

CUMMINS INC
Form 10-Q
August 02, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q
QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended July 3, 2016

Commission File Number 1-4949

CUMMINS INC.
(Exact name of registrant as specified in its charter)
Indiana 35-0257090
(State of Incorporation) (IRS Employer Identification No.)
500 Jackson Street
Box 3005
Columbus, Indiana 47202-3005
(Address of principal executive offices)

Telephone (812) 377-5000
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of July 3, 2016, there were 168,641,183 shares of common stock outstanding with a par value of \$2.50 per share.

Website Access to Company's Reports

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Cummins maintains an internet website at www.cummins.com. Investors can obtain copies of our filings from this website free of charge as soon as reasonably practicable after they are electronically filed with, or furnished, to the Securities and Exchange Commission. Cummins is not including the information provided on the website as part of, or incorporating such information by reference into, this Quarterly Report on Form 10-Q.

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PART I. FINANCIAL INFORMATION

ITEM 1. Condensed Consolidated Financial Statements

CUMMINS INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

In millions, except per share amounts	Three months ended		Six months ended	
	July 3, 2016	June 28, 2015	July 3, 2016	June 28, 2015
NET SALES ^(a)	\$ 4,528	\$ 5,015	\$ 8,819	\$ 9,724
Cost of sales	3,331	3,683	6,566	7,197
GROSS MARGIN	1,197	1,332	2,253	2,527
OPERATING EXPENSES AND INCOME				
Selling, general and administrative expenses	524	537	1,014	1,054
Research, development and engineering expenses	155	166	321	361
Equity, royalty and interest income from investees (Note 4)	88	94	160	162
Other operating expense, net	(39)	—	(41)	(3)
OPERATING INCOME	567	723	1,037	1,271
Interest income	6	6	12	11
Interest expense (Note 8)	16	17	35	31
Other income (expense), net	18	(8)	26	1
INCOME BEFORE INCOME TAXES	575	704	1,040	1,252
Income tax expense (Note 5)	148	208	280	352
CONSOLIDATED NET INCOME	427	496	760	900
Less: Net income attributable to noncontrolling interests	21	25	33	42
NET INCOME ATTRIBUTABLE TO CUMMINS INC.	\$ 406	\$ 471	\$ 727	\$ 858
EARNINGS PER COMMON SHARE ATTRIBUTABLE TO CUMMINS INC.				
Basic	\$ 2.41	\$ 2.63	\$ 4.27	\$ 4.77
Diluted	\$ 2.40	\$ 2.62	\$ 4.26	\$ 4.76
WEIGHTED AVERAGE SHARES OUTSTANDING				
Basic	168.8	179.2	170.3	179.9
Dilutive effect of stock compensation awards	0.2	0.4	0.2	0.4
Diluted	169.0	179.6	170.5	180.3
CASH DIVIDENDS DECLARED PER COMMON SHARE	\$ 0.975	\$ 0.78	\$ 1.95	\$ 1.56

^(a) Includes sales to nonconsolidated equity investees of \$276 million and \$518 million and \$357 million and \$682 million for the three and six months ended July 3, 2016 and June 28, 2015, respectively.

The accompanying notes are an integral part of the Condensed Consolidated Financial Statements.

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CUMMINS INC. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
 (Unaudited)

In millions	Three months ended		Six months ended	
	July 3, 2016	June 28, 2015	July 3, 2016	June 28, 2015
CONSOLIDATED NET INCOME	\$ 427	\$ 496	\$760	\$ 900
Other comprehensive (loss) income, net of tax (Note 11)				
Foreign currency translation adjustments	(213)	145	(270)	(31)
Unrealized (loss) gain on derivatives	(6)	8	(27)	8
Change in pension and other postretirement defined benefit plans	9	15	18	28
Unrealized gain on marketable securities	1	1	1	—
Total other comprehensive (loss) income, net of tax	(209)	169	(278)	5
COMPREHENSIVE INCOME	218	665	482	905
Less: Comprehensive income attributable to noncontrolling interests	15	20	27	40
COMPREHENSIVE INCOME ATTRIBUTABLE TO CUMMINS INC.	\$ 203	\$ 645	\$455	\$ 865

The accompanying notes are an integral part of the Condensed Consolidated Financial Statements.

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CUMMINS INC. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED BALANCE SHEETS
 (Unaudited)

In millions, except par value	July 3, 2016	December 31, 2015
ASSETS		
Current assets		
Cash and cash equivalents	\$1,045	\$ 1,711
Marketable securities (Note 6)	235	100
Total cash, cash equivalents and marketable securities	1,280	1,811
Accounts and notes receivable, net		
Trade and other	2,811	2,640
Nonconsolidated equity investees	212	180
Inventories (Note 7)	2,778	2,707
Prepaid expenses and other current assets	549	609
Total current assets	7,630	7,947
Long-term assets		
Property, plant and equipment	7,432	7,322
Accumulated depreciation	(3,729)	(3,577)
Property, plant and equipment, net	3,703	3,745
Investments and advances related to equity method investees	1,073	975
Goodwill	481	482
Other intangible assets, net	328	328
Pension assets	764	735
Other assets	1,041	922
Total assets	\$15,020	\$ 15,134
LIABILITIES		
Current liabilities		
Accounts payable (principally trade)	\$1,825	\$ 1,706
Loans payable (Note 8)	19	24
Commercial paper (Note 8)	200	—
Accrued compensation, benefits and retirement costs	353	409
Current portion of accrued product warranty (Note 9)	335	359
Current portion of deferred revenue	433	403
Other accrued expenses	947	863
Current maturities of long-term debt (Note 8)	38	39
Total current liabilities	4,150	3,803
Long-term liabilities		
Long-term debt (Note 8)	1,614	1,576
Postretirement benefits other than pensions	328	349
Pensions	299	298
Other liabilities and deferred revenue	1,434	1,358
Total liabilities	\$7,825	\$ 7,384
Commitments and contingencies (Note 10)		
EQUITY		
Cummins Inc. shareholders' equity		

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Common stock, \$2.50 par value, 500 shares authorized, 222.4 and 222.4 shares issued	\$2,196	\$ 2,178
Retained earnings	10,716	10,322
Treasury stock, at cost, 53.7 and 47.2 shares	(4,422)	(3,735)
Common stock held by employee benefits trust, at cost, 0.7 and 0.9 shares	(9)	(11)
Accumulated other comprehensive loss (Note 11)	(1,620)	(1,348)
Total Cummins Inc. shareholders' equity	6,861	7,406
Noncontrolling interests	334	344
Total equity	\$7,195	\$ 7,750
Total liabilities and equity	\$15,020	\$ 15,134

The accompanying notes are an integral part of the Condensed Consolidated Financial Statements.

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CUMMINS INC. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 (Unaudited)

In millions	Six months ended	
	July 3, 2016	June 28, 2015
CASH FLOWS FROM OPERATING ACTIVITIES		
Consolidated net income	\$760	\$900
Adjustments to reconcile consolidated net income to net cash provided by operating activities		
Restructuring payments (Note 12)	(42)	—
Loss contingency (Note 10)	39	—
Depreciation and amortization	259	254
Deferred income taxes	2	(63)
Equity in income of investees, net of dividends	(87)	(68)
Pension contributions in excess of expense (Note 3)	(82)	(122)
Other post-retirement benefits payments in excess of expense (Note 3)	(17)	(15)
Stock-based compensation expense	20	17
Translation and hedging activities	(45)	27
Changes in current assets and liabilities, net of acquisitions		
Accounts and notes receivable	(252)	(426)
Inventories	(101)	(127)
Other current assets	189	18
Accounts payable	139	97
Accrued expenses	(209)	(21)
Changes in other liabilities and deferred revenue	129	133
Other, net	32	(35)
Net cash provided by operating activities	734	569
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(189)	(247)
Investments in internal use software	(27)	(22)
Investments in and advances to equity investees	(17)	(17)
Acquisitions of businesses, net of cash acquired	(1)	(15)
Investments in marketable securities—acquisitions (Note 6)	(379)	(173)
Investments in marketable securities—liquidations (Note 6)	237	155
Cash flows from derivatives not designated as hedges	(21)	5
Other, net	6	14
Net cash used in investing activities	(391)	(300)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from borrowings	109	12
Net borrowings of commercial paper (Note 8)	200	—
Payments on borrowings and capital lease obligations	(133)	(31)
Distributions to noncontrolling interests	(24)	(14)
Dividend payments on common stock	(333)	(280)
Repurchases of common stock	(695)	(514)
Other, net	(16)	(2)
Net cash used in financing activities	(892)	(829)

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EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	(117)	19
Net decrease in cash and cash equivalents	(666)	(541)
Cash and cash equivalents at beginning of year	1,711	2,301
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$1,045	\$1,760

The accompanying notes are an integral part of the Condensed Consolidated Financial Statements.

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CUMMINS INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
(Unaudited)

In millions	Common Stock	Additional Paid-in Capital	Retained Earnings	Treasury Stock	Common Stock Held in Trust	Other Comprehens ive Loss	Total Cummins Shareholder Equity	Noncontrol ling Interests	Total Equity
BALANCE AT DECEMBER 31, 2014	\$ 556	\$ 1,583	\$ 9,545	\$(2,844)	\$(13)	\$(1,078)	\$ 7,749	\$ 344	\$ 8,093
Net income			858				858	42	900
Other comprehensive (loss) income, net of tax (Note 11)						7	7	(2)	5
Issuance of shares		3					3	—	3
Employee benefits trust activity		16			1		17	—	17
Acquisition of shares				(514)			(514)	—	(514)
Cash dividends on common stock			(280)				(280)	—	(280)
Distributions to noncontrolling interests							—	(25)	(25)
Stock based awards		(4)		8			4	—	4
Other shareholder transactions		10					10	1	11
BALANCE AT JUNE 28, 2015	\$ 556	\$ 1,608	\$ 10,123	\$(3,350)	\$(12)	\$(1,071)	\$ 7,854	\$ 360	\$ 8,214
BALANCE AT DECEMBER 31, 2015	\$ 556	\$ 1,622	\$ 10,322	\$(3,735)	\$(11)	\$(1,348)	\$ 7,406	\$ 344	\$ 7,750
Net income			727				727	33	760
Other comprehensive (loss) income, net of tax (Note 11)						(272)	(272)	(6)	(278)
Issuance of shares		4					4	—	4
Employee benefits trust activity		14			2		16	—	16
Acquisition of shares (Note 2)				(695)			(695)	—	(695)
Cash dividends on common stock			(333)				(333)	—	(333)
Distributions to noncontrolling interests							—	(31)	(31)
Stock based awards		(6)		8			2	—	2
Other shareholder transactions		6					6	(6)	—
BALANCE AT JULY 3, 2016	\$ 556	\$ 1,640	\$ 10,716	\$(4,422)	\$(9)	\$(1,620)	\$ 6,861	\$ 334	\$ 7,195

The accompanying notes are an integral part of the Condensed Consolidated Financial Statements.

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CUMMINS INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1. NATURE OF OPERATIONS

Cummins Inc. (“Cummins,” “we,” “our” or “us”) was founded in 1919 as a corporation in Columbus, Indiana, as one of the first diesel engine manufacturers. We are a global power leader that designs, manufactures, distributes and services diesel and natural gas engines and engine-related component products, including filtration, aftertreatment, turbochargers, fuel systems, controls systems, air handling systems and electric power generation systems. We sell our products to original equipment manufacturers (OEMs), distributors and other customers worldwide. We serve our customers through a network of approximately 600 company-owned and independent distributor locations and over 7,200 dealer locations in more than 190 countries and territories.

NOTE 2. BASIS OF PRESENTATION

The unaudited Condensed Consolidated Financial Statements reflect all adjustments which, in the opinion of management, are necessary for a fair statement of the results of operations, financial position and cash flows. All such adjustments are of a normal recurring nature. The Condensed Consolidated Financial Statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission and in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with GAAP have been condensed or omitted as permitted by such rules and regulations. Certain reclassifications have been made to prior period amounts to conform to the presentation of the current period condensed financial statements.

Our reporting period usually ends on the Sunday closest to the last day of the quarterly calendar period. The second quarters of 2016 and 2015 ended on July 3 and June 28, respectively. Our fiscal year ends on December 31, regardless of the day of the week on which December 31 falls.

Preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect reported amounts presented and disclosed in our Condensed Consolidated Financial Statements. Significant estimates and assumptions in these Condensed Consolidated Financial Statements require the exercise of judgment and are used for, but not limited to, allowance for doubtful accounts, useful lives for depreciation and amortization, estimates of future cash flows and other assumptions associated with goodwill and long-lived asset impairment tests, determination of discount rates and other assumptions for pension and other postretirement benefit costs, warranty programs, income taxes and deferred tax valuation allowances, lease classification, contingencies and restructuring costs. Due to the inherent uncertainty involved in making estimates, actual results reported in future periods may be different from these estimates.

The weighted-average diluted common shares outstanding exclude the anti-dilutive effect of certain stock options since such options had an exercise price in excess of the monthly average market value of our common stock. The options excluded from diluted earnings per share for the three and six months ended July 3, 2016 and June 28, 2015, were as follows:

Three months ended		Six months ended	
July 3, 2016	June 28, 2015	July 3, 2016	June 28, 2015

Options excluded	1,262,469	490,085	1,475,068	414,982
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These interim condensed financial statements should be read in conjunction with the Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2015. Our interim period financial results for the three and six month periods presented are not necessarily indicative of results to be expected for any other interim period or for the entire year. The year-end Condensed Consolidated Balance Sheet data was derived from audited financial statements, but does not include all disclosures required by GAAP.

On February 9, 2016, we entered into an accelerated share repurchase (ASR) agreement with a third party financial institution to repurchase \$500 million of our common stock under our previously announced share repurchase plans.

Pursuant to the terms of the agreement, we paid the full \$500 million purchase price and initially received approximately 4.1 million shares representing approximately 80 percent of the shares expected to be repurchased. The unsettled portion of the ASR met the criteria to be accounted for as a forward contract indexed to our stock and qualified as an equity transaction. This resulted in a \$100 million reduction to additional paid-in capital during the first quarter of 2016. In the second quarter of 2016, the ASR was completed, and we received approximately 0.6 million additional shares, based on our volume-weighted average stock price

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during the term of the transaction, less a discount, for a total of 4.7 million shares purchased under the ASR at an average purchase price of \$105.50 per share. The settlement resulted in the reclassification of the \$100 million reduction of additional paid-in capital recognized in the first quarter of 2016 to treasury stock.

The delivery of shares resulted in a reduction to our common stock outstanding used to calculate earnings per share in the quarter the shares were received and subsequent quarters.

NOTE 3. PENSION AND OTHER POSTRETIREMENT BENEFITS

We sponsor funded and unfunded domestic and foreign defined benefit pension and other postretirement plans.

Contributions to these plans were as follows:

In millions	Three months ended		Six months ended	
	July 3, 2016	June 28, 2015	July 3, 2016	June 28, 2015
Defined benefit pension plans				
Voluntary contribution	\$ 37	\$ 36	\$85	\$ 72
Mandatory contribution	6	6	18	82
Defined benefit pension contributions	\$ 43	\$ 42	\$103	\$ 154
Other postretirement plans	\$ 15	\$ 12	\$28	\$ 25
Defined contribution pension plans	\$ 14	\$ 17	\$35	\$ 42

We anticipate making additional defined benefit pension contributions during the remainder of 2016 of \$43 million. The estimated \$146 million of pension contributions for the full year include voluntary contributions of approximately \$102 million. These contributions may be made from trusts or company funds either to increase pension assets or to make direct benefit payments to plan participants. We expect our 2016 net periodic pension cost to approximate \$42 million.

The components of net periodic pension and other postretirement benefit costs under our plans were as follows:

In millions	Pension						Other Postretirement Benefits	
	U.S. Plans		U.K. Plans		Other Postretirement Benefits			
	Three months ended		Three months ended		Three months ended		Three months ended	
	July 3, 2016	June 28, 2015	July 3, 2016	June 28, 2015	July 3, 2016	June 28, 2015	July 3, 2016	June 28, 2015
Service cost	\$23	\$ 20	\$ 6	\$ 6	\$ —	\$ —	\$ —	\$ —
Interest cost	28	26	13	14	4	4	4	4
Expected return on plan assets	(51)	(48)	(19)	(22)	—	—	—	—
Recognized net actuarial loss	7	12	4	8	2	1	2	1
Net periodic benefit cost	\$7	\$ 10	\$ 4	\$ 6	\$ 6	\$ 5	\$ 6	\$ 5
In millions	Pension						Other Postretirement Benefits	
	U.S. Plans		U.K. Plans		Other Postretirement Benefits			
	Six months ended		Six months ended		Six months ended		Six months ended	
	July 3, 2016	June 28, 2015	July 3, 2016	June 28, 2015	July 3, 2016	June 28, 2015	July 3, 2016	June 28, 2015
Service cost	\$46	\$ 40	\$11	\$ 13	\$ —	\$ —	\$ —	\$ —
Interest cost	56	51	26	28	8	8	8	8
Expected return on plan assets	(102)	(95)	(38)	(45)	—	—	—	—
Recognized net actuarial loss	14	23	8	17	3	2	3	2
Net periodic benefit cost	\$14	\$ 19	\$7	\$ 13	\$ 11	\$ 10	\$ 11	\$ 10

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NOTE 4. EQUITY, ROYALTY AND INTEREST INCOME FROM INVESTEEES

Equity, royalty and interest income from investees included in our Condensed Consolidated Statements of Income for the reporting periods was as follows:

In millions	Three months ended		Six months ended	
	July 3, 2016	June 28, 2015	July 3, 2016	June 28, 2015
Distribution Entities				
Komatsu Cummins Chile, Ltda.	\$ 8	\$ 8	\$18	\$ 15
North American distributors	6	8	11	18
All other distributors	1	—	1	1
Manufacturing Entities				
Beijing Foton Cummins Engine Co., Ltd.	22	22	40	29
Dongfeng Cummins Engine Company, Ltd.	15	15	22	29
Chongqing Cummins Engine Company, Ltd.	9	11	17	23
All other manufacturers	16	21	32	28
Cummins share of net income	77	85	141	143
Royalty and interest income	11	9	19	19
Equity, royalty and interest income from investees	\$ 88	\$ 94	\$160	\$ 162

NOTE 5. INCOME TAXES

Our effective tax rate for the year is expected to approximate 27.0 percent, excluding any one-time items that may arise. Our tax rate is generally less than the 35 percent U.S. statutory income tax rate primarily due to lower tax rates on foreign income and the research tax credit.

Our effective tax rate for the three and six months ended July 3, 2016, was 25.7 percent and 26.9 percent, respectively.

Our effective tax rate for the three and six months ended June 28, 2015, was 29.5 percent and 28.1 percent, respectively. The tax rate for the six months ended June 2