decreased \$14 million from the first quarter of 1998, due to Brazilian currency translation losses, loss on various asset dispositions and reduction in royalty income.

Provision for Income Taxes:

The Company's income tax provision in the first quarter of 1999 was \$10 million, reflecting an effective tax rate of 29 percent for the year.

Cash Flow and Financial Condition

Key elements of cash flows were:

\$ Millions	First Quarter	
	1999	1998
Net cash used for operating and investing activities	\$ (14)	\$ (533)
Net cash from financing activities	21	532
Net change in cash and cash equivalents	\$ 7	\$ (1)

In the first quarter of 1999, net cash used for operating and investing

activities was \$14 million. The high level of net cash requirements in the first quarter of 1998 was due primarily to the acquisition of Nelson and planned capital expenditures of \$83 million. In the first quarter of 1998, the Company issued \$765 million face amount of notes and debentures to support working capital and to complete the acquisition of Nelson.

FORWARD-LOOKING STATEMENTS

When used herein, the terms "expect, plan, anticipate, believe" or similar expressions, as they relate to the Company or its management, are intended to identify forward-looking statements.

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

PART II. OTHER INFORMATION

Item 4. Submission of Matters to a Vote of Security Holders

The Company held its annual meeting of security holders on April 6, 1999 at which security holders elected 13 directors of the Company for the ensuing year and ratified the appointment of Arthur Andersen LLP as auditors for the year 1999.

Results of the voting in connection with each of the items were as follows:

Voting on Directors:

	For	Withheld
H. Brown	36,074,950	1,402,960
R. Darnall	36,258,197	1,219,713
J. M. Deutch	36,247,396	1,230,514
W. Y. Elisha	36,245,001	1,232,909
H. H. Gray	36,148,638	1,329,272
J. A. Henderson	36,121,573	1,356,337
J. A. Johnson	36,249,849	1,228,061
W. I. Miller	36,259,031	1,218,879
W. D. Ruckelshaus	36,206,535	1,271,375
H. B. Schacht	36,235,405	1,242,505
T. M. Solso	36,015,077	1,462,833
F. A. Thomas	36,247,743	1,230,167
J. L. Wilson	36,211,409	1,266,501

Ratify Appointment of Auditors:

For	Against	Abstain
36,684,408	602,364	191,138

With regard to the election of directors, votes were cast in favor of or withheld from each nominee; votes that were withheld were excluded entirely from the vote and had no effect. Abstentions on the ratification of the appointment of Arthur Andersen LLP were counted as present for purposes of determining the existence of a quorum. Under the rules of the New York Stock Exchange, brokers who held shares in street names had the authority to vote on certain items when they did not receive instructions from beneficial owners. Brokers who did not receive instructions were entitled to vote on the election of directors. Under applicable Indiana law, a broker non-vote had no effect on the outcome of the election of directors.

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

- (a) See the Index to Exhibits on Page 15 for a list of exhibits filed herewith.
- (b) The Company was not required to file a Form 8-K during the first quarter of 1999.

Signatures

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

CUMMINS ENGINE COMPANY, INC.

By: /s/Rick J. Mills

May 4, 1999

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

CUMMINS ENGINE COMPANY, INC.

INDEX TO EXHIBITS

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