value

Cummins

Annual Report 1998

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Highlights

Cummins Engine Company, Inc.

$ Millions, except per share amounts	1998	1997
Net sales	$6,266	$5,625
Gross profit	1,249	1,280
Selling and administrative expenses	787	744
Research and engineering expenses	255	260
Other income, net	13	26
Earnings before interest and taxes:		
Before unusual charges	282	312
As reported	65	312
Net earnings (loss)	(21)	212
Basic earnings (loss) per share	(0.55)	5.55
Diluted earnings (loss) per share	(0.55)	5.48
Dividends per share	1.10	1.075

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Cummins Annual Report 1998

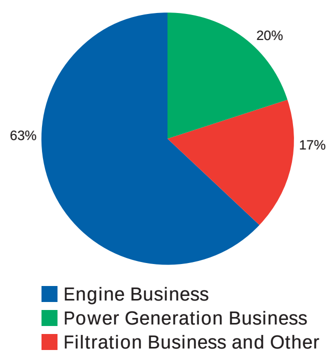
Cummins Engine Company is the leading worldwide designer and manufacturer of diesel engines ranging from 60 to 6,000 horsepower and the largest producer of diesel engines over 200 horsepower. These engines are used by customers in a wide variety of automotive and industrial markets and for power generation. The company also provides filtration systems and natural gas engines as well as engine components and electronic systems. Cummins' 1998 sales were $6.3 billion and it employed 28,300 people.

Left: Jim Henderson, Chairman and Chief Executive Officer
Right: Tim Solso, President and Chief Operating Officer

Value Vision

Sales by Segment

1998 Sales $6.3 Billion



Dear Fellow Shareholders:
The theme of this 1998 report to shareholders is VALUE — the fundamental on which any endeavor is judged by those involved or affected. For a business enterprise, this starts with the value brought to its shareholders.

If shareholder value is to be sustained over any period of time, it must be linked to the value customers and partners of that enterprise receive from doing business with it.

Clearly, companies that deliver superior value to their shareholders over time are the ones that deliver superior value to their customers and partners over time.

We at Cummins firmly believe we can deliver superior value to both shareholders *and* customers and partners. In 1998, while our financial results fell short of our goals, we took important steps towards delivering superior value to our customers and partners and towards meeting our financial objectives.

We believe meeting those objectives will deliver superior value to our shareholders.

Our financial objectives are to achieve earnings before interest and taxes (EBIT) of 9 percent in years when a majority of our markets are healthy. This will equate to a return on average net assets of approximately 25 percent and a strong free cash flow.

Our engine-related products are associated with capital purchases by our customers and are, therefore, affected significantly by economic slowdowns. In recession years our earnings target before interest and taxes is at least 3 percent.

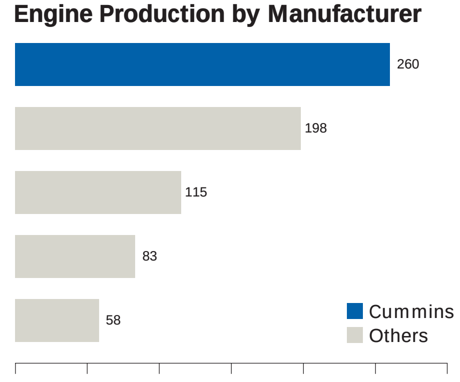
We begin 1999 with continued economic difficulties in Asia and Latin America and some concern about European markets, but North American automotive and construction markets remain generally strong. While forecasting in our business is difficult, we currently expect relatively level revenues in the next two-year period. That could change rapidly.

An economic slowdown that included Europe and North America would inevitably affect the timing by which we will hit our targets. Regardless of economic conditions, however, we anticipate steady progress over the next two years as we work to meet the needs of customers in all our markets, to reduce costs and to improve gross margin and cash flow.

We are confident that the actions we are taking will put us in a position to meet our targets consistently in the future.

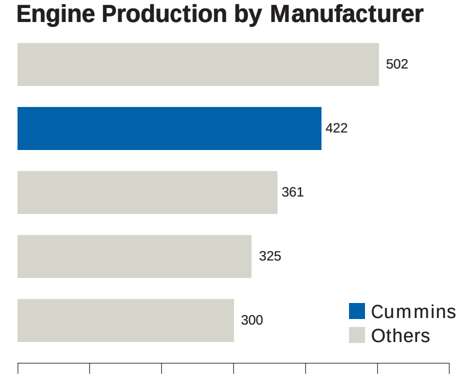
Because motivated, capable people are vital to taking care of the customer in cost-effective ways, they are central to our achievement of shareholder value. Sustained profitable growth that meets the expectations of shareholders will give our people opportunities for personal growth, bring value to our suppliers, and provide resources that permit us to contribute value to the countries and communities in which we operate.

1997 Worldwide 200 HP+ Diesel Engine Production by Manufacturer



Units in thousands
Source: Rhein & Associates, modified

1997 Worldwide 50 HP+ Diesel Engine Production by Manufacturer



Units in thousands
Source: Rhein & Associates, modified

The Year 1998
We had solid accomplishments in 1998. Our revenues were a record $6.266 billion, compared to $5.625 billion in 1997. In North America, automotive, construction, power generation and filtration markets were strong, offsetting sales declines in Asia and in our agricultural and other commodity-based markets around the world. We completed our acquisition of Nelson Industries and successfully integrated it into our Filtration Business. We launched a record six new engines and two new fuel systems. Our Power Generation Business made significant progress toward improved profitability.

Excluding special charges, earnings were $282 million before interest and taxes. Reported results included special charges for restructuring, product coverage and our settlement with the U.S. Environmental Protection Agency (EPA), resulting in a net loss of $21 million or 55 cents per share. Settling with the EPA avoided costly litigation and disruption in the marketplace, even though we believe firmly we were and are in full compliance with all federal and state regulations.

Actions we are taking to improve profitability are described in more detail later in this letter. They include restructuring and major initiatives to reduce the costs of the materials and services we buy.

Overall, 1998 was a year in which we brought more value to customers in each of our markets and laid the foundation for improvements in earnings and cash flow to bring more value to our shareholders.

Value for our Customers
Customer value derives from three principal elements.

- Products that provide our customers with the most cost-effective performance
- Information that enables our customers to run their businesses more efficiently
- Responsive support for all aspects of customer need

Cummins made substantial progress in all three areas in 1998.

Cummins is the world leader in diesel engine production over 200 horsepower and is the second largest producer of engines above 50 horsepower. We have achieved this position by designing and producing products that meet the needs of our customers better than our competitors' products.

We emerged from the early 1990s with improving financial performance, but recognized that electronics and information technology had opened a whole new horizon for our industry. Also, we knew tougher emissions

Value for Our Customers

standards were likely to emerge after the year 2000. In order to continue as the industry's technical leader, we needed to respond boldly. And we did. In the years since 1994, we have been upgrading or replacing engines across our entire product line — incorporating advanced electronic controls, combustion and air handling technology — and adding new engines on both the upper and lower ends of the horsepower range.

1998 was the year of peak expense in this program. We introduced a record six new engines together with two entirely new fuel systems. New midrange engines were the ISB and ISC, which incorporate full-authority electronic controls and software. The ISC uses our new CAPS fuel system. Industrial versions of these midrange engines are being introduced in 1999.

For our customers in heavy-duty markets, we introduced the ISM and the revolutionary Signature 600 engine with our HPI fuel system. In addition, we introduced two new high-horsepower engines, the 3200-horsepower CW170, part of our Cummins Wartsila joint venture, and the 2700-horsepower QSK60.

Both of these high-horsepower engines are designed to increase our penetration in the prime power generation market and to establish leadership in mining equipment markets.

All of the new engines are meeting marketplace objectives, and customers report that they are delighted with the engines' responsiveness, power and fuel economy.

This year, 1999, will see the release of four more new engines: a version of the Signature series for automotive fleet customers and industrial markets; a new 9-litre engine based on advanced electronic C-series technology; the QSK45 — a lower horsepower version of the QSK60; and a 3.3 litre engine to be produced at the Komatsu Cummins Engine Company in Oyama, Japan.

The acquisition of Nelson Industries — a major producer of air and liquid filtration products, and exhaust and emissions control systems — enables us to bring more product value to our OEMs. Nelson is the leading producer of exhaust systems for diesel-powered equipment in North America and ranks second in air intake systems. Combined with Fleetguard, this acquisition makes us an integrated first tier supplier of three critical engine subsystems: air intake, fluids and exhaust. These subsystems are required for every engine, regardless of market or application, so we can bring additional business to Nelson from our other businesses.

Closely related to the value superior products bring to our customers is the information we can provide.

Electronics and information technology are an integral part of the operation of our engines. We are also using information technology to enable our customers to manage more efficiently by integrating vehicles into their business operations and into the supply chain. We are the principal owners of Innovative Computing Corporation, which provides fleet management solutions and Internet-based products, enabling customers to exchange data throughout the entire supply chain.

Providing support is the third critical part of creating value for our customers. This goes beyond technology and information systems to what we call *PowerCare* — powerful care for our customers. Our 31 North American and 110 international distributors are our partners in delivering superior support to our customers through programs such as *QuickServe*, which offers one-hour diagnosis and completion of most repairs within six hours, and *Support Plus*, which guarantees instant parts access with no service premiums.

We continue to rely on customer councils as we develop new support programs and new products for our heavy-duty automotive, construction, mining and power generation markets.

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Valuable Alliances

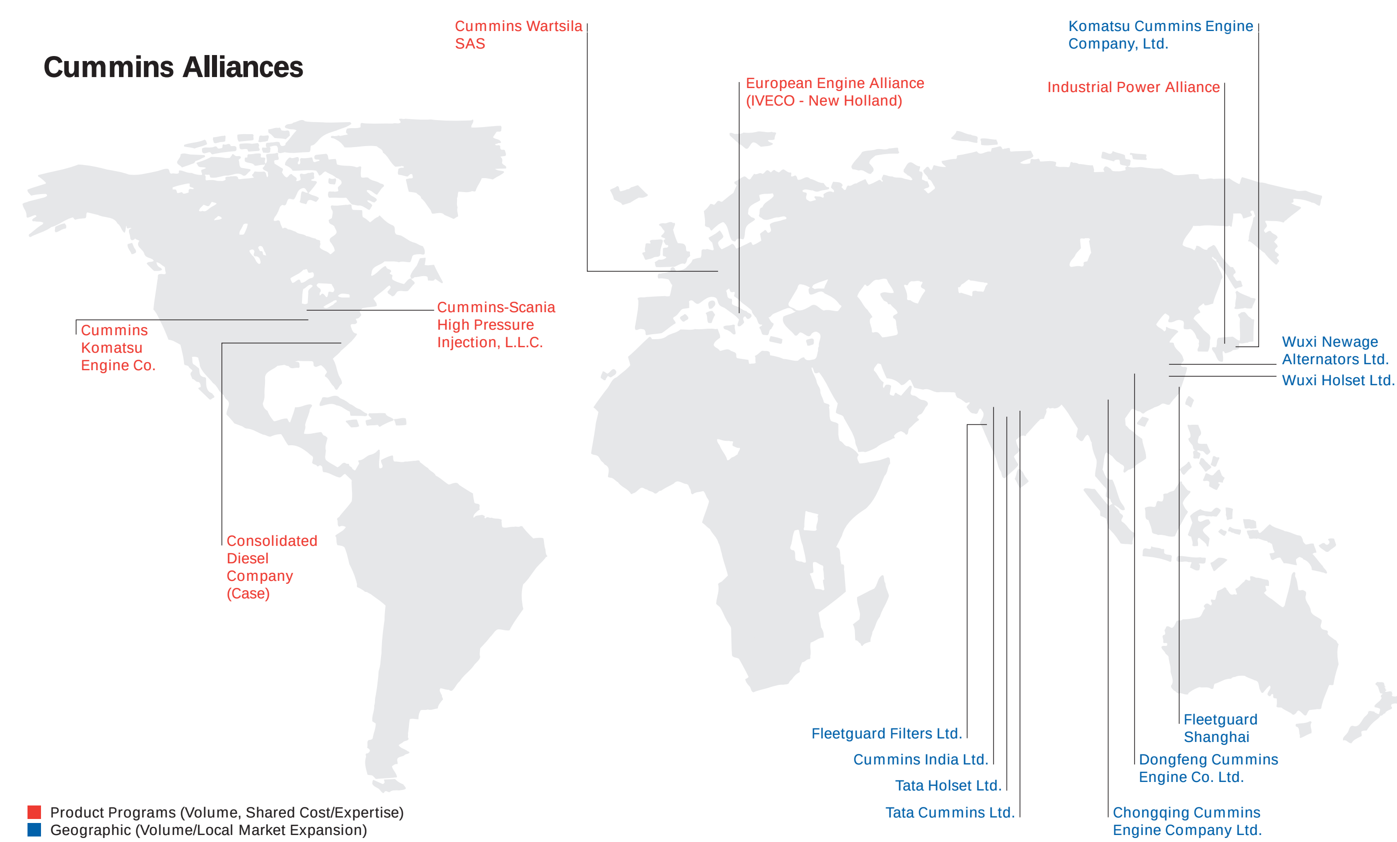
Our success in creating value for our customers has made Cummins a highly desirable alliance partner for many leading companies around the world.

We have pursued two kinds of partnerships. First, we have alliances with strong technical partners with whom we can share expertise and the costs of developing new products.

Our technical alliance partners include Case, IVECO, Komatsu, New Holland, Scania and Wartsila, and we are working collaboratively with them to develop the next generation of products for the 21st century. The second type of business alliance partnership is with leading equipment producers in important markets for future growth like China, India, Turkey and Japan. Our partners provide invaluable knowledge and contacts in the local business and political communities, as well as market leadership.

In October, Cummins and five other diesel engine manufacturers ended nearly a year of intense negotiations with the U.S. Environmental Protection Agency and the Department of Justice by signing consent decrees. The settlement requires diesel engines to meet some new emissions standards immediately. Substantially tougher standards originally set for 2004 must be met 15 months earlier, in October 2002. The major impact is on our heavy-duty, line-haul engines.

Cummins Alliances



The Cummins Policy Committee provides leadership and a real commitment to building our business and value for you. Members of the Committee, clockwise from lower left: Kiran Patel, Jean Blackwell, Tim Solso, Joe Loughrey, Jim Henderson, Jack Edwards, Dave Jones, Roberto Cordaro, Mark Gerstle and Pamela Carter.

Increasing Shareholder Value

Because Cummins has laid a technical foundation unequaled in our industry, we are confident of our ability to meet the new standards.

In the markets in which we participate, the goal of cleaner air coexists with the goal of durable and cost-effective products. We believe these goals are not mutually exclusive, and we have the technology to deliver on both.

We expect to continue as the industry leader in an environment of more demanding emission controls.

Value for Our Shareholders

The second area of accomplishment in 1998 was laying the foundation for future improvement in earnings and cash flow. Free cash flow provides the opportunity to reward the shareholder through share repurchase, dividend increases and/or investment in future growth.

We have simplified our financial objectives based on an analysis of the nature of our business as well as on benchmarking the world's best. The objectives reflect profitable performance over the business cycle.

In order to hit our financial objective of 9 percent EBIT in good years, our cost structure targets are 25 percent gross margin and 16 percent selling, administrative, research and engineering (SAR) expense. We believe our goals are realistic and attainable, and we are pursuing them on three fronts: gross margin improvement, lower SAR expense and cash flow improvement.

Gross Margin. In 1994 and early in 1995, Cummins achieved a gross margin of 25 percent. As the costs of the new product development program increased, the percentage of gross margin declined to just above 20 percent in the fourth quarter of 1998. We intend to return to the 25-percent gross margin level by improving product coverage costs, lowering start-up costs, restructuring and achieving lower material cost.

Our gross margin was lower than planned in 1998 and below our target. A key factor was higher costs for launching our new engines. Because of learning curves and inevitable reliability problems associated with any new product launch, new products cost more than the ones they replace for some period of time. Then, as volume builds, initial problems are corrected, manufacturing becomes more efficient and costs come down.

We are confident production costs for our new engines will eventually be lower than for the products replaced.

While we will be introducing four new engines in 1999, the risks are considerably lower. Three are derivatives of engines released in 1998, so the work to improve their cost and quality is already underway. The fourth, the 3.3 litre engine, is based upon proven technology.

Gross margin will also be improved as a result of the actions announced in the third quarter when we took a charge of $114 million for restructuring Cummins operations and those of our joint ventures around the world. Restructuring is underway and includes consolidating both office and manufacturing operations and outsourcing production of non-strategic components. Cummins staffing levels will fall by over 1,100, and employment in joint ventures will decline by an additional 1,200 people. Benefits began modestly in 1998, will grow in 1999 and are expected to reach more than $50 million annually beginning in 2000, with most of these savings contributing to gross margin improvement.

Finally, we have embarked on a program to reduce the costs of materials that go directly into our products. Those materials represent the largest single item on our income statement, so the opportunity for savings is substantial. A parallel program is in place for goods and services like office supplies, computers, freight, travel and health care, with some of the savings affecting gross margin and the balance lowering SAR costs.

Valuable Improvements

Selling, Administrative and Research (SAR) Costs. A major success in 1998 has been the steady reduction of selling, administrative and research costs. In 1994, these costs totaled 18.5 percent of sales. In the first quarter of 1998 they were just below 18 percent. In the fourth quarter they were reduced to 16 percent, which is our target. Compared to the first quarter, fourth-quarter administrative costs were lower by $9 million, a full point as a percent of sales. Fourth-quarter research costs were below 4 percent.

We will pursue opportunities to move below 16 percent in the future.

Cash Flow. The prospect for our business to generate increased free cash flow in the future is excellent, even with relatively level revenues in the next two years. First, major capital expenditures for this cycle of new product development are behind us. Second, improving overall profitability through restructuring and purchasing and supply management, as we have described above, will also contribute to cash flow. Finally, we have a major program to improve our management of working capital – specifically, inventory and receivables – providing another opportunity for cash flow improvement.

The cash generated will give Cummins the flexibility to maintain a prudent capital structure and provide a return to shareholders through dividends and buying back Cummins shares. Over the past four years, share repurchases have resulted in a decrease in shares outstanding from 41.6 million to 38.4 million.

Business Results. Our Engine Business, made up of a broad variety of automotive and industrial markets, is the one in which we have made the investment in new products. Therefore, its results have been impacted significantly in the last year.

We expect to see the improvement we have described above reflected in returns from these markets in the next two years.

The Power Generation Business has been making progress towards its financial objectives primarily through restructuring and cost reduction to date. Much of the restructuring announced in the third quarter is directed towards further improving Power Generation results. A continuing challenge is the release of the Cummins-Wartsila engines in the face of Asian market weakness. The engines will, however, permit us to compete more effectively in the more profitable prime power market.

Our Filtration Business and Other includes our filtration companies, Fleetguard and Nelson, as well as our turbocharger company, Holset, and 14 distributorships owned by Cummins. The acquisition of Nelson Industries has proven to be very successful, adding approximately 6 cents per share to corporate results. In addition, the filtration and exhaust systems business enables us to benefit from marketplace synergies with customers of our Engine and Power Generation businesses.

Corporate Values

At Cummins, our commitment to providing value for our shareholders and customers goes hand in hand with our commitment to corporate responsibility. We believe firmly that acting with honesty and integrity is sound business — absolutely essential if we are to attract the very best people, customers, suppliers, partners and distributors.

We are also convinced that it is in Cummins' best interest to be concerned about the communities and the society in which we do business, because a healthy society provides the best foundation for business success.

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Corporate Values

As we work to create value for our customers and our shareholders, we recognize the value added by our own people around the world — in our technical centers, plants, offices and distributorships. People are the source of innovation in our products, care for our customers and operational improvements. We depend on their commitment, their hard work and their ideas.

We thank our people for helping Cummins meet the challenges of 1998, and we will continue to rely on them in the years ahead.

Board Changes. Another valuable asset for Cummins is its diverse Board of Directors. We have had two changes to the Board since our last Annual Report. First, Don Perkins, former Chairman of the Jewel Companies and a member of Cummins' Board of Directors for 25 years, reaches the mandatory retirement age for Board members in 1999 and is not, therefore, being nominated for re-election to the Board. Over his years with us, Don has served the Board in many roles, most recently as Chair of the Audit Committee. Don's experience, his understanding of worldwide business, and his leadership in improving corporate governance are unmatched, and we have benefited greatly from his perspective and insight.

Don has been steadfast in his commitment to the interests of our shareholders, and all of us have learned immeasurably from him. We will miss him.

Second, we are pleased to welcome a new Board member, Jim Johnson, Chairman of the Executive Committee of the Board of Directors of the Federal National Mortgage Association (FNMA or "Fannie Mae"), the largest non-bank financial services company in the world. Jim has an outstanding record of effectiveness in creating shareholder value while chairman and chief executive officer of Fannie Mae from 1991 through 1998 as well as a thorough understanding of public policy issues.

Outlook

The future for Cummins and its shareholders is bright. Our people are focused on delivering superior value to shareholders by delivering superior value to our customers and partners.

Our investment in innovation offers our customers advanced technology and puts Cummins in a better position than anyone else in the industry to meet tough new emissions standards, increase market share around the world and grow profitably.

We have clear targets for financial return. We are confident that we will make significant progress toward these targets in the next few years despite a continued unsettled world economic situation. While we are not anticipating substantial growth in our markets for 1999, we expect to gain market share as our new products make their mark and as growth synergies resulting from our Nelson acquisition are realized.

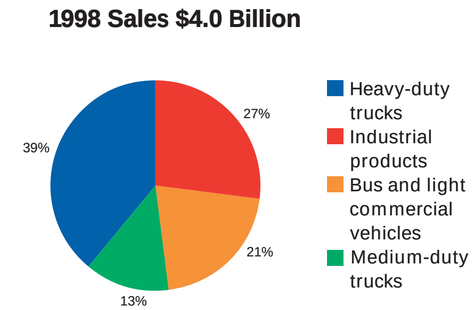
We thank you, the owners of Cummins, for your continued support. We remain dedicated to increasing the value of your investment and look forward to sharing our progress and prospects with you at our Annual Shareholders' Meeting on Tuesday, April 6, in Columbus Indiana.

James A. Henderson
Chairman and Chief Executive Officer

Theodore M. Solso
President and Chief Operating Officer

Cummins Engine Company, Inc.
March 3, 1999

Cummins' Worldwide Business Sales, Markets and Products



Engine Business

Automotive

The automotive business comprises three primary markets: heavy-duty truck, medium-duty truck, and bus and light commercial vehicles. Products in these markets include a full range of diesel and alternate-fueled engines from 135 to 600 horsepower. In 1998, Cummins launched major new engine platforms as part of the "Interact System" of electronically controlled products including the ISB, ISC, ISM, and Signature engines.

For the past twenty-six years, Cummins has been the North American market leader in heavy-duty trucks, which represents the largest portion of the Engine Business sales. Cummins also leads the market in Mexico, Australia, South Africa and is a major presence in the United Kingdom and in many other countries.

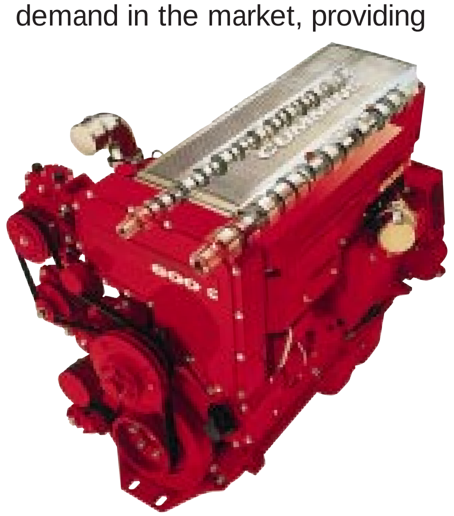
The Signature 600, introduced in 1998, continues to generate unprecedented excitement and demand in the market, providing 600 horsepower of high-torque performance as well as 600 horsepower of braking power with the new Cummins' Intebrake. The N14, recognized as the industry leader in durability and performance, remains the foundation of the heavy-duty product line.

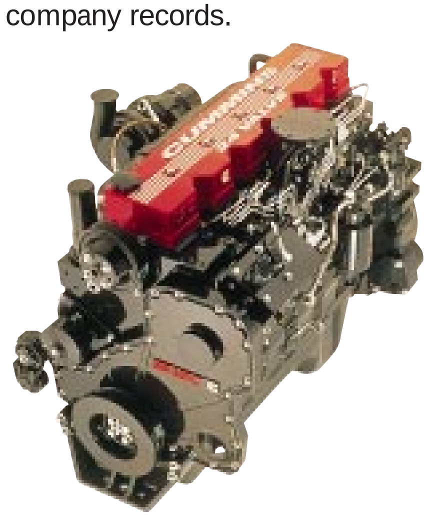
Introduced in late 1998, the ISM builds upon the industry-leading fuel economy of the M11 Plus engine while providing the latest electronics technology and features. The ISM provides the best fuel economy and power-to-weight performance in the industry.

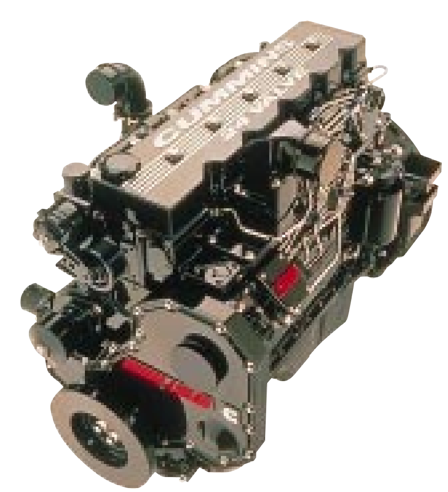
The ISB and ISC electronic four-valve-head engines provide the primary power for the medium-duty truck segment, ranging from 175 to 300 horsepower. Key territories in the medium-duty truck segment include North America, Latin America, Europe, China, India, Turkey and Australia where Cummins powers a wide variety of medium-duty trucks and other on-road vehicles. In 1998, shipments of ISB and ISC engines surpassed all previous company records.

In the bus and light commercial segment, the ISB powers the Dodge Ram pickup. The bus market, including shuttle, transit, coach, school bus, and the recreational vehicle market, utilizes diesel engines throughout the ISB to N14 product range. Cummins continues to enjoy strong market share in this growing business in North America, Europe, Mexico and Asia. Bus customers worldwide remain interested in natural gas engines from 150 to 300 horsepower. In 1998, Cummins achieved record sales in the North American transit bus market and has over 75 percent share in the Class A motor home market. Cummins entered the pickup truck market in Brazil with the ISB, further expanding our presence in this market segment internationally.

With the most modern product range in the industry, Cummins delivers engine hardware, electronic systems and information, and business support as part of our Interact System of products, which deliver exceptional value to each of our customers.



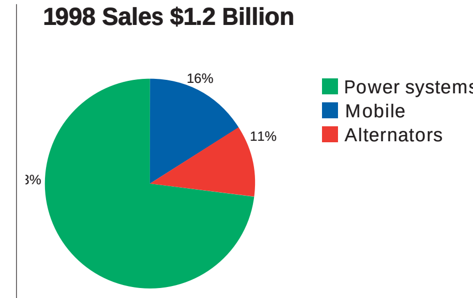




Industrial

Cummins engines power virtually every type of equipment made for construction, agricultural, mining, logging, rail, military, commercial marine and pleasure boat markets. Continuing alliances with our delivery partners worldwide, as well as closer relationships with our end customers, offer us significant market share in most of these markets.

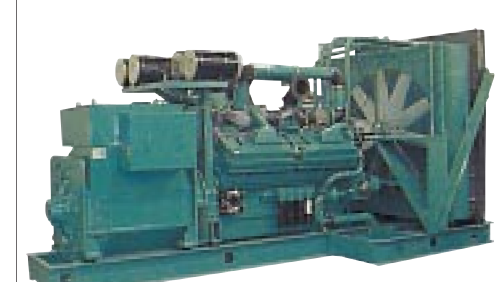
Through a joint venture manufacturing agreement with Komatsu Ltd., Cummins offers its latest midrange engine, the B3.3. Along with the addition of the B3.3 and the release of the high horsepower QSK60 engine, the Industrial Group offers the complete Cummins engine power range to its markets from 60 to 2700 horsepower.

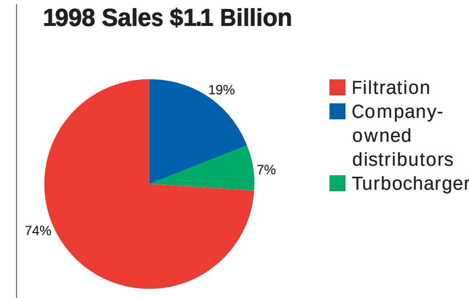


Power Generation Business

The Power Generation Business provides a wide range of equipment and services for the generation and control of electrical power for both standby and prime power customers throughout the world. Customers include major utilities, independent power providers, hospitals and commercial office towers, manufacturing plants, telecommunications companies, equipment rental houses, as well as manufacturers of mobile recreation vehicles.

The Power Generation Business, together with Cummins Wartsila, offers products that span a broad power output from 2 kilowatts to 4 megawatts, and a choice of diesel, natural gas or gasoline-fired power generator sets. Cummins also offers a range of services including turnkey power plant solutions and long-term operation and maintenance contracts.





Filtration Business and Other

The Filtration Business serves a broad base of customers in more than 100 countries with a wide range of filtration and exhaust systems. Products include filters for engine applications and hydraulic and air intake systems for both engine and industrial applications.

Cummins owns 14 distributorships, most of them outside the United States, with the largest being in Australia, India and the United Kingdom.

Holset is a Cummins subsidiary that designs and produces turbochargers for worldwide engine markets.

Delivering Value

Over two million customers a day depend on FedEx for timely, dependable delivery of their packages and freight to locations worldwide.

Cummins delivers that same level of world-class service and value to FedEx with a broad line of automotive and industrial engines.

Engine Business

With $4.0 billion in annual sales, our engine business is Cummins' largest. Our customers — both original equipment manufacturers (OEMs) and end users — buy engines and parts produced in Cummins plants around the world, and our worldwide distributor network plays a prominent role in both sales and customer support.

Our overall strategy in the engine business is to give end-user customers comparative advantage through a 'value package' of technically advanced products, customer-focused information and support. We rely heavily on end-user customer councils to identify emerging product and support needs.

A partnership between Cummins and its distributor network, Cummins *PowerCare* is designed to earn customer loyalty and repeat business through superior support. One innovative *PowerCare* program is *QuickServe*, promising one-hour diagnosis and rapid repair. *QuickServe* is now available in over 150 distributor locations, and mobile *QuickServe*, designed to bring support to the customer's construction or mine site, is being piloted in China and the U.S., with widespread deployment to begin in late 1999.

Our engine business serves a broad variety of Automotive and Industrial markets. Automotive markets include buses and trucks of all sizes — from the Dodge Ram pickup to the heavy-duty trucks that are the backbone of the freight delivery system. Industrial customers use our engines for construction, mining, and agriculture and also in marine, rail and military applications.

Automotive

With the 1998 introduction of three new engines and two new fuel systems, our automotive product line-up has positioned us firmly as the leader in performance, fuel economy, emissions control, electronics and information technology. In 1999, the ISX and the ISL engines will be released, rounding out our completely redesigned product line. Product leadership attracted new and repeat business in 1998 from many U.S. fleet customers such as FedEx, Wal-Mart, UPS and J. B. Hunt. In October, two large original equipment manufacturers, Mack and Volvo, announced that Cummins would be their key outside engine supplier for North America and Australia.

Business was strong in North American automotive markets in 1998, particularly in the highly competitive heavy-duty market, where Cummins remained the market share leader for the 26th consecutive year. Heavy-duty shipments grew by 20 percent. We increased our share of light- and medium-duty engine sales in bus markets by 24 percent, and we shipped a record 98,700 ISB engines to our largest customer, DaimlerChrysler, for the Dodge Ram pickup truck. Outside the U.S., automotive sales slowed during 1998 in Mexico and Brazil, and towards the end of the year there were signs of a slowdown in the United Kingdom and Turkey.

Industrial

We build value for our industrial customers by providing cleanly designed engines that require less maintenance. These engines, featuring high pressure injection systems and electronic controls, deliver increased power and performance with reduced emissions. In late 1998, we began a series of new product introductions with the limited introduction of the new fully electronic 2700-horsepower QSK60 engine for mining applications and the new 635-horsepower M11 engine for pleasure boat applications. These will be followed in 1999 by the QSK45 and the industrial versions of the new Signature, ISB and ISC engines (called the QSX15, QSB5.9 and QSC8.3 respectively). The B3.3 engine, developed with our joint-venture partner Komatsu, is scheduled for release in the second half of 1999.

Industrial markets were mixed in 1998. Construction sales remained strong in the U.S. and Europe, but economic problems affected sales of construction and commercial marine equipment in Asia. Outside Asia, marine sales grew. Agricultural sales were down worldwide because of lower commodity prices, which also affected some mining markets during the second half of the year. We are confident, however, that new products and programs like mobile QuickServe position us for a strong rebound when these markets recover.

The largest multi-set installation in Africa is in Tema, where Cummins provides 24 hour energy peace of mind for the government and people of Ghana.

Generating Value

Power Generation Business

Cummins Power Generation offers value to customers by providing integrated power solutions to users of prime and standby electrical power. This integration is made possible because Cummins is the only company to make all elements of a generator set — engines, alternators and advanced electronic controls.

1998 Power Generation sales were $1.2 billion, 2 percent above 1997. Profitability improved because of our success in reducing costs. Lower costs allowed us to hold prices level despite increases by our competition, enhancing our competitive position and the value of Cummins power solutions for our customers.

In the Americas, 1998 was a very successful year in sales and improved profitablity. We completed our restructuring program, closing our Huntsville, Alabama engine plant. Huntsville's manufacturing operations were successfully integrated into our Fridley, Minnesota facility, which now produces generator sets ranging from 2 megawatts at the top end down to the 2.8-kilowatt Onan generator sets used for recreational vehicles. The RV market remained buoyant in 1998, and we continued to dominate, with a market share in excess of 80 percent.

Economic conditions affected sales throughout Asia and to some European customers for G-drive engines. Recognizing the trend early, we launched a second round of restructuring, closing and downsizing plants in Asia and streamlining production at Newage, our alternator company. Lower Asian sales also meant a difficult and challenging year for our Cummins Wartsila joint venture. In response, we announced major restructuring to enable the joint venture to be successful in spite of less favorable near-term sales volumes.

In addition to improving our share in the market for larger industrial generator sets used for standby power, the Power Generation Business took a major step forward in the emerging market for prime power when we received our largest single order ever, for $17 million from the Government of Ghana. Cummins Power Generation supplied 39 diesel-powered generator sets to operate in parallel at a single power station, connecting seamlessly into the utility grid. This marks the first time that Cummins Power Generation has taken on responsibility for building, operating and maintaining an entire power plant.

Our focus on prime power has given us the ability to move to integrated power solutions that go beyond hardware. In addition to selling generator sets, we can offer value-adding services such as extended warranty, maintenance and service contracts, and 'Uptime' guarantees. At Cummins Power Generation, we continue to increase our value to customers by selling kilowatts — providing reliable energy at reasonable cost around the world.

Enhancing Value

Filtration Business and Other

At $1.1 billion, Filtration Business and Other sales set a record, exceeding the $1-billion mark for the first time. The revenue comes from sales of our filtration companies — Fleetguard, Nelson, Kuss and Universal Silencer; our turbocharger company, Holset; and company-owned distributors, most of them outside the United States.

Our filtration companies work together to provide customers with an integrated system for air intake and filtration, fluid filtration and conditioning, air handling and exhaust. We offer value by enhancing equipment performance, reducing operating costs and controlling emissions and noise.

Early in 1998, Cummins completed the acquisition of Nelson Industries, North America's leading producer of exhaust systems and its number two supplier of air intake systems for diesel powered equipment. The integration of Nelson with Fleetguard has gone exceptionally well; organizations have been merged; overlaps have been eliminated; and complementary product lines are attracting new customers around the world. The acquisition was accretive to earnings in its first year.

Fleetguard and Nelson are continuing on the path to global leadership by offering customers the best technical solutions available in the industry. We lead the world in providing filtration and exhaust technology for heavy-duty diesel engines. Together, we rank sixth in the world among filtration companies and first in the heavy-duty market.

Fuel filters made by Kuss Corporation were installed in over 60 percent of automobiles made in North America and in almost 20 percent of those made in Europe. Universal Silencer, which supplies air filtration and exhaust silencing for gas turbines and other plant and equipment operations, had a record year in sales and profits in 1998.

Fleetguard's commitment to quality was recognized in 1998 when it was the only manufacturing company awarded the Tennessee Quality Governor's Award. Fleetguard was the first company ever to win the Global Excellence Award for demonstrating leadership in the international marketplace.

Cummins' ownership of 14 distributorships links us closely to our end-user customers in strategic locations worldwide.

Holset has restructured its operations to focus on its core competence in turbocharging. Breakthrough variable geometry technology enables Holset turbochargers to improve performance for the driver while lowering operating costs for the truck owner. Closely integrated with Cummins' advanced fuel systems, Holset's air handling technology is at the heart of Cummins' strategy to meet emissions requirements for the year 2002 and beyond.

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Integrated System

Air Intake Systems

Engine: Air Handling, Fluid Filtration and Conditioning Systems

Exhaust Systems

The Filtration Group enhances value by designing an integrated system that includes air intake, engine filtration and exhaust systems. Our customers receive improved performance at lower cost from a single supplier.

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 and 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 in 1998 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. These charges relate to a revised estimate of product coverage liability for engines manufactured in previous years. 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 estimated 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. 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, 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 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 in 1998 was 12.8 percent of sales, 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 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 periodic basis.

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 10% adverse change in the foreign currency exchange rates would decrease earnings by approximately $4 million. This calculation does not reflect the impact of the gains and losses in the underlying exposures that would be offset, in part, by the results of the derivative instruments. The sensitivity analysis also 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 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 hypothetical 100 basis-point increase in the floating interest rate from the current level would correspond to a $2 million increase in interest expense over a one-year period. This sensitivity analysis does not account for the change in the Company's competitive environment indirectly related to change in interest rates and the potential managerial action taken in response to these changes.

The Company is exposed to fluctuation 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. The effect of a hypothetical 10% depreciation of the underlying commodity price would be a loss of approximately $5 million. This amount excludes the offsetting impact of the price changes in commodity costs.

Forward-looking Statements:
This Management's Discussion and Analysis of Results of Operations and Financial Condition and other sections of this Annual Report 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.

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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 and administrative expenses	787	744	725
Research and 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.

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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 and 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 and 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 and 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 and cash equivalents at beginning of year	49	108	60
Cash and 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.

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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.

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 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

Net sales of the joint ventures and alliances were $1.2 billion in 1998 and $1.3 billion in 1997 and 1996. 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 and the Company's compensation expense 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 and post-employment benefits	$ 720	$487
Accrued product coverage and 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 and 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 rate 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 5.0% 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:

$ Millions	Pension Benefits 1998	1997	1996	Other Benefits 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.

Options	Number of Shares	Weighted-average exercise price
Dec. 31, 1995	1,183,275	$38.45
Granted	394,150	40.13
Exercised	(47,475)	32.43
Cancelled	(19,800)	41.00
Dec. 31, 1996	1,510,150	38.88
Granted	766,500	60.61
Exercised	(294,025)	35.85
Cancelled	(61,775)	42.66
Dec. 31, 1997	1,920,850	46.08
Granted	703,660	45.34
Exercised	(54,075)	36.36
Cancelled	(27,425)	53.80
Dec. 31, 1998	2,543,010	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 Comprehensive 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 December 31, 1995	$ (73)	$—	$(22)	$ (95)
Change in 1996	26	—	9	35
Balance at December 31, 1996	(47)	—	(13)	(60)
Change in 1997	(21)	(1)	12	(10)
Balance at December 31, 1997	(68)	(1)	(1)	(70)
Change in 1998	(43)	—	(54)	(97)
Balance at December 31, 1998	$(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 and 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 and 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 and 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 and 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 and 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	All 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.

Responsibility for Financial Statements

Management is responsible for the preparation of the Company's consolidated financial statements and all related information appearing in this Report. 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.
Five-Year Supplemental Data

$ Millions, except per share amounts	1998	1997	1996	1995	1994
Net sales	$6,266	$5,625	$5,257	$5,245	$4,737
Cost of goods sold	4,925	4,345	4,072	3,974	3,551
Special charges	92	—	—	—	—
Gross profit	1,249	1,280	1,185	1,271	1,186
Selling and administrative expenses	787	744	725	692	641
Research and engineering expenses	255	260	252	263	238
Expense (income) from joint ventures and alliances	30	(10)	—	2	(4)
Interest expense	71	26	18	13	17
Other (income) expense, net	(13)	(26)	(24)	6	—
Restructuring and other non-recurring charges	125	—	—	118	—
Earnings (loss) before income taxes	(6)	286	214	177	294
Provision (benefit) for income taxes	4	74	54	(47)	41
Minority interest	11	—	—	—	—
Net earnings (loss)	$ (21)	$ 212	$ 160	$ 224	$ 253
Net earnings (loss) per share:					
Basic	$ (.55)	$ 5.55	$ 4.02	$ 5.53	$ 6.14
Diluted	(.55)	5.48	4.01	5.52	6.11
Number of shares for EPS:					
Basic	38.5	38.2	39.8	40.6	41.2
Diluted	38.5	38.7	39.9	40.7	41.4
Cash dividends per share	$ 1.10	$1.075	$ 1.00	$ 1.00	$ .625
Shareholders' investment per share	33.11	37.05	33.24	29.39	25.79
Working capital	$ 805	$ 655	$ 532	$ 335	$ 458
Property, plant and equipment, net	1,671	1,532	1,286	1,148	1,090
Total assets	4,542	3,765	3,369	3,056	2,706
Total debt	1,227	654	415	219	233
Shareholders' investment	1,272	1,422	1,312	1,183	1,072
Property, plant and equipment additions	$ 271	$ 405	$ 304	$ 223	$ 238
Depreciation and amortization	199	158	149	143	128
Shareholders of record	5,200	4,700	4,800	5,000	4,800
Number of employees (a)	28,300	26,300	23,500	24,300	25,600

(a) Represents the number of employees at year-end. At December 31, 1998, number of employees included 2,600 employees of Nelson Industries, Inc., which was acquired in January 1998. At December 31, 1997, number of employees included 2,800 employees of Cummins India Limited, which was consolidated in the fourth quarter of 1997.

Earnings per share for 1994 through 1996 have been restated to reflect the adoption of SFAS No. 128 as disclosed in *Note 1* to the *Consolidated Financial Statements*.

The Cummins Board of Directors is pictured outside the new Signature 600 Plant entrance where customer service for heavy-duty users has shaped a new approach to engine manufacturing.

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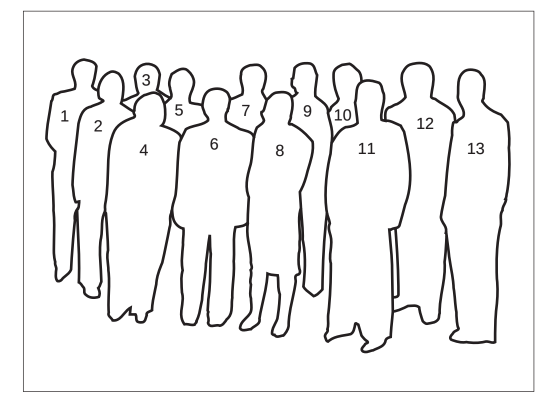
Directors and Committees

Directors

James A. Henderson	Chairman and Chief Executive Officer of Cummins
Theodore M. Solso	President and Chief Operating Officer of Cummins
Harold Brown [d,e]	Counselor, Center for Strategic & International Studies; Partner, Warburg, Pincus & Co., venture banking firm
Robert J. Darnall [a,e]	President and Chief Executive Officer, ISPAT North America Inc., steel manufacturing
John M. Deutch [d,e]	Institute Professor, Massachusetts Institute of Technology
Walter Y. Elisha [a,e]	Retired Chairman, Springs Industries, Inc., manufacturer of home furnishings, industrial and specialty fabrics
Hanna H. Gray [c,e]	President Emeritus and Professor of History, University of Chicago
James A. Johnson [a,e]	Chairman of the Executive Committee of the Board of Directors of the Federal National Mortgage Association (FNMA)
William I. Miller [b,e]	Chairman, Irwin Financial Corporation, financial services company
Donald S. Perkins [a,e]	Retired Chairman, Jewel Companies, Inc., diversified retailing
William D. Ruckelshaus [c,e]	Principal, Madrona Investment Group, L.L.C.
Henry B. Schacht [b,e]	Senior Advisor and Former Chairman, Lucent Technologies, Inc., communication industry products
Franklin A. Thomas [c,e,f]	Consultant, TFF Study Group, non-profit initiative to assist the development process in South Africa
J. Lawrence Wilson [b,e]	Chairman and Chief Executive Officer, Rohm and Haas Company, chemical manufacturing
J. Irwin Miller	Honorary Chairman

a Audit Committee
b Finance Committee
c Compensation Committee
d Technology Committee
e Nominating and Organization Committee
f Lead Director

Key to Opposite Page



1 Franklin A. Thomas
2 Donald S. Perkins
3 Henry B. Schacht
4 Walter Y. Elisha
5 J. Lawrence Wilson
6 Robert J. Darnall
7 Theodore M. Solso
8 Hanna H. Gray
9 James A. Henderson
10 William D. Ruckelshaus
11 Harold Brown
12 John Deutch
13 William I. Miller
Not pictured: James A. Johnson

Officers and Executives

Executive Officers

Senior Management

James A. Henderson	Chairman and Chief Executive Officer
Theodore M. Solso	President and Chief Operating Officer

Policy Committee

Jean S. Blackwell	Vice President - Human Resources
Pamela F. Carter	Vice President, General Counsel and Secretary
C. Roberto Cordaro	Executive Vice President, Group President - Automotive
John K. Edwards	Executive Vice President, Group President - Power Generation
Mark R. Gerstle	Vice President - Cummins Business Services
M. David Jones	Vice President - Filtration Business, President - Fleetguard, Inc.
F. Joseph Loughrey	Executive Vice President, Group President - Industrial
Kiran M. Patel	Vice President and Chief Financial Officer

Engine Business		
Martha F. Brooks	Vice President	Worldwide Marketing for Medium-Duty and Heavy-Duty Trucks
Charles J. Bumb	Vice President	National Accounts
Keith E. Chambers	Vice President	Heavy-Duty Engine Program
Pedro N. Ferro	Vice President	Automotive Information Business
Richard M. Gold	Vice President	PowerCare Business
Dale F. Good	Vice President	North American Automotive Sales and Service
Jeffrey D. Jones	Vice President	National Accounts
James D. Kelly	Vice President	Industrial Marketing
Frank J. McDonald	Vice President	Worldwide Midrange Operations
Peter V. McDowell	Vice President	European Automotive Business
Larry O. Moore	Vice President	Worldwide Operations, Automotive Business
John H. Stang	Vice President	Automotive Engineering
Bryan W. Swank	Vice President	Worldwide Midrange Engineering
Bharat S. Vedak	Vice President	Industrial Customer Engineering
Christine M. Vujovich	Vice President	Worldwide Marketing for Bus and Light Commercial Automotive, and Environmental Management
Robert J. Weimer	Vice President	PowerCare Customer Support
William H. Wolpert	General Manager	Worldwide Marine Business
Power Generation Business		
R. Siisi Adu-Gyamfi	Vice President	Marketing, Power Generation
Iain M. Barrowman	President and Director General	Cummins Wartsila SAS
Samuel D. Hires	Vice President	High-Horsepower Engine Development
Jerry E. Johnson	Vice President and General Manager	Power Generation Americas
Michael F. Mitchell	Vice President, Operations	Power Generation
Tony Satterthwaite	Executive Director	Power Generation, Asia Pacific
Steven L. Zeller	Vice President and Managing Director	Newage International Ltd.
International		
Mark A. Levett	Vice President	International
Derek Boulton	General Manager	Japan
Steven M. Chapman	Vice President	China and Southeast Asia
Ricardo Chuahy	General Manager	Latin America
	President	Cummins Brasil
J. Thompson Dewing	Vice President and Managing Director	Central Area Business Organization
Michael Green	Managing Director	South Pacific
Jong S. Kim	Managing Director	Korea
Steven P. Knaebel	Vice President	Mexico
	President	CUMMSA S.C.
Ronald L. Moore	Vice President and General Manager	India
Technology and Operations Support		
John M. Crowther	Vice President	Information Technology and Chief Information Officer
Alan R. Dohner	Vice President	Fuel Systems
Patrick F. Flynn	Vice President	Research
Jeffrey C. Hamilton	Vice President	Advanced Engineering and Design
Tom Linebarger	Vice President	Supply Chain Management
David S. Moorhouse	Managing Director	Holset Engineering Company, Ltd.
George L. Muntean	Vice President	Fuel Systems Engineering
Richard B. Stoner, Jr.	Group Vice President	Technology Businesses
Ronald H. Temple	Vice President	Electronic Technology
John C. Wall	Vice President	Research and Development
Corporate Support		
George Fauerbach	Vice President	Business Development
Rick J. Mills	Vice President	Corporate Controller
Brenda S. Pitts	Vice President	Corporate Responsibility and Diversity
John A. Swaim	Vice President	Quality
Donald W. Trapp	Vice President	Treasurer

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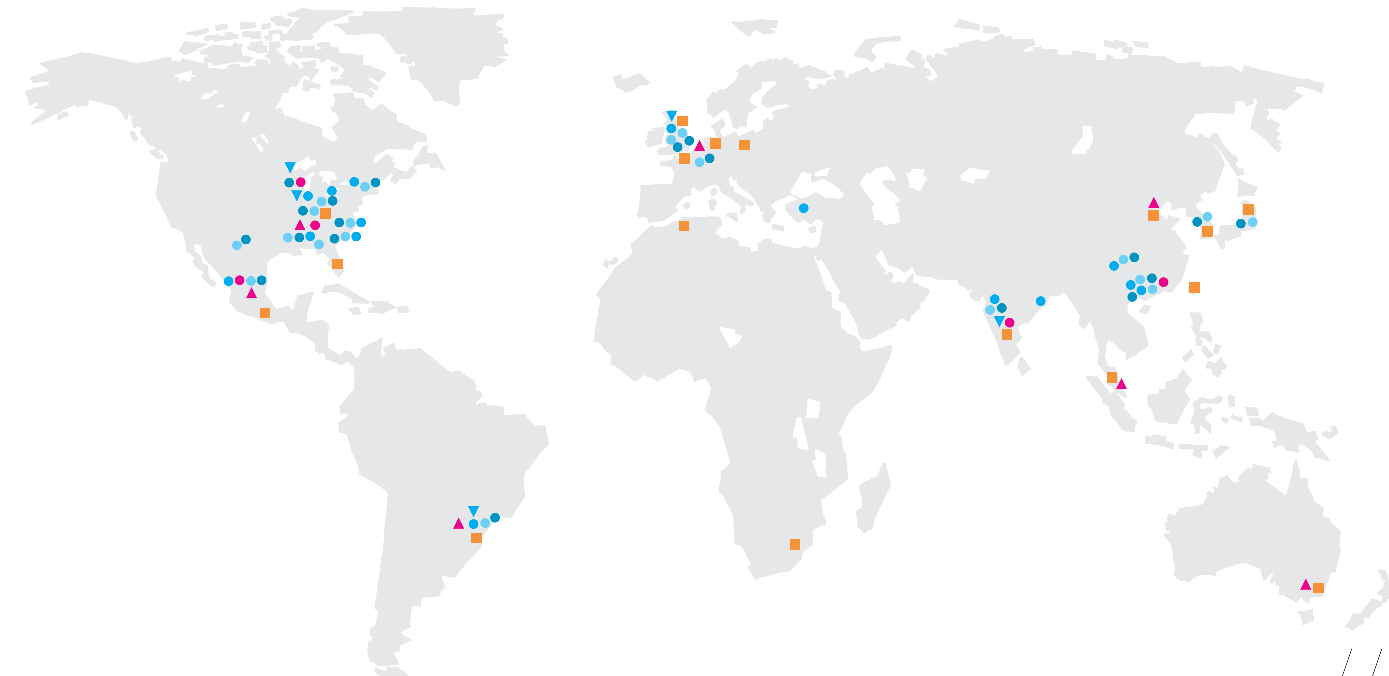
Cummins Worldwide Locations



■ International Offices
▲ Parts Distribution Centers
▼ Technical Centers
* Joint Venture
** Licensee

Operations	Production	Automotive	Industrial	Power Generation	Filtration
BMC Sanayi veTicaret A.S.** *Izmir, Turkey*	B3.9/5.9 C8.3	●			
Chongqing Cummins Engine Company Ltd.* *Chongqing, China*	NT K19/38/50 L10/M11	●	●	●	
Columbus Engine Plant *Columbus, Indiana*	N14/NT Signature 600	●	●	●	
Columbus Midrange Engine Plant *Columbus, Indiana*	B5.9 ISB	●			
Consolidated Diesel Company* *Rocky Mount, North Carolina*	B3.9/5.9 C8.3 ISB ISC	●	●	●	
Cummins Brasil Ltda. *Sao Paulo, Brazil*	B3.9/5.9 C8.3 NT/N14	●	●	●	
Cummins India Limited *Pune, India*	C8.3 NT/N14 V28 K38/50		●	●	
Cummins Industrial Center *Seymour, Indiana*	K19 V903 QSK19		●	●	
Cummins Komatsu Engine Co.* *Seymour, Indiana*	QST30		●	●	
Cummins Marine Division *Charleston, South Carolina*	Marine product development and upfit		●		
Cummins Natural Gas Engines, Inc. *Fort Worth, Texas*	G-NT G-K19 G-V28		●	●	
Cummins Wartsila SAS* *Mulhouse, France*	QSZ – 200		●	●	
Cummins Wartsila SAS* *Daventry, England*	QSW – 170		●	●	
Darlington Engine Plant *Darlington, England*	B3.9/5.9 C8.3	●	●	●	
Daventry Engine Plant *Daventry, England*	K38/50 QSK60		●	●	
Dongfeng Cummins Engine Co. Ltd.* *Xiangfan, Hubei, China*	C8.3	●	●	●	
Dongfeng Motor Corporation** *Xiangfan, Hubei, China*	B3.9/5.9	●			
Jamestown Engine Plant *Jamestown, New York*	M11 L10 G-L10	●	●	●	
Komatsu Cummins Engine Company, Ltd.* *Oyama, Japan*	B3.9/B5.9		●	●	
Onan Corporation *Fridley, Minnesota*	Generator sets and electronic controls			●	
Cummins Power Generation UK *Ramsgate, England*	Generator sets and electronic controls			●	
SsangYong Heavy Industries Co., Ltd.** *Seoul, South Korea*	K19 V903		●	●	
Tata Cummins Ltd.* *Jamshedpur, India*	B3.9/B5.9	●			
Components					
Atlas Inc. *Fostoria, Ohio*	Crankshafts and camshafts	●	●	●	
Cummins S.A. *San Luis Potosi, Mexico*	Engine components and remanufactured engines	●	●	●	●
Diesel ReCon Company *Memphis, Tennessee*	Remanufactured engines and components	●	●	●	
European Engine Alliance* *High Wycombe, England*	B engine components B2.8/B3.9/B4.9/B5.9	●	●	●	
Fleetguard Filters Ltd.* *Pune, India*	Filtration systems				●
Fleetguard, Inc. *Nashville, Tennessee*	Filtration systems				●
Fleetguard Shanghai* *Shanghai, China*	Filtration systems				●
Fuel Systems Division *Columbus, Indiana*	Fuel system design and manufacture	●	●	●	
Holset Engineering Company Ltd. *Charleston, South Carolina*	Turbochargers	●	●	●	
Holset Engineering Company Ltd. *Huddersfield, England*	Turbochargers	●	●	●	
Nelson Industries, Inc. *Stoughton, Wisconsin*	Filtration and exhaust systems				●
Newage International Ltd. *Stamford, England*	Alternators			●	
Tata Holset Ltd.* *Dewas, India*	Turbochargers	●			
Wuxi Holset Ltd.* *Wuxi, China*	Turbochargers	●	●	●	
Wuxi Newage Alternators Ltd.* *Wuxi, China*	Alternators			●	
Technical Centers					
Columbus, Indiana Fridley, Minnesota Darlington, England Pune, India Sao Paulo, Brazil	Research, technology, and engine and other product development				

Shareholder Information

Annual Meeting:
Shareholders are invited to attend the Company's Annual Meeting on April 6, 1999 at 10:30 a.m. (Eastern Standard Time) in Columbus, Indiana. The meeting will be held in the Robbins Auditorium of Columbus East High School.

Stock Transfer Agent, Registrar and Dividend Disbursing Agent:
The First Chicago Trust Company, a division of EquiServe, is the Company's common stock transfer agent and registrar. The bank maintains the Company's shareholder records and is responsible for disbursing dividend checks. Changes of address and questions should be addressed as follows:

General Shareholder Correspondence
First Chicago Trust Company
P. O. Box 2500, Jersey City, NJ 07303-2500

Questions concerning transfers of stock ownership should be directed to The First Chicago Trust Company of New York, P. O. Box 2506, Jersey City, NJ 07303-25060. Cummins' Shareholder Representatives at the bank may be called at 800-446-2617 from inside the U.S., or at 201-324-0498 from outside the U.S. They also are available on the Internet at http://www.equiserve.com and for the hearing impaired at TDD @ 201-222-4955.

Dividend Distribution:
Common stock dividends are payable quarterly, upon authorization of the Board of Directors, on or about the fifteenth of March, June, September and December.

Dividend Reinvestment:
As an added service to shareholders, Cummins has a Dividend Reinvestment Plan, administered by First Chicago Trust Company of New York. This plan gives shareholders of record the option of having their cash dividends and optional cash payments applied toward the purchase of additional shares. Commissions and other expenses of the plan are paid by Cummins so that participants' funds are used solely for the purchase of additional shares.

Shareholders wishing information about this plan may call 800-446-2617 or write to:
First Chicago Trust Company of New York
P. O. Box 2598, Jersey City, NJ 07303-2598

Exchange Listings:
The common stock of Cummins Engine Company, Inc., was listed on the New York Stock Exchange in 1964 and the Pacific Stock Exchange in 1988. The stock is listed under the symbol CUM.

Inquiries:

Shareholders or others desiring a copy of the Company's 1998 Form 10-K filed with the Securities and Exchange Commission, quarterly results or other information about the Company may contact:

Chip Wochomurka
Executive Director-
Investor Relations and Strategic Planning
Cummins Engine Company, Inc.
Box 3005 (Mail Code 60118)
Columbus, IN 47202-3005
investor_relations@cummins.com
Phone: 812-377-3121
Fax: 812-377-4937

General information, the Annual Report, quarterly results and other financial information also are available on Cummins' home page on the Internet.
http://www.cummins.com

The Company's press releases by fax may be requested by calling News on Demand at 888-329-2305.

Corporate Headquarters
Cummins Engine Company, Inc.
Columbus, Indiana 47202-3005

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