

CUMMINS INC
Form 10-Q
May 01, 2013
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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 March 31, 2013

Commission File Number 1-4949

CUMMINS INC.

(Exact name of registrant as specified in its charter)

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Indiana
(State of Incorporation)

35-0257090
(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 March 31, 2013, there were 189,738,852 shares of common stock outstanding with a par value of \$2.50 per share.

Website Access to Company's Reports

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.

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CUMMINS INC. AND SUBSIDIARIES

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In millions, except per share amounts	Three months ended	
	March 31, 2013	April 1, 2012
NET SALES (a)	\$ 3,922	\$ 4,472
Cost of sales	2,965	3,274
GROSS MARGIN	957	1,198
OPERATING EXPENSES AND INCOME		
Selling, general and administrative expenses	444	475
Research, development and engineering expenses	182	181
Equity, royalty and interest income from investees (Note 4)	82	104
Other operating income (expense), net	1	2
OPERATING INCOME	414	648
Interest income	5	8
Interest expense	6	8
Other income (expense), net	18	2
INCOME BEFORE INCOME TAXES	431	650
Income tax expense (Note 5)	119	175
CONSOLIDATED NET INCOME	312	475
Less: Net income attributable to noncontrolling interests	30	20
NET INCOME ATTRIBUTABLE TO CUMMINS INC.	\$ 282	\$ 455
EARNINGS PER COMMON SHARE ATTRIBUTABLE TO CUMMINS INC.		
Basic	\$ 1.50	\$ 2.39
Diluted	\$ 1.49	\$ 2.38
WEIGHTED AVERAGE SHARES OUTSTANDING		
Basic	188.4	190.4
Dilutive effect of stock compensation awards	0.4	0.4
Diluted	188.8	190.8
CASH DIVIDENDS DECLARED PER COMMON SHARE	\$ 0.50	\$ 0.40

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(a) Includes sales to nonconsolidated equity investees of \$552 million and \$669 million for the three months ended March 31, 2013 and April 1, 2012, 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	
	March 31, 2013	April 1, 2012
CONSOLIDATED NET INCOME	\$ 312	\$ 475
Other comprehensive income (loss), net of tax (Note 13)		
Foreign currency translation adjustments	(150)	106
Unrealized gain (loss) on marketable securities	(10)	(1)
Unrealized gain (loss) on derivatives	(6)	19
Change in pension and other postretirement defined benefit plans	19	11
Total other comprehensive income (loss), net of tax	(147)	135
COMPREHENSIVE INCOME	165	610
Less: Comprehensive income attributable to noncontrolling interest	28	30
COMPREHENSIVE INCOME ATTRIBUTABLE TO CUMMINS INC.	\$ 137	\$ 580

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	March 31, 2013	December 31, 2012
ASSETS		
Current assets		
Cash and cash equivalents	\$ 1,483	\$ 1,369
Marketable securities (Note 6)	196	247
Total cash, cash equivalents and marketable securities	1,679	1,616
Accounts and notes receivable, net		
Trade and other	2,250	2,235
Nonconsolidated equity investees	246	240
Inventories (Note 8)	2,387	2,221
Prepaid expenses and other current assets	658	855
Total current assets	7,220	7,167
Long-term assets		
Property, plant and equipment	5,942	5,876
Accumulated depreciation	(3,173)	(3,152)
Property, plant and equipment, net	2,769	2,724
Investments and advances related to equity method investees	944	897
Goodwill	444	445
Other intangible assets, net	366	369
Other assets	1,013	946
Total assets	\$ 12,756	\$ 12,548
LIABILITIES		
Current liabilities		
Loans payable	\$ 13	\$ 16
Accounts payable (principally trade)	1,554	1,339
Current maturities of long-term debt (Note 9)	54	61
Current portion of accrued product warranty (Note 10)	396	386
Accrued compensation, benefits and retirement costs	280	400
Deferred revenue	230	215
Taxes payable (including taxes on income)	203	173
Other accrued expenses	527	546
Total current liabilities	3,257	3,136
Long-term liabilities		
Long-term debt (Note 9)	736	698
Postretirement benefits other than pensions	422	432
Other liabilities and deferred revenue	1,296	1,308
Total liabilities	5,711	5,574
Commitments and contingencies (Note 11)		
EQUITY		
Cummins Inc. shareholders' equity		
Common stock, \$2.50 par value, 500 shares authorized, 222.2 and 222.4 shares issued	2,064	2,058
Retained earnings	7,530	7,343
Treasury stock, at cost, 32.5 and 32.6 shares	(1,827)	(1,830)

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Common stock held by employee benefits trust, at cost, 1.4 and 1.5 shares	(17)	(18)
Accumulated other comprehensive loss (Note 13)		
Defined benefit postretirement plans	(775)	(794)
Other	(320)	(156)
Total accumulated other comprehensive loss	(1,095)	(950)
Total Cummins Inc. shareholders' equity	6,655	6,603
Noncontrolling interests	390	371
Total equity	7,045	6,974
Total liabilities and equity	\$ 12,756	\$ 12,548

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	Three months ended	
	March 31, 2013	April 1, 2012
CASH FLOWS FROM OPERATING ACTIVITIES		
Consolidated net income	\$ 312	\$ 475
Adjustments to reconcile consolidated net income to net cash provided by operating activities		
Depreciation and amortization	98	85
Gain on fair value adjustment for consolidated investee	(7)	
Deferred income taxes	5	(27)
Equity in income of investees, net of dividends	(36)	(59)
Pension contributions in excess of expense (Note 3)	(54)	(27)
Other post-retirement benefits payments in excess of expense (Note 3)	(8)	(4)
Stock-based compensation expense	7	7
Excess tax benefits on stock-based awards	(7)	(11)
Translation and hedging activities	(5)	10
Changes in current assets and liabilities, net of acquisitions		
Accounts and notes receivable	(29)	(135)
Inventories	(177)	(209)
Other current assets	158	(28)
Accounts payable	204	148
Accrued expenses	(142)	(196)
Changes in other liabilities and deferred revenue	47	29
Other, net	62	(37)
Net cash provided by operating activities	428	21
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(114)	(126)
Investments in internal use software	(12)	(16)
Investments in and advances to equity investees	(24)	(5)
Acquisition of businesses, net of cash acquired	(17)	(5)
Investments in marketable securities acquisitions (Note 6)	(133)	(146)
Investments in marketable securities liquidations (Note 6)	187	184
Cash flows from derivatives not designated as hedges	(30)	11
Other, net		1
Net cash used in investing activities	(143)	(102)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from borrowings		12
Payments on borrowings and capital lease obligations	(27)	(38)
Net borrowings (payments) under short-term credit agreements	15	
Distributions to noncontrolling interests	(19)	(22)
Dividend payments on common stock	(95)	(77)
Repurchases of common stock		(8)
Excess tax benefits on stock-based awards	7	11
Other, net	16	9
Net cash used in financing activities	(103)	(113)
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	(68)	27

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Net increase (decrease) in cash and cash equivalents	114	(167)
Cash and cash equivalents at beginning of year	1,369	1,484
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 1,483	\$ 1,317

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	Accumulated Other Comprehensive Loss	Treasury Stock	Common Stock Held in Trust	Total Cummins Inc. Shareholders Equity	Noncontrolling Interests	Total Equity
BALANCE AT DECEMBER 31, 2011	\$ 555	\$ 1,446	\$ 6,038	\$ (938)	\$ (1,587)	\$ (22)	\$ 5,492	\$ 339	\$ 5,831
Net income			455				455	20	475
Other comprehensive income (loss)				125			125	10	135
Issuance of shares	1						1		1
Employee benefits trust activity		12				2	14		14
Acquisition of shares					(8)		(8)		(8)
Cash dividends on common stock			(77)				(77)		(77)
Distribution to noncontrolling interests								(35)	(35)
Stock option exercises					5		5		5
Other shareholder transactions		3					3	14	17
BALANCE AT APRIL 1, 2012	\$ 556	\$ 1,461	\$ 6,416	\$ (813)	\$ (1,590)	\$ (20)	\$ 6,010	\$ 348	\$ 6,358
BALANCE AT DECEMBER 31, 2012	\$ 556	\$ 1,502	\$ 7,343	\$ (950)	\$ (1,830)	\$ (18)	\$ 6,603	\$ 371	\$ 6,974
Net income			282				282	30	312
Other comprehensive income (loss)				(145)			(145)	(2)	(147)
Issuance of shares		1					1		1
Employee benefits trust activity		8				1	9		9
Cash dividends on common stock			(95)				(95)		(95)
Distribution to noncontrolling interests								(19)	(19)
Stock option exercises					3		3		3
Other shareholder transactions		(3)					(3)	10	7
BALANCE AT MARCH 31, 2013	\$ 556	\$ 1,508	\$ 7,530	\$ (1,095)	\$ (1,827)	\$ (17)	\$ 6,655	\$ 390	\$ 7,045

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 approximately 6,500 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 (SEC) 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 first quarters of 2013 and 2012 ended on March 31, and April 1, respectively. The interim period for both 2013 and 2012 contained 13 weeks. Our fiscal year ends on December 31, regardless of the day of the week on which December 31 falls.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect reported amounts in the *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, estimates of future cash flows and other assumptions associated with goodwill and long-lived asset impairment tests, useful lives for depreciation and amortization, warranty programs, determination of discount and other rate assumptions for pension and other postretirement benefit expenses, income taxes and deferred tax valuation allowances, lease classifications and contingencies. 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

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the three month periods ended March 31, 2013, and April 1, 2012, were as follows:

	Three months ended	
	March 31, 2013	April 1, 2012
Options excluded	563,350	143,300

You should read these interim condensed financial statements in conjunction with the *Consolidated Financial Statements* included in our Annual Report on Form 10-K for the year ended December 31, 2012. Our interim period financial results for the three month interim 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.

Table of Contents**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	
	March 31, 2013	April 1, 2012
Defined benefit pension and other postretirement plans		
Voluntary contribution	\$ 39	\$ 38
Mandatory contribution	37	5
Defined benefit pension contributions	76	43
Other postretirement plans	14	9
Total defined benefit plans	\$ 90	\$ 52
Defined contribution pension plans	\$ 22	\$ 27

We made \$76 million of pension contributions in the three month period ended March 31, 2013, and we anticipate making an additional \$89 million of contributions during the remainder of 2013. We paid \$14 million of claims and premiums for other postretirement benefits in the three month period ended March 31, 2013; payments for the remainder of 2013 are expected to be \$33 million. The \$165 million of contributions for the full year include voluntary contributions of approximately \$110 million. These contributions and payments may be made from trusts or company funds either to increase pension assets or to make direct benefit payments to plan participants. Our expected pension expense for 2013 has been reduced \$10 million, to \$87 million, from the amount we had expected at year-end, due to a remeasurement of the U.S. plan for changes in employee census data.

The components of net periodic pension and other postretirement benefit cost under our plans consisted of the following:

In millions	U.S. Plans		Pension		U.K. Plans		Other Postretirement Benefits	
	March 31, 2013	April 1, 2012	March 31, 2013	April 1, 2012	Three months ended March 31, 2013	April 1, 2012	March 31, 2013	April 1, 2012
Service cost	\$ 17	\$ 14	\$ 5	\$ 6	\$ 6	\$ 6	\$ 4	\$ 5
Interest cost	24	26	14	14				
Expected return on plan assets	(42)	(39)	(18)	(20)				
Amortization of prior service credit								(1)
Recognized net actuarial loss	16	12	6	3			2	1
Net periodic benefit cost	\$ 15	\$ 13	\$ 7	\$ 3	\$ 6	\$ 6	\$ 6	\$ 5

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

In millions	Three months ended	
	March 31, 2013	April 1, 2012
Distribution Entities		
North American distributors	\$ 35	\$ 40
Komatsu Cummins Chile, Ltda.	5	5
All other distributors		1
Manufacturing Entities		
Chongqing Cummins Engine Company, Ltd.	12	18
Dongfeng Cummins Engine Company, Ltd.	12	16
Shanghai Fleetguard Filter Co., Ltd.	3	3
Valvoline Cummins, Ltd.	3	2
Tata Cummins, Ltd.	1	4
Beijing Foton Cummins Engine Co., Ltd.	1	(2)
Cummins Westport, Inc.		5
Komatsu manufacturing alliances	(1)	(1)
All other manufacturers	2	1
Cummins share of net income	73	92
Royalty and interest income	9	12
Equity, royalty and interest income from investees	\$ 82	\$ 104

NOTE 5. INCOME TAXES

Our effective tax rate for the year is expected to approximate 29.5 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 research tax credits. The tax rate for the three month period ended March 31, 2013, was 27.6 percent. This tax rate includes a discrete tax benefit of \$28 million attributable to the 2012 research credit as well as a discrete tax expense of \$17 million, which primarily relates to the write-off of a deferred tax asset deemed unrecoverable. On January 2, 2013, the American Taxpayer Relief Act of 2012 was signed into law and reinstated the research tax credit. The expiration of this credit resulted in a higher income tax provision of \$28 million in 2012. As tax law changes are accounted for in the period of enactment, we recognized the discrete tax benefit in the first quarter of 2013.

Our effective tax rate for the three months ended April 1, 2012, was 26.9 percent. The increase in the 2013 effective tax rate compared to 2012 is due primarily to an unfavorable change in the pre-tax mix of income taxed in higher rate jurisdictions, partially offset by \$11 million of net discrete tax benefits.

NOTE 6. MARKETABLE SECURITIES

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A summary of marketable securities, all of which are classified as current, was as follows:

In millions	Cost	March 31, 2013 Gross unrealized gains/(losses)	Estimated fair value	Cost	December 31, 2012 Gross unrealized gains/(losses)	Estimated fair value
Available-for-sale						
Debt mutual funds	\$ 110	\$ 1	\$ 111	\$ 139	\$ 3	\$ 142
Bank debentures	22		22	45		45
Certificates of deposit	59		59	47		47
Government debt securities-non-U.S.	3		3	3		3
Corporate debt securities	1		1	1		1
Equity securities and other(1)					9	9
Total marketable securities	\$ 195	\$ 1	\$ 196	\$ 235	\$ 12	\$ 247

(1) In the first quarter of 2013 we recognized a \$9 million gain on the sale of equity securities.

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At March 31, 2013, the fair value of available-for-sale investments in debt securities by contractual maturity was as follows:

Maturity date In millions	Fair value
1 year or less	\$ 23
1-5 years	2
5-10 years	1
Total	\$ 26

NOTE 7. FAIR VALUE OF FINANCIAL INSTRUMENTS

The majority of the assets and liabilities we carry at fair value are available-for-sale (AFS) securities and derivatives. AFS securities are derived from Level 1 or Level 2 inputs. Derivative assets and liabilities are derived from Level 2 inputs. The predominance of market inputs are actively quoted and can be validated through external sources, including brokers, market transactions and third-party pricing services. When material, we adjust the values of our derivative contracts for counter-party or our credit risk. There were no transfers into or out of Levels 2 or 3 in the first three months of 2013 and 2012.

The following table summarizes our financial instruments recorded at fair value in our *Condensed Consolidated Balance Sheets* at March 31, 2013:

In millions	Fair Value Measurements Using			Total
	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	
Available-for-sale debt securities				
Debt mutual funds	\$ 78	\$ 33	\$	\$ 111
Bank debentures		22		22
Certificates of deposit		59		59
Government debt securities-non-U.S.		3		3
Corporate debt securities		1		1
Derivative assets				
Interest rate contracts		77		77
Commodity swap contracts		2		2
Foreign currency forward contracts		1		1
Commodity call option contracts		1		1
Total assets	\$ 78	\$ 199	\$	\$ 277
Derivative liabilities				
Foreign currency forward contracts		8		8
Commodity swap contracts				