

CUMMINS INC  
Form 10-K  
February 17, 2015

UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-K  
ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the Fiscal Year Ended December 31, 2014  
Commission File Number 1-4949  
CUMMINS INC.

Indiana  
(State of Incorporation)  
500 Jackson Street  
Box 3005  
Columbus, Indiana 47202-3005  
(Address of principal executive offices)  
Telephone (812) 377-5000

35-0257090  
(IRS Employer Identification No.)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, \$2.50 par value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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 (§ 229.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 <input checked="" type="checkbox"/>	Accelerated filer <input type="checkbox"/>	Non-accelerated filer <input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company <input type="checkbox"/>
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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

The aggregate market value of the voting stock held by non-affiliates was approximately \$28.4 billion at June 29, 2014. This value includes all shares of the registrant's common stock, except for treasury shares.

As of January 30, 2015, there were 181,945,783 shares outstanding of \$2.50 par value common stock.

Documents Incorporated by Reference

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Portions of the registrant's definitive Proxy Statement for its 2015 annual meeting of shareholders, which will be filed with the Securities and Exchange Commission on Schedule 14A within 120 days after the end of 2014, will be incorporated by reference in Part III of this Form 10-K to the extent indicated therein upon such filing.

Website Access to Company's Reports

We maintain an internet website at [www.cummins.com](http://www.cummins.com). Investors may obtain copies of our filings from this website free of charge as soon as reasonable practicable after they are electronically filed with, or furnished to, the Securities and Exchange Commission.

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Cummins Inc. and its consolidated subsidiaries are hereinafter sometimes referred to as "Cummins," "we," "our," or "us."

**CAUTIONARY STATEMENTS REGARDING FORWARD-LOOKING INFORMATION**

Certain parts of this annual report contain forward-looking statements intended to qualify for the safe harbors from liability established by the Private Securities Litigation Reform Act of 1995. Forward-looking statements include those that are based on current expectations, estimates and projections about the industries in which we operate and management's beliefs and assumptions. Forward-looking statements are generally accompanied by words such as "anticipates," "expects," "forecasts," "intends," "plans," "believes," "seeks," "estimates," "could," "should" or words of similar meaning. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions, which we refer to as "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. Some future factors that could cause our results to differ materially from the results discussed in such forward-looking statements are discussed below and shareholders, potential investors and other readers are urged to consider these future factors carefully in evaluating forward-looking statements. Readers are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date hereof. Future factors that could affect the outcome of forward-looking statements include the following:

- a sustained slowdown or significant downturn in our markets;
- a slowdown in infrastructure development;
- unpredictability in the adoption, implementation and enforcement of emission standards around the world;
- the actions of, and income from, joint ventures and other investees that we do not directly control;
- changes in the engine outsourcing practices of significant customers;
- a downturn in the North American truck industry or financial distress of a major truck customer;
- a major customer experiencing financial distress;
- any significant problems in our new engine platforms;
- supply shortages and supplier financial risk, particularly from any of our single-sourced suppliers;
- variability in material and commodity costs;
- product recalls;
- competitor pricing activity;
- increasing competition, including increased global competition among our customers in emerging markets;
- exposure to information technology security threats and sophisticated "cyber attacks;"
- political, economic and other risks from operations in numerous countries;
- changes in taxation;
- global legal and ethical compliance costs and risks;
- aligning our capacity and production with our demand;
- product liability claims;
- the development of new technologies;
- obtaining additional customers for our new light-duty diesel engine platform and avoiding any related write-down in our investments in such platform;
- increasingly stringent environmental laws and regulations;
- foreign currency exchange rate changes;
- the price and availability of energy;
- the performance of our pension plan assets;
- labor relations;
- changes in accounting standards;
- our sales mix of products;

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- protection and validity of our patent and other intellectual property rights;
- technological implementation and cost/financial risks in our increasing use of large, multi-year contracts;
- the cyclical nature of some of our markets;
- the outcome of pending and future litigation and governmental proceedings;
- continued availability of financing, financial instruments and financial resources in the amounts, at the times and on the terms required to support our future business;
- the consummation and integration of the planned acquisitions of our partially-owned United States and Canadian distributors; and
- other risk factors described in Item IA under the caption "Risk Factors."

Shareholders, potential investors and other readers are urged to consider these factors carefully in evaluating the forward-looking statements and are cautioned not to place undue reliance on such forward-looking statements. The forward-looking statements made herein are made only as of the date of this annual report and we undertake no obligation to publicly update any forward-looking statements, whether as a result of new information, future events or otherwise.

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## PART I

## ITEM 1. Business

## OVERVIEW

Cummins Inc. 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 7,200 dealer locations in more than 190 countries and territories.

## OPERATING SEGMENTS

We have four complementary operating segments: Engine, Distribution, Components and Power Generation. These segments share technology, customers, strategic partners, brand recognition and our distribution network in order to compete more efficiently and effectively in their respective markets. In each of our operating segments, we compete worldwide with a number of other manufacturers and distributors that produce and sell similar products. Our products compete primarily on the basis of performance, fuel economy, speed of delivery, quality, customer support and price. Financial information about our operating segments, including geographic information, is incorporated by reference from Note 19, "OPERATING SEGMENTS," to our Consolidated Financial Statements.

## Engine Segment

Engine segment sales and earnings before interest and taxes (EBIT) as a percentage of consolidated results were:

	Years ended December 31,			
	2014	2013	2012	
Percent of consolidated net sales <sup>(1)</sup>	45	% 47	% 50	%
Percent of consolidated EBIT <sup>(1)</sup>	48	% 48	% 54	%

<sup>(1)</sup> Measured before intersegment eliminations

Our Engine segment manufactures and markets a broad range of diesel and natural gas powered engines under the Cummins brand name, as well as certain customer brand names, for the heavy- and medium-duty truck, bus, recreational vehicle (RV), light-duty automotive, agricultural, construction, mining, marine, oil and gas, rail and governmental equipment markets. We offer a wide variety of engine products including:

• Engines with a displacement range of 2.8 to 95 liters and horsepower ranging from 49 to 5,100;

• New parts and service, as well as remanufactured parts and engines, through our extensive distribution network;

• The newly developed 5.0 liter V8 diesel engine, which will be sold through the RV, pick-up, bus and certain medium-duty truck markets; and

• The newly developed 95 liter QSK95 diesel engine will begin production in 2015.

Our Engine segment is organized by engine displacement size and serves these end-user markets:

• Heavy-duty truck - We manufacture diesel engines that range from 310 to 600 horsepower serving global heavy-duty truck customers worldwide.

• Medium-duty truck and bus - We manufacture medium-duty diesel engines ranging from 200 to 450 horsepower serving medium-duty and inter-city delivery truck customers worldwide, with key markets including North America, Latin America, Europe and Mexico. We also provide diesel and natural gas engines for school buses, transit buses and shuttle buses worldwide, with key markets including North America, Europe, Latin America and Asia.

• Light-duty automotive and RV - We manufacture 320 to 385 horsepower diesel engines for Chrysler Group, LLC's (Chrysler) heavy-duty chassis cab and pickup trucks and 200 to 600 horsepower diesel engines for Class A motor homes (RVs), primarily in North America.

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Industrial - We provide mid-range, heavy-duty and high-horsepower engines that range from 49 to 5,100 horsepower for a wide variety of equipment in the construction, agricultural, mining, rail, government, oil and gas, power generation and commercial and recreational marine applications throughout the world. Across these markets we have major customers in North America, Europe, Middle East, Africa, China, Korea, Japan, Latin America, India, Russia, Southeast Asia, South Pacific and Mexico.

The principal customers of our heavy- and medium-duty truck engines include truck manufacturers such as PACCAR Inc. (PACCAR), Daimler Trucks North America, Navistar International Corporation (Navistar), Ford Motor Company, MAN Latin America and Volvo. We sell our industrial engines to manufacturers of construction, agricultural and marine equipment, including Komatsu, Belaz, Hyundai, Hitachi and JLG. The principal customers of our light-duty on-highway engines are Chrysler and manufacturers of RVs.

In the markets served by our Engine segment, we compete with independent engine manufacturers as well as OEMs who manufacture engines for their own products. Our primary competitors in North America are Navistar, Daimler Trucks North America, Caterpillar Inc. (CAT), Volvo Powertrain, Ford Motor Company and Hino Power. Our primary competitors in international markets vary from country to country, with local manufacturers generally predominant in each geographic market. Other engine manufacturers in international markets include Weichai Power Co. Ltd., MAN Nutzfahrzeuge AG (MAN), Fiat Power Systems, Guangxi Yuchai Group, GE Jenbacher, Tognum AG, CAT, Volvo, Yanmar Co., Ltd. and Deutz AG.

**Distribution Segment**

Distribution segment sales and EBIT as a percentage of consolidated results were:

	Years ended December 31,			
	2014	2013	2012	
Percent of consolidated net sales <sup>(1)</sup>	22	% 18	% 16	%
Percent of consolidated EBIT <sup>(1)</sup>	19	% 18	% 16	%

<sup>(1)</sup> Measured before intersegment eliminations

Our Distribution segment consists of 34 company-owned and 8 joint venture distributors that service and distribute the full range of our products and services to end-users at over 400 locations in approximately 80 distribution territories. Our company-owned distributors are located in key markets, including North America, Australia, Europe, the Middle East, India, China, Africa, Russia, Japan, Brazil, Singapore and Central America, while our joint venture distributors are located in key markets, including North America, South America, China, Thailand, Singapore and Vietnam. The Distribution segment consists of the following businesses which service and/or distribute the full range of our products and services:

Parts and filtration;  
Power generation;  
Engines; and  
Service.

The Distribution segment is organized into seven primary geographic regions:

North and Central America;  
Europe, CIS and China;  
Asia Pacific;  
Middle East;  
Africa;  
India; and  
South America.

Asia Pacific is composed of six smaller regional distributor organizations (South Pacific, Korea, Japan, Philippines, Malaysia and Singapore) which allow us to better manage these vast geographic territories.



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North and Central America are comprised of a network of wholly-owned, partially-owned and independent distributors. Internationally, our network consists of independent, partially-owned and wholly-owned distributors. Through these networks, we provide parts and service to our customers. These full-service solutions include maintenance contracts, engineering services and integrated products, where we customize our products to cater to specific needs of end-users. Our distributors also serve and develop dealers, predominantly OEM dealers, in their territories by providing new products, technical support, tools, training, parts and product information.

In addition to managing our involvement with our wholly-owned and partially-owned distributors, our Distribution segment is responsible for managing the performance and capabilities of our independent distributors. Our Distribution segment serves a highly diverse customer base with approximately 43 percent of its 2014 sales being generated from new engines and power generation equipment, compared to 44 percent in 2013, with its remaining sales generated by parts and filtration and service revenue.

Financial information about our distributors accounted for under the equity method are incorporated by reference from Note 3, "INVESTMENTS IN EQUITY INVESTEEES," to our Consolidated Financial Statements.

Our distributors compete with distributors or dealers that offer similar products. In many cases, these competing distributors or dealers are owned by, or affiliated with the companies that are listed as competitors of our Engine, Components or Power Generation segments. These competitors vary by geographical location.

In September 2013, we announced our intention to acquire the equity that we do not already own in most of our partially-owned United States and Canadian distributors over the next three to five years. During 2014, we spent \$460 million on these acquisitions and the related debt retirements. Refer to Note 2, "ACQUISITIONS," to our Consolidated Financial Statements for additional information.

**Components Segment**

Components segment sales and EBIT as a percentage of consolidated results were:

	Years ended December 31,			
	2014	2013	2012	
Percent of consolidated net sales <sup>(1)</sup>	21	% 21	% 19	%
Percent of consolidated EBIT <sup>(1)</sup>	27	% 24	% 18	%

<sup>(1)</sup> Measured before intersegment eliminations

Our Components segment supplies products which complement our Engine segment, including aftertreatment systems, turbochargers, filtration products and fuel systems for commercial diesel applications. We manufacture filtration systems for on- and off-highway heavy-duty and mid-range equipment, and we are a supplier of filtration products for industrial and passenger car applications. In addition, we develop aftertreatment systems and turbochargers to help our customers meet increasingly stringent emission standards and fuel systems which to date have primarily supplied our Engine segment and our joint venture partner Scania.

Our Components segment is organized around the following businesses:

**Emission solutions** - Our emission solutions business is a global leader in designing, manufacturing and integrating aftertreatment technology and solutions for the commercial on-and off-highway medium-duty, heavy-duty and high-horsepower engine markets. Our emission solutions business develops and produces various emission solutions, including custom engineering systems and integrated controls, oxidation catalysts, particulate filters, oxides of nitrogen (NOx) reduction systems such as selective catalytic reduction and NOx adsorbers and engineered components including dosers and sensors. Our emission solutions business primarily serves markets in North America, Europe, China, Brazil, Russia and Australia and serves both OEM and engine first fit and retrofit customers.

**Turbo technologies** - Our turbo technologies business designs, manufactures and markets turbochargers for light-duty, mid-range, heavy-duty and high-horsepower diesel markets with manufacturing facilities in five countries and sales and distribution worldwide. Our turbo technologies business provides critical air handling technologies for engines, including variable geometry turbochargers, to meet challenging performance requirements and worldwide emission standards. Our turbo technologies business primarily serves markets in North America, Europe, Asia and Brazil.



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**Filtration** - Our filtration business designs and manufactures filtration, coolant and chemical products. Our filtration business offers over 8,300 products including air filters, fuel filters, fuel water separators, lube filters, hydraulic filters, coolant, diesel exhaust fluid, fuel additives and other filtration systems to OEMs, dealers/distributors and end users. Our filtration business supports a wide customer base in a diverse range of markets including on-highway, off-highway, oil and gas, agriculture, construction, power generation, marine, industrial and light-duty trucks. We produce and sell globally recognized Fleetguard® branded products in over 160 countries including countries in North America, Europe, South America, Asia, Australia and Africa. Fleetguard products are available through thousands of distribution points worldwide.

**Fuel systems** - Our fuel systems business designs and manufactures new and replacement fuel systems primarily for heavy-duty on-highway diesel engine applications and also remanufactures fuel systems.

Customers of our Components segment generally include our Engine and Distribution segments, truck manufacturers and other OEMs, many of which are also customers of our Engine segment, such as PACCAR, Daimler, Navistar, Volvo, Scania, Fiat, Komatsu, Ford and other manufacturers that use our components in their product platforms.

Our Components segment competes with other manufacturers of aftertreatment systems, filtration, turbochargers and fuel systems. Our primary competitors in these markets include Robert Bosch GmbH, Donaldson Company, Inc., Clarcor Inc., Mann+Hummel Group, Honeywell International, Borg-Warner, Tenneco Inc., Eberspacher Holding GmbH & Co. KG and Denso Corporation.

On July 18, 2012, we acquired the doser technology business assets from Hilite Germany GmbH (Hilite) in a \$176 million cash transaction. The acquisition was accounted for as a business combination with the majority of the purchase price being allocated to goodwill and technology and customer related intangible assets. The results of the acquired entity were included in the Components operating segment after the acquisition date.

**Power Generation Segment**

Power Generation segment sales and EBIT as a percentage of consolidated results were:

	Years ended December 31,			
	2014	2013	2012	
Percent of consolidated net sales <sup>(1)</sup>	12	% 14	% 15	%
Percent of consolidated EBIT <sup>(1)</sup>	6	% 10	% 12	%

<sup>(1)</sup> Measured before intersegment eliminations

Our Power Generation segment designs and manufactures most of the components that make up power generation systems, including controls, alternators, transfer switches and switchgear. This segment is a global provider of power generation systems, components and services for a diversified customer base, including the following:

- Standby power solutions for customers who rely on uninterrupted sources of power to meet the needs of their customers;

- Distributed generation power solutions for customers with less reliable electrical power infrastructures, typically in developing countries. In addition, our power solutions provide an alternative source of generating capacity located close to its point of use, which is purchased by utilities, independent power producers and large power customers for use as prime or peaking power; and

- Mobile power solutions, which provide a secondary source of power (other than drivetrain power) for mobile applications.

Our Power Generation segment is organized around the following businesses:

**Power products** - Our power products business manufactures generators for commercial and consumer applications ranging from two kilowatts (kW) to one megawatt (MW) under the Cummins Power Generation and Cummins Onan brands.

**Power systems** - Our power systems business manufactures and sells diesel fuel-based generator sets over one MW, paralleling systems and transfer switches for critical protection and distributed generation applications. We also offer integrated systems that consist of generator sets, power transfer and paralleling switchgear for applications such as data centers, health care facilities and waste water treatment plants.



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Alternators - Our alternator business designs, manufactures, sells and services A/C generator/alternator products internally as well as to other generator set assemblers. Our products are sold under the Stamford, AVK and Markon brands and range in output from 0.6 kilovolt-amperes (kVA) to 30,000 kVA.

Power Solutions - Our power solutions business provides natural gas fuel-based turnkey solutions for distributed generation and energy management applications in the range of 300-2000 kW products. The business also serves a global rental account for diesel and gas generator sets.

This segment continuously explores emerging technologies and provides integrated power generation products using technologies other than reciprocating engines. We use our own research and development capabilities as well as those of our business partnerships to develop cost-effective and environmentally sound power solutions.

Our customer base for our power generation products is highly diversified, with customer groups varying based on their power needs. India, China, the United Kingdom (U.K.), Western Europe, Latin America and the Middle East are our largest geographic markets outside of North America.

Power Generation competes with a variety of engine manufacturers and generator set assemblers across the world.

Our primary competitors are CAT, Tognum (MTU) and Kohler/SDMO (Kohler Group), but we also compete with GE Jenbacher, FG Wilson (CAT group), Generac, Mitsubishi (MHI) and numerous regional generator set assemblers. Our alternators business competes globally with Emerson Electric Co., Marathon Electric and Meccalte, among others.

**JOINT VENTURES, ALLIANCES AND NON-WHOLLY-OWNED SUBSIDIARIES**

We have entered into a number of joint venture agreements and alliances with business partners around the world. Our joint ventures are either distribution or manufacturing entities. We also own controlling interests in non-wholly-owned manufacturing and distribution subsidiaries. Seven entities, in which we own more than a 50 percent equity interest or have a controlling interest, are consolidated in our Distribution segment results as well as several manufacturing joint ventures in the other operating segments.

In the event of a change of control of either party to certain of these joint ventures and other strategic alliances, certain consequences may result including automatic termination and liquidation of the venture, exercise of "put" or "call" rights of ownership by the non-acquired partner, termination or transfer of technology license rights to the non-acquired partner and increases in component transfer prices to the acquired partner. We will continue to evaluate joint venture and partnership opportunities in order to penetrate new markets, develop new products and generate manufacturing and operational efficiencies.

Financial information about our investments in joint ventures and alliances is incorporated by reference from Note 3, "INVESTMENTS IN EQUITY INVESTEEES," to the Consolidated Financial Statements.

Our equity income from these investees was as follows:

In millions	Years ended December 31,								
	2014			2013			2012		
Distribution Entities									
North American distributors	\$107	32	%	\$129	40	%	\$147	42	%
Komatsu Cummins Chile, Ltda.	29	9	%	25	8	%	26	8	%
All other distributors	4	1	%	1	—	%	4	1	%
Manufacturing Entities									
Dongfeng Cummins Engine Company, Ltd.	67	20	%	63	19	%	52	15	%
Chongqing Cummins Engine Company, Ltd.	51	16	%	58	18	%	61	18	%
Beijing Foton Cummins Engine Co., Ltd. (Light-duty)	28	8	%	17	5	%	5	1	%
Beijing Foton Cummins Engine Co., Ltd. (Heavy-duty)	(30)	(9)	%	(21)	(6)	%	(13)	(4)	%
All other manufacturers	74	23	%	53	16	%	65	19	%
Cummins share of net income <sup>(1)</sup>	\$330	100	%	\$325	100	%	\$347	100	%

<sup>(1)</sup> This total represents our share of net income of our equity investees and is exclusive of royalties and interest income from our equity investees. To see how this amount reconciles to "Equity, royalty and interest income from

investees" in the Consolidated Statements of Income, see Note 3, "INVESTMENTS IN EQUITY INVESTEES," to our Consolidated Financial Statements.

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## Distribution Entities

North American Distributors - As of December 31, 2014, our distribution channel in North America included three unconsolidated partially-owned distributors. Our equity interests in these nonconsolidated entities ranged from 49 percent to 50 percent. We also had more than a 50 percent ownership interest in two partially owned distributors which we consolidate. While each distributor is a separate legal entity, the business of each is substantially the same as that of our wholly-owned distributors based in other parts of the world. All of our distributors, irrespective of their legal structure or ownership, offer the full range of our products and services to customers and end-users in their respective markets.

Komatsu Cummins Chile, Ltda. - Komatsu Cummins Chile, Ltda. is a joint venture with Komatsu America Corporation. The joint venture is a distributor that offers the full range of our products and services to customers and end-users in the Chilean and Peruvian markets.

Our distribution agreements with independent and partially-owned distributors generally have a renewable three-year term and are restricted to specified territories. Our distributors develop and maintain a network of dealers with which we have no direct relationship. Our distributors are permitted to sell other, noncompetitive products only with our consent. We license all of our distributors to use our name and logo in connection with the sale and service of our products, with no right to assign or sublicense the trademarks, except to authorized dealers, without our consent. Products are sold to the distributors at standard domestic or international distributor net prices, as applicable. Net prices are wholesale prices we establish to permit our distributors an adequate margin on their sales. Subject to local laws, we can generally refuse to renew these agreements upon expiration or terminate them upon written notice for inadequate sales, change in principal ownership and certain other reasons. Distributors also have the right to terminate the agreements upon 60-day notice without cause, or 30-day notice for cause. Upon termination or failure to renew, we are required to purchase the distributor's current inventory, signage and special tools and may, at our option purchase other assets of the distributor, but are under no obligation to do so.

See further discussion of our distribution network under the Distribution segment section above.

## Manufacturing Entities

Our manufacturing joint ventures have generally been formed with customers and generally are intended to allow us to increase our market penetration in geographic regions, reduce capital spending, streamline our supply chain management and develop technologies. Our largest manufacturing joint ventures are based in China and are included in the list below. Our engine manufacturing joint ventures are supplied by our Components segment in the same manner as it supplies our wholly-owned Engine segment and Power Generation segment manufacturing facilities. Our Components segment joint ventures and wholly owned entities provide fuel systems, filtration, aftertreatment systems and turbocharger products that are used in our engines as well as some competitors' products. The results and investments in our joint ventures in which we have 50 percent or less ownership interest are included in "Equity, royalty and interest income from investees" and "Investments and advances related to equity method investees" in our Consolidated Statements of Income and Consolidated Balance Sheets, respectively.

Chongqing Cummins Engine Company, Ltd. - Chongqing Cummins Engine Company, Ltd. (CCEC) is a joint venture in China with Chongqing Machinery and Electric Co. Ltd. This joint venture manufactures several models of our heavy-duty and high-horsepower diesel engines, primarily serving the industrial and stationary power markets in China.

Dongfeng Cummins Engine Company, Ltd. - Dongfeng Cummins Engine Company, Ltd. (DCEC) is a joint venture in China with Dongfeng Automotive Co. Ltd., a subsidiary of Dongfeng Motor Corporation (Dongfeng), one of the largest medium-duty and heavy-duty truck manufacturers in China. DCEC produces Cummins 4- to 13-liter mechanical engines, full-electric diesel engines, with a power range from 125 to 545 horsepower, and natural gas engines.

Beijing Foton Cummins Engine Co., Ltd. - Beijing Foton Cummins Engine Co., Ltd. is a joint venture in China with Beiqi Foton Motor Co., Ltd., a commercial vehicle manufacturer, which consists of two distinct lines of business, a light-duty business and a heavy-duty business. The light-duty business produces ISF 2.8 liter and ISF 3.8 liter families of our high performance light-duty diesel engines in Beijing. These engines are used in light-duty commercial trucks, pickup trucks, buses, multipurpose and sport utility vehicles with main markets in China, Brazil and Russia. Certain

types of marine, small construction equipment and industrial applications are also served by these engine families. The heavy-duty business has been in the development stage for the past several years but started production of ISG 10.5 liter and ISG 11.8 liter families of our high performance heavy-duty diesel engines in the second quarter of 2014 in Beijing. These engines are used in heavy-duty commercial trucks in China and will be used in world wide markets. Certain types of construction equipment and industrial applications will also be served by these engine families in the future.



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### Non-Wholly-Owned Subsidiary

We have a controlling interest in Cummins India Ltd. (CIL), which is a publicly listed company on various stock exchanges in India. CIL produces mid-range, heavy-duty and high-horsepower engines, generators for the Indian and export markets and natural gas spark-ignited engines for power generation, automotive and industrial applications. CIL also has distribution and power generation operations.

### SUPPLY

The performance of the end-to-end supply chain, extending through to our suppliers, is foundational to our ability to meet customers' expectations and support long-term growth. We are committed to having a robust strategy for how we select and manage our suppliers to enable a market focused supply chain. This requires us to continuously evaluate and upgrade our supply base, as necessary, to ensure we are meeting the needs of our customers.

We have a strategic sourcing policy that guides decisions on what we make internally, what we purchase externally and when we establish supplier partnerships to provide the lowest total cost and highest supply chain performance. We design and/or manufacture our strategic components used in or with our engines and power generation units, including cylinder blocks and heads, turbochargers, connecting rods, camshafts, crankshafts, filters, alternators, electronic and emissions controls, and fuel systems. We source externally purchased material and manufactured components from leading global suppliers. Many key suppliers are managed through long-term supply agreements that assure capacity, delivery, quality and cost requirements are met over an extended period. Approximately 55 percent of the direct material in our product designs are single sourced to external suppliers. Although we have elected to source a relatively high proportion of our total raw materials and components from single suppliers, we have an established sourcing strategy and supplier management process to evaluate and mitigate risk. These processes are leading us to determine our need for dual sourcing and increase our use of dual and parallel sources to minimize risk and increase supply chain responsiveness. Our current target for dual and parallel sourcing is approximately 64 percent of our direct material spend. As of December 31, 2014, we have 45 percent of direct material spend with dual or parallel sources or 72 percent of the target.

Other important elements of our sourcing strategy include:

- working with suppliers to measure and improve their environmental footprint;
- selecting and managing suppliers to comply with our supplier code of conduct; and
- assuring our suppliers comply with Cummins' prohibited and restricted materials policy.

### PATENTS AND TRADEMARKS

We own or control a significant number of patents and trademarks relating to the products we manufacture. These patents and trademarks were granted and registered over a period of years. Although these patents and trademarks are generally considered beneficial to our operations, we do not believe any patent, group of patents, or trademark (other than our leading brand house trademarks) is significant to our business.

### SEASONALITY

While individual product lines may experience modest seasonal variation in production, there is no material effect on the demand for the majority of our products on a quarterly basis with the exception that our Power Generation segment normally experiences seasonal declines in the first quarter due to general declines in construction spending during this period and our Distribution segment normally experiences seasonal declines in its first quarter business activity due to holiday periods in Asia and Australia.

Table of Contents**LARGEST CUSTOMERS**

We have thousands of customers around the world and have developed long-standing business relationships with many of them. PACCAR is our largest customer, accounting for approximately 14 percent of our consolidated net sales in 2014, compared to approximately 12 percent in 2013 and 13 percent in 2012. We have long-term supply agreements with PACCAR for our heavy-duty ISX 15 liter and ISX 11.9 liter engines and our ISL 9 liter mid-range engine. While a significant number of our sales to PACCAR are under long-term supply agreements, these agreements provide for particular engine requirements for specific vehicle models and not a specific volume of engines. PACCAR is our only customer accounting for more than 10 percent of our net sales in 2014. The loss of this customer or a significant decline in the production level of PACCAR vehicles that use our engines would have an adverse effect on our results of operations and financial condition. We have been an engine supplier to PACCAR for over 70 years. A summary of principal customers for each operating segment is included in our segment discussion.

In addition to our agreement with PACCAR, we have long-term heavy-duty engine supply agreements with Navistar, Volvo Trucks North America and Daimler Trucks North America and long-term mid-range supply agreements with Daimler Trucks North America, Navistar, Ford and MAN. We also have an agreement with Chrysler to supply engines for its Ram trucks. In our off-highway markets, we have various engine and component supply agreements across our mid-range and high-horsepower businesses with Komatsu Ltd., as well as various joint ventures and other license agreements in our Engine, Component and Distribution segments. Collectively, our net sales to these eight customers, including PACCAR, were approximately 37 percent of our consolidated net sales in 2014, compared to approximately 36 percent in 2013 and 35 percent in 2012. Excluding PACCAR, net sales to any single customer were less than 8 percent of our consolidated net sales in 2014, compared to less than 7 percent in 2013 and less than 8 percent in 2012. These agreements contain standard purchase and sale agreement terms covering engine and engine parts pricing, quality and delivery commitments, as well as engineering product support obligations. The basic nature of our agreements with OEM customers is that they are long-term price and operations agreements that help assure the availability of our products to each customer through the duration of the respective agreements. Agreements with most OEMs contain bilateral termination provisions giving either party the right to terminate in the event of a material breach, change of control or insolvency or bankruptcy of the other party.

**BACKLOG**

We have supply agreements with some truck and off-highway equipment OEMs, however most of our business is transacted through open purchase orders. These open orders are historically subject to month-to-month releases and are subject to cancellation on reasonable notice without cancellation charges and therefore are not considered firm. As of December 31, 2014, we did not have any significant backlogs.

**RESEARCH AND DEVELOPMENT**

In 2014, we increased our research, development and engineering expenses as we continued to invest in future critical technologies and products. We will continue to make investments to improve our current technologies, continue to meet the future emission requirements around the world and improve fuel economy.

Our research and development program is focused on product improvements, innovations and cost reductions for our customers. Research and development expenditures include salaries, contractor fees, building costs, utilities, administrative expenses and allocation of corporate costs and are expensed, net of contract reimbursements, when incurred. From time to time, we enter into agreements with customers to fund a portion of the research and development costs of a particular project. We generally account for these reimbursements as an offset to the related research and development expenditure. Research and development expenses, net of contract reimbursements, were \$737 million in 2014, \$700 million in 2013 and \$721 million in 2012. Contract reimbursements were \$121 million in 2014, \$76 million in 2013 and \$86 million in 2012.

For 2013 and 2012, approximately \$15 million and \$101 million, or 2 percent and 14 percent, respectively, of our research and development expenditures were directly related to compliance with 2013 EPA emission standards. For 2014 and 2013, approximately \$60 million and \$32 million, or 8 percent and 5 percent, respectively, of our research and development expenditures were directly related to compliance with 2017 EPA emission standards.

**ENVIRONMENTAL SUSTAINABILITY**

Cummins adopted its first-ever comprehensive environmental sustainability plan in 2014 that builds on the many years of good work already done to positively impact the environment through the products we make, the use of our facilities, management of our supply chain and improvement of the communities where we live and work. We examined our entire environmental footprint, focusing on the key areas of water, waste, energy and greenhouse gases. We then identified the top four

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environmental sustainability priorities of products in-use, materials and fuel efficiency, transportation and facilities and operations. We set initial goals in our facilities, where we have the most data, influence and experience. Those goals are to reduce energy use and greenhouse gas emissions by 25% and 27%, respectively, by 2015 against a 2005 baseline and adjusted for sales; reduce direct water use by 33% adjusted for hours worked and achieve water neutrality at 15 sites by 2020; and increase our recycling rate from 88% to 95% and achieve zero disposal at 30 sites by 2020. We continue to invest significantly in our products to further reduce emissions and increase efficiency. We endeavor to work collaboratively with customers to improve their fuel efficiency, reduce their carbon footprints and conserve other resources. Our next efforts will be specifically focused on products, both in design and in use, as well as on how we use the best mode and method of transportation to reduce emissions in moving goods throughout the Cummins network.

Over the past four years, we believe that we have reduced company-wide water usage intensity by approximately 30 percent, U.S.-wide process-derived hazardous waste generation by approximately 41 percent and company-wide disposal waste by approximately 28 percent, all normalized to total work hours. As part of the U.S. Department of Energy's Better Buildings, Better Plants program, we have pledged to achieve a 25 percent energy intensity (energy use adjusted for sales) reduction by 2015; at the end of 2013, we had achieved a 33 percent reduction. We also have articulated our positions on key public policy issues and on a wide range of environmental issues. We are actively engaged with regulatory, industry and other stakeholder groups around the world as greenhouse gas and fuel efficiency standards become more prevalent globally. For the ninth consecutive year, we were named to the Dow Jones North American Sustainability Index and as well as a "Natural Capital Decoupling Leader" by Green Biz Group and Trucost for reductions in environmental footprint amid company growth. Our Sustainability Report for 2013/2014 and prior reports as well as an addendum of more detailed environmental data is available on our website at [www.cummins.com](http://www.cummins.com), although such report and addendum are not incorporated into this Form 10-K.

## ENVIRONMENTAL COMPLIANCE

### Product Environmental Compliance

Our engines are subject to extensive statutory and regulatory requirements that directly or indirectly impose standards governing emission and noise. We have substantially increased our global environmental compliance presence and expertise to better prepare for, understand and ultimately meet emerging product environmental regulations around the world. Our products comply with current emission standards that the European Union (EU), EPA, the California Air Resources Board (CARB) and other state and international regulatory agencies have established for heavy-duty on-highway diesel and gas engines and off-highway engines. Our ability to comply with these and future emission standards is an essential element in maintaining our leadership position in regulated markets. We have made, and will continue to make, significant capital and research expenditures to comply with these standards. Our failure to comply with these standards could result in adverse effects on our future financial results.

### EU and EPA Engine Certifications

The current on-highway emission standards came into effect in the European Union (EU) on January 1, 2013 (Euro VI) and on January 1, 2010 for the EPA. To meet the more stringent heavy-duty on-highway emission standards, we used an evolution of our proven selective catalytic reduction (SCR) and exhaust gas recirculation (EGR) technology solutions and refined them for the EU and EPA certified engines to maintain power and torque with substantial fuel economy improvement and maintenance intervals comparable with our previous compliant engines. We offer a complete lineup of on-highway engines to meet the near-zero emission standards. Mid-range and heavy-duty engines for EU and EPA require NO<sub>x</sub> aftertreatment. NO<sub>x</sub> reduction is achieved by an integrated technology solution comprised of the XPI High Pressure Common Rail fuel system, SCR technology, next-generation cooled EGR, advanced electronic controls, proven air handling and the Cummins Diesel Particulate Filter (DPF). The EU, EPA, and CARB have certified that our engines meet the current emission requirements. Emission standards in international markets, including Japan, Mexico, Australia, Brazil, Russia, India and China are becoming more stringent. We believe that our experience in meeting the EU and EPA emission standards leaves us well positioned to take advantage of opportunities in these markets as the need for emission control capability grows.

We received certification from the EPA that we met both the EPA 2013 and 2014 greenhouse gas (GHG) regulations and rules. The EPA 2013 regulations add the requirement of On-Board Diagnostics, which were introduced on the ISX15 in 2010, across the full on-highway product line in 2013 in addition to maintaining the same near-zero emission levels of NOx and Particulate Matter (PM) required in 2010. On-Board Diagnostics provide enhanced service capability with standardized diagnostic trouble codes, service tool interface, in-cab warning lamp and service information availability. The new GHG and fuel-efficiency regulations were required for all heavy-duty diesel and natural gas engines beginning in January 2014. Our GHG certification was the first engine certificate issued by the EPA and uses the same proven base engine with the XPI fuel system, Variable Geometry Turbocharger (VGT™), Cummins Aftertreatment System with DPF and SCR technology.

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Other Environmental Statutes and Regulations

Expenditures for environmental control activities and environmental remediation projects at our facilities in the U.S. have not been a substantial portion of our annual capital outlays and are not expected to be material in 2015. We believe we are in compliance in all material respects with laws and regulations applicable to our plants and operations. In the U.S., pursuant to notices received from federal and state agencies and/or defendant parties in site environmental contribution actions, we have been identified as a potentially responsible party under the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended or similar state laws, at less than 20 waste disposal sites. Based upon our experiences at similar sites we believe that our aggregate future remediation costs will not be significant. We have established accruals that we believe are adequate for our expected future liability with respect to these sites.

In addition, we have several other sites where we are working with governmental authorities on remediation projects. The costs for these remediation projects are not expected to be material.

EMPLOYEES

As of December 31, 2014, we employed approximately 54,600 persons worldwide. Approximately 17,680 of our employees worldwide are represented by various unions under collective bargaining agreements that expire between 2015 and 2019.

AVAILABLE INFORMATION

We file annual, quarterly and current reports, proxy statements and other information electronically with the Securities and Exchange Commission (SEC). You may read and copy any document we file with the SEC at the SEC's public reference room at 100 F Street, N.E., Washington, DC 20549. Please call the SEC at 1-800-SEC-0330 for information on the public reference room. The SEC maintains an internet site that contains annual, quarterly and current reports, proxy and information statements and other information that issuers (including Cummins) file electronically with the SEC. The SEC's internet site is [www.sec.gov](http://www.sec.gov).

Our internet site is [www.cummins.com](http://www.cummins.com). You can access our Investors and Media webpage through our internet site, by clicking on the heading "Investors and Media" followed by the "Investor Relations" link. We make available, free of charge, on or through our Investors and Media webpage, our proxy statements, annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any amendments to those reports filed or furnished pursuant to the Securities Exchange Act of 1934 or the Securities Act of 1933, as amended, as soon as reasonably practicable after such material is electronically filed with, or furnished to, the SEC.

We also have a Corporate Governance webpage. You can access our Governance Documents webpage through our internet site, [www.cummins.com](http://www.cummins.com), by clicking on the heading "Investors and Media," followed by the "Investor Relations" link and then the topic heading of "Governance Documents" within the "Corporate Governance" heading. Code of Conduct, Committee Charters and other governance documents are included at this site. Our Code of Conduct applies to all employees, regardless of their position or the country in which they work. It also applies to the employees of any entity owned or controlled by us. We will post any amendments to the Code of Conduct and any waivers that are required to be disclosed by the rules of either the SEC or the New York Stock Exchange LLC (NYSE), on our internet site. The information on our internet site is not incorporated by reference into this report.

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## EXECUTIVE OFFICERS OF THE REGISTRANT

Following are the names and ages of our executive officers, their positions with us as of January 31, 2015, and summaries of their backgrounds and business experience:

Name and Age	Present Cummins Inc. position and year appointed to position	Principal position during the past five years other than Cummins Inc. position currently held
N. Thomas Linebarger (52)	Chairman of the Board of Directors and Chief Executive Officer (2012)	President and Chief Operating Officer (2008-2011)
Richard J. Freeland (57)	President and Chief Operating Officer (2014)	Vice President and President - Engine Business (2010-2014) Vice President and President-Components Group (2008-2010) Chief Information Officer (2013-2014)
Sherry A. Aaholm (52)	Vice President—Chief Information Officer (2014)	Executive Vice President, Information Technology, FedEx Services (1998-2013) Partner—Law firm of Foley & Lardner (2011-2012)
Sharon R. Barner (57)	Vice President—General Counsel (2012)	Deputy Under Secretary of Commerce—Intellectual Property and Deputy Director of the United States Patent and Trademark Office (2009-2011)
Pamela L. Carter (65)	Vice President and President—Distribution Business (2007)	
Steven M. Chapman (60)	Group Vice President—China and Russia (2009)	
Jill E. Cook (51)	Vice President—Human Resources (2003)	
Dave J. Crompton (49)	Vice President and President—Engine Business (2014)	Vice President and General Manager - Engine Business (2013-2014) Vice President and General Manager - Midrange Engine Business (2005-2013) Vice President and President—Turbo Technologies (2012-2014)
Tracy A. Embree (41)	Vice President and President—Components Group (2015)	General Manager, Turbo Technologies—Asia (2011-2012) Executive Director—On Highway Business (2010-2011) Executive Director—Chrysler Business (2008-2010)

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Thaddeaus B. Ewald (47)	Vice President - Corporate Strategy and Business Development (2010)	Executive Director—Growth Office (2008-2010)
Richard E. Harris (62)	Vice President—Chief Investment Officer (2008)	
Marsha L. Hunt (51)	Vice President—Corporate Controller (2003)	
Mark A. Levett (65)	Vice President—Corporate Responsibility and Chief Executive Officer - Cummins Foundation (2013)	General Manager and Vice President—High Horsepower (1999-2013)



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Mark J. Osowick (47)	Vice President - Human Resources Operations (2014)	Executive Director—Human Resources, Components Segment & India ABO (2010-2014) Executive Director, Global Organization Development & Recruiting (2007-2010)
Marya M. Rose (52)	Vice President—Chief Administrative Officer (2011)	Vice President—General Counsel and Corporate Secretary (2001-2011)
Livingston L. Satterthwaite (54)	Vice President and President—Power Generation (2008)	
Anant J. Talaulicar (53)	Chairman and Managing Director-Cummins India Area Business Organization (2003)	Vice President and President - Components Group (2010-2014)
John C. Wall (63)	Vice President—Chief Technical Officer (2000)	
Patrick J. Ward (51)	Vice President—Chief Financial Officer (2008)	
Lisa M. Yoder (51)	Vice President—Global Supply Chain & Manufacturing (2011)	Vice President—Corporate Supply Chain (2010-2011), Executive Director—Supply Chain & Operations-Power Generation (2007-2010)

Our Chairman and Chief Executive Officer is elected annually by our Board of Directors and holds office until the meeting of the Board of Directors at which his election is next considered. Other officers are appointed by the Chairman and Chief Executive Officer, are ratified by our Board of Directors and hold office for such period as the Chairman and Chief Executive Officer or the Board of Directors may prescribe.

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ITEM 1A. Risk Factors

Set forth below and elsewhere in this Annual Report on Form 10-K are some of the principal risks and uncertainties that could cause our actual business results to differ materially from any forward-looking statements contained in this Report and could individually, or in combination, have a material adverse effect on our results of operations, financial position or cash flows. These risk factors should be considered in addition to our cautionary comments concerning forward-looking statements in this Report, including statements related to markets for our products and trends in our business that involve a number of risks and uncertainties. Our separate section above, "CAUTIONARY STATEMENTS REGARDING FORWARD-LOOKING INFORMATION," should be considered in addition to the following statements.

A sustained slowdown or significant downturn in our markets could materially and adversely affect our results of operations, financial condition or cash flows.

The U.S. economy began to improve in 2014, although many international markets continued to struggle. If the global economy or some of our significant markets encounter a sustained slowdown; depending upon the length, duration and severity of such a slowdown, our results of operations, financial condition and cash flow would almost certainly be materially adversely affected. Specifically, our revenues would likely decrease, we may be forced to consider further restructuring actions, we may need to increase our allowance for doubtful accounts, our days sales outstanding may increase and we could experience impairments to assets of certain of our businesses.

A slowdown in infrastructure development could adversely affect our business.

Infrastructure development has been a significant driver of our business in recent years, especially in the emerging markets of China and Brazil. General weakness in economic growth or the perception that infrastructure has been overbuilt could lead to a decline in infrastructure spending. Any sustained downturns in infrastructure development that result from these or other circumstances could adversely affect our business.

Unpredictability in the adoption, implementation and enforcement of increasingly stringent emission standards by multiple jurisdictions around the world could adversely affect our business.

Our engines are subject to extensive statutory and regulatory requirements governing emission and noise, including standards imposed by the EPA, the European Union, state regulatory agencies (such as the CARB) and other regulatory agencies around the world. We have made, and will be required to continue to make, significant capital and research expenditures to comply with these emission standards. Developing engines to meet numerous changing government regulatory requirements, with different implementation timelines and emission requirements, makes developing engines efficiently for multiple markets complicated and could result in substantial additional costs that may be difficult to recover in certain markets. In some cases, we may be required to develop new products to comply with new regulations, particularly those relating to air emissions. While we have met previous deadlines, our ability to comply with other existing and future regulatory standards will be essential for us to maintain our position in the engine markets we serve. The successful development and introduction of new and enhanced products in order to comply with new regulatory requirements are subject to other risks, such as delays in product development, cost over-runs and unanticipated technical and manufacturing difficulties.

In addition to these risks, the nature and timing of government implementation and enforcement of increasingly stringent emission standards in emerging markets are unpredictable and subject to change, or delays which could result in the products we developed or modified to comply with these standards becoming unnecessary or becoming necessary later than expected and in some cases negating our competitive advantage. This in turn can delay, diminish or eliminate the expected return on capital and research expenditures that we have invested in such products and may adversely affect our perceived competitive advantage in being an early, advanced developer of compliant engines.

We derive significant income from investees that we do not directly control.

Our net income includes significant equity, royalty and interest income from investees that we do not directly control. For 2014, we recognized \$370 million of equity, royalty and interest income from investees, compared to \$361 million in 2013. The majority of our equity, royalty and interest income from investees is from our unconsolidated North American distributors and from two of our joint ventures in China, Dongfeng Cummins Engine Company, Ltd. (DCEC) and Chongqing Cummins Engine Company, Ltd. (CCEC) at December 31, 2014. Our equity ownership

interests in our unconsolidated North American distributors ranged from 49 percent to 50 percent at December 31, 2014. We have 50 percent equity ownership interests in DCEC and CCEC. As a result, although a significant percentage of our net income is derived from these unconsolidated entities, we do not unilaterally control their management or their operations, which puts a substantial portion of our net income at risk from the actions or inactions of these entities. A significant reduction in the level of contribution by these entities to our net income would likely have a material adverse effect on our results of operations.

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Our truck manufacturers and original equipment manufacturers (OEMs) customers may not continue to outsource their engine supply needs.

Several of our engine customers, including PACCAR, Volvo AB, Navistar, Chrysler and DCEC, are truck manufacturers or OEMs that manufacture engines for some of their own products. Despite their own engine manufacturing abilities, these customers have historically chosen to outsource certain types of engine production to us due to the quality of our engine products, our emission capabilities, our systems integration, their customers' preferences, their desire for cost reductions, their desire for eliminating production risks and their desire to maintain company focus. However, there can be no assurance that these customers will continue to outsource, or outsource as much of, their engine production in the future. Increased levels of OEM vertical integration could result from a number of factors, such as shifts in our customers' business strategies, acquisition by a customer of another engine manufacturer, the inability of third-party suppliers to meet product specifications and the emergence of low-cost production opportunities in foreign countries. Any significant reduction in the level of engine production outsourcing from our truck manufacturer or OEM customers could have a material adverse effect on our results of operations. A downturn in the North American truck industry or other factors negatively affecting any of our truck OEM customers could materially adversely impact our results of operations.

We make significant sales of engines and components to a few large truck OEMs in North America. If the North American truck market suffers a significant downturn, or if one of our large truck OEM customers experienced financial distress or bankruptcy, such circumstance would likely lead to significant reductions in our revenues and earnings, commercial disputes, receivable collection issues, and other negative consequences that could have a material adverse impact on our results of operations.

The discovery of any significant problems with our recently-introduced engine platforms in North America could materially adversely impact our results of operations, financial condition and cash flow.

The EPA and CARB have certified all of our 2012/2013 on-highway and off-highway engines, which utilize SCR technology to meet requisite emission levels. We introduced SCR technology into our engine platforms in 2010. The effective performance of SCR technology and the overall performance of these engine platforms impact a number of our operating segments and remain crucial to our success in North America. While these 2010 and 2013 engine platforms have performed well in the field, the discovery of any significant problems in these platforms could result in recall campaigns, increased warranty costs, reputational risk and brand risk, and could materially adversely impact our results of operations, financial condition and cash flow.

We are vulnerable to supply shortages from single-sourced suppliers.

During 2014, we single sourced approximately 55 percent of the total types of parts in our product designs. Any delay in our suppliers' deliveries may adversely affect our operations at multiple manufacturing locations, forcing us to seek alternative supply sources to avoid serious disruptions. Delays may be caused by factors affecting our suppliers, including capacity constraints, labor disputes, economic downturns, availability of credit, the impaired financial condition of a particular supplier, suppliers' allocations to other purchasers, weather emergencies, natural disasters or acts of war or terrorism. Any extended delay in receiving critical supplies could impair our ability to deliver products to our customers and our results of operations.

Our products are exposed to variability in material and commodity costs.

Our businesses establish prices with our customers in accordance with contractual time frames; however, the timing of material and commodity market price increases may prevent us from passing these additional costs on to our customers through timely pricing actions. Additionally, higher material and commodity costs around the world may offset our efforts to reduce our cost structure. While we customarily enter into financial transactions and contractual pricing adjustment provisions with our customers that attempt to address some of these risks (notably with respect to copper, platinum and palladium), there can be no assurance that commodity price fluctuations will not adversely affect our results of operations. In addition, while the use of commodity price hedging instruments may provide us with some protection from adverse fluctuations in commodity prices, by utilizing these instruments we potentially forego the benefits that might result from favorable fluctuations in price. As a result, higher material and commodity costs, as well as hedging these commodity costs during periods of decreasing prices, could result in declining margins.



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Our products are subject to recall for performance or safety-related issues.

Our products may be subject to recall for performance or safety-related issues. Product recalls subject us to harm to our reputation, loss of current and future customers, reduced revenue and product recall costs. Product recall costs are incurred when we decide, either voluntarily or involuntarily, to recall a product through a formal campaign to solicit the return of specific products due to a known or suspected performance issue. Any significant product recalls could have a material adverse effect on our results of operations, financial condition and cash flows.

Failure to successfully integrate the planned acquisitions of the equity we do not already own of our partially-owned United States and Canadian distributors could have an adverse impact on our realization of expected benefits to our financial condition and results of operations.

The completion of our plan to acquire all of the equity we do not already own of our partially-owned United States and Canadian distributors (each, an "Acquisition," and collectively, the "Acquisitions"), is subject to various risks, including, among other things, our ability to realize the full extent of the incremental revenue, earnings, cash flow, cost savings and other benefits that we expect to realize as a result of the completion of the Acquisitions within the anticipated time frame, or at all; the costs that are expected to be incurred in connection with evaluating, negotiating, consummating and integrating the Acquisitions; the ability of management to focus adequate time and attention on evaluating, negotiating, consummating and integrating the Acquisitions; and diversion of management's attention from base strategies and objectives, both during and after the acquisition process. Further, as with all merger and acquisition activity, there can be no assurance that we will be able to negotiate, consummate and integrate the Acquisitions in accordance with our plans. Those persons holding the third-party ownership of our partially-owned United States and Canadian distributors may not agree to our acquisition proposals, including the terms and conditions thereof, and may claim that our proposals to exercise certain contractual rights that we have with respect to acquiring such distributors may violate applicable state franchise and distributor laws, which may prohibit, delay or otherwise adversely affect the consummation of such Acquisitions on terms and conditions that are less favorable to us than we currently anticipate, or not at all.

After completion of the Acquisitions, we may fail to realize the expected enhanced revenue, earnings, cash flow, cost savings and other benefits.

The financial success of the Acquisitions will depend, in substantial part, on our ability to successfully combine our business with the businesses of our partially-owned United States and Canadian distributors, transition operations and realize the expected enhanced revenue, earnings, cash flow, cost savings and other benefits from such Acquisitions. While we currently believe that these enhanced revenue, earnings, cash flow, cost savings and other benefits estimates are achievable, it is possible that we will be unable to achieve these objectives within the anticipated time frame, or at all. Our enhanced revenue, earnings, cash flow, cost savings and other benefits estimates also depend on our ability to execute and integrate the Acquisitions in a manner that permits those benefits to be realized. If these estimates turn out to be incorrect or we are not able to execute our integration strategy successfully, the anticipated enhanced revenue, earnings, cash flow, cost savings and other benefits, resulting from the Acquisitions may not be realized fully, or at all, or may take longer to realize than expected.

Specifically, issues that must be addressed in integration in order to realize the anticipated benefits and costs savings of the Acquisitions include, among other things:

- maintaining and improving management and employee engagement, morale, motivation and productivity;
- recruiting and retaining executives and key employees;
- retaining and strengthening relationships with existing customers and attracting new customers;
- conforming standards, controls, procedures and policies, business cultures and compensation structures among the companies;
- consolidating and streamlining corporate and administrative infrastructures;
- consolidating sales, customer service and marketing operations;
- identifying and eliminating redundant and underperforming operations and assets;
- integrating the distribution, sales, customer service and administrative support activities among the companies;
-

integrating information technology systems, including those systems managing data security for sensitive employee, customer and vendor information, and diverse network applications across the companies;

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managing the broadened competitive landscape, including responding to the actions taken by competitors in response to the Acquisitions;

- coordinating geographically dispersed organizations;
- managing the additional business risks of businesses that we have not previously directly managed; and
- managing tax costs or inefficiencies associated with integrating our operations following completion of the Acquisitions.

Delays encountered in the process of integrating the Acquisitions could negatively impact our revenues, expenses, operating results, cash flow and financial condition after completion of the Acquisitions, including through the loss of current customers or suppliers. Although significant benefits, such as enhanced revenue, earnings, cash flow and cost savings, are expected to result from the Acquisitions, there can be no assurance that we will realize any of these anticipated benefits after completion of any or all of the Acquisitions.

Additionally, significant costs are expected to be incurred in connection with the integration of the Acquisitions. We continue to assess the magnitude of these costs and additional unanticipated costs may be incurred, including costs associated with assuming our partially-owned United States and Canadian distributors' exposure to outstanding and anticipated legal claims and other liabilities. Although we believe that the elimination of duplicative costs, as well as the realization of other synergies and efficiencies related to the integration of the Acquisitions, will offset incremental integration-related costs over time, no assurances can be given that this net benefit will be achieved in the near term, or at all. In addition, the process of integrating the operations of our partially-owned United States and Canadian distributors may distract management and employees from delivering against base strategies and objectives, which could negatively impact other segments of our business following the completion of the Acquisitions.

Furthermore, the Acquisitions and the related integration efforts, could result in the departure of key managers and employees, and we may fail to identify managerial resources to fill both executive-level and lower-level managerial positions and replace key employees, including those who oversee customer relationships, any of which could have a negative impact on our business, and, prior to the completion of the Acquisitions, the businesses of our partially-owned United States and Canadian distributors.

The completion of the Acquisitions may be subject to the receipt of certain required clearances or approvals from governmental entities that could prevent or delay their completion or impose conditions that could have an adverse effect on us.

Completion of each of the Acquisitions may be conditioned upon the receipt of certain governmental clearances or approvals, including, but not limited to, the expiration or termination of any applicable waiting periods under U.S. competition and trade laws with respect to such Acquisitions as well as applicable state regulations and restrictions. There can be no assurance that these clearances and approvals will be obtained, and, additionally, government authorities from which these clearances and approvals are required may impose conditions on the completion of any, or all, of the Acquisitions or require changes to their respective terms. If, in order to obtain any clearances or approvals required to complete any of the Acquisitions, we become subject to any material conditions after completion of any of such Acquisitions, our business and results of operations after completion of any of such Acquisitions may be adversely affected.

We face significant competition in the markets we serve.

The markets in which we operate are highly competitive. We compete worldwide with a number of other manufacturers and distributors that produce and sell similar products. We primarily compete in the market with diesel engines and related diesel products; however, new technologies continue to be developed for gasoline, natural gas and other technologies and we will continue to face new competition from these expanding technologies. Our products primarily compete on the basis of price, performance, fuel economy, speed of delivery, quality and customer support. We also face competitors in some emerging markets who have established local practices and long standing relationships with participants in these markets. There can be no assurance that our products will be able to compete successfully with the products of other companies and in other markets. For a more complete discussion of the competitive environment in which each of our segments operates, see "Operating Segments" in "Item 1 Business."





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Increasing global competition among our customers may affect our existing customer relationships and restrict our ability to benefit from some of our customers' growth.

As our customers in emerging markets continue to grow in size and scope, they are increasingly seeking to export their products to other countries. This has meant greater demand for our advanced engine technologies to help these customers meet the more stringent emissions requirements of developed markets, as well as greater demand for access to our distribution systems for purposes of equipment servicing. As these emerging market customers enter into and begin to compete in more developed markets, they may increasingly begin to compete with our existing customers in these markets. Our further aid to emerging market customers could adversely affect our relationships with developed market customers and, as a result, we may be pressured to restrict sale or support of some of our products in the areas of increased competition. In addition, to the extent the competition does not correspond to overall growth in demand, we may see little or no benefit from this type of expansion by our emerging market customers.

We are exposed to, and may be adversely affected by, information technology security threats and sophisticated "cyber attacks."

We rely on our information technology systems and networks in connection with various of our business activities. Some of these networks and systems are managed by third party service providers and are not under our direct control. Our operations routinely involve receiving, storing, processing and transmitting sensitive information pertaining to our business, customers, dealers, suppliers, employees and other sensitive matters. Information technology security threats, including security breaches, computer malware and other "cyber attacks" are increasing in both frequency and sophistication. These threats could create financial liability, subject us to legal or regulatory sanctions or damage our reputation with customers, dealers, suppliers and other stakeholders. We continuously seek to maintain a robust program of information security and controls, but the impact of a material information technology event could have a material adverse effect on our competitive position, reputation, results of operations, financial condition and cash flow.

We are exposed to political, economic and other risks that arise from operating a multinational business.

Approximately 48 percent of our net sales for 2014 and 52 percent in 2013 were attributable to customers outside the U.S. Accordingly, our business is subject to the political, economic and other risks that are inherent in operating in numerous countries. These risks include:

- the difficulty of enforcing agreements and collecting receivables through foreign legal systems;
- trade protection measures and import or export licensing requirements;
- the imposition of taxes on foreign income and tax rates in certain foreign countries that exceed those in the U.S.;
- the imposition of tariffs, exchange controls or other restrictions;
- difficulty in staffing and managing widespread operations and the application of foreign labor regulations;
- required compliance with a variety of foreign laws and regulations;
- and
- changes in general economic and political conditions in countries where we operate, particularly in emerging markets.

As we continue to operate our business globally, our success will depend, in part, on our ability to anticipate and effectively manage these and other related risks. There can be no assurance that the consequences of these and other factors relating to our multinational operations will not have a material adverse effect upon us.

Unanticipated changes in our effective tax rate, the adoption of new tax legislation or exposure to additional income tax liabilities could adversely affect our profitability.

We are subject to income taxes in the U.S. and numerous international jurisdictions. Our income tax provision and cash tax liability in the future could be adversely affected by changes in the distribution of earnings in countries with differing statutory tax rates, changes in the valuation of deferred tax assets and liabilities, changes to our assertions regarding permanent re-investment of our foreign earnings, changes in tax laws and the discovery of new information in the course of our tax return preparation process. The carrying value of deferred tax assets, which are predominantly in the U.S., is dependent on our ability to generate future taxable income in the U.S. We are also subject to ongoing tax audits. These audits can involve complex issues, which may require an extended period of time to resolve and can be highly judgmental. Tax authorities may disagree with certain tax reporting positions taken by us and, as a result,

assess additional taxes against us. We regularly assess the likely outcomes of these audits in order to determine the appropriateness of our tax provision. The amounts ultimately paid upon resolution of these or subsequent tax audits could be materially different from the amounts previously included in our income tax provision and, therefore, could have a material impact on our tax provision.

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Our global operations are subject to laws and regulations that impose significant compliance costs and create reputational and legal risk.

Due to the international scope of our operations, we are subject to a complex system of commercial and trade regulations around the world. Recent years have seen an increase in the development and enforcement of laws regarding trade compliance and anti-corruption such as the U.S. Foreign Corrupt Practices Act and similar laws from other countries. Our numerous foreign subsidiaries, affiliates and joint venture partners are governed by laws, rules and business practices that differ from those of the U.S. The activities of these entities may not comply with U.S. laws or business practices or our Code of Business Conduct. Violations of these laws may result in severe criminal or civil sanctions, could disrupt our business, and result in an adverse effect on our reputation, business and results of operations or financial condition. We cannot predict the nature, scope or effect of future regulatory requirements to which our operations might be subject or the manner in which existing laws might be administered or interpreted.

We face the challenge of accurately aligning our capacity with our demand.

We can experience capacity constraints and longer lead times for certain products in times of growing demand while we can also experience idle capacity as economies slow or demand for certain products decline. Accurately forecasting our expected volumes and appropriately adjusting our capacity have been, and will continue to be, important factors in determining our results of operations. We cannot guarantee that we will be able to increase manufacturing capacity to a level that meets demand for our products, which could prevent us from meeting increased customer demand and could harm our business. However, if we overestimate our demand and overbuild our capacity, we may have significantly underutilized assets and we may experience reduced margins. If we do not accurately align our manufacturing capabilities with demand it could have a material adverse effect on our results of operations.

Our business is exposed to risks of product liability claims.

We face an inherent business risk of exposure to product liability claims in the event that our products' failure to perform to specification results or is alleged to result in property damage, bodily injury and/or death. We may experience material product liability losses in the future. While we maintain insurance coverage with respect to certain product liability claims, we may not be able to obtain such insurance on acceptable terms in the future, if at all, and any such insurance may not provide adequate coverage against product liability claims. In addition, product liability claims can be expensive to defend and can divert the attention of management and other personnel for significant periods of time, regardless of the ultimate outcome. An unsuccessful defense of a significant product liability claim could have a material adverse effect upon us. In addition, even if we are successful in defending against a claim relating to our products, claims of this nature could cause our customers to lose confidence in our products and us. We may need to write off significant investments in our new North American light-duty diesel engine platform if customer commitments deteriorate.

We began development of a new North American light-duty diesel engine platform in July 2006 to be used in a variety of on- and off-highway applications. Since that time, and as of December 31, 2014, we have capitalized investments of approximately \$251 million. Market uncertainty due to the global recession resulted in some customers delaying or cancelling their vehicle programs, while others remained active. We reached an agreement to supply Nissan Motor Co. Ltd. with our light-duty diesel engine beginning in 2015, however, if customer expectations or volume projections deteriorate from our current expected levels and we do not identify new customers, we may need to recognize an impairment charge.

Our operations are subject to increasingly stringent environmental laws and regulations.

Our plants and operations are subject to increasingly stringent environmental laws and regulations in all of the countries in which we operate, including laws and regulations governing air emission, discharges to water and the generation, handling, storage, transportation, treatment and disposal of waste materials. While we believe that we are in compliance in all material respects with these environmental laws and regulations, there can be no assurance that we will not be adversely impacted by costs, liabilities or claims with respect to existing or subsequently acquired operations, under either present laws and regulations or those that may be adopted or imposed in the future. We are also subject to laws requiring the cleanup of contaminated property. If a release of hazardous substances occurs at or from any of our current or former properties or at a landfill or another location where we have disposed of hazardous materials, we may be held liable for the contamination and the amount of such liability could be material.



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We are subject to foreign currency exchange rate and other related risks.

We conduct operations in many areas of the world involving transactions denominated in a variety of currencies. We are subject to foreign currency exchange rate risk to the extent that our costs are denominated in currencies other than those in which we earn revenues. In addition, since our financial statements are denominated in U.S. dollars, changes in foreign currency exchange rates between the U.S. dollar and other currencies have had, and will continue to have, an impact on our results of operations. While we customarily enter into financial transactions that attempt to address these risks and many of our supply agreements with customers include foreign currency exchange rate adjustment provisions, there can be no assurance that foreign currency exchange rate fluctuations will not adversely affect our results of operations. In addition, while the use of currency hedging instruments may provide us with some protection from adverse fluctuations in foreign currency exchange rates, by utilizing these instruments we potentially forego the benefits that might result from favorable fluctuations in foreign currency exchange rates.

We also face risks arising from the imposition of foreign exchange controls and currency devaluations. Foreign exchange controls may limit our ability to convert foreign currencies into U.S. dollars or to remit dividends and other payments by our foreign subsidiaries or businesses located in or conducted within a country imposing controls. Currency devaluations result in a diminished value of funds denominated in the currency of the country instituting the devaluation.

We are exposed to risks arising from the price and availability of energy.

The level of demand for our products and services is influenced in multiple ways by the price and availability of energy. High energy costs generally drive greater demand for better fuel economy in almost all countries in which we operate. Some of our engine products have been developed with a primary purpose of offering fuel economy improvements, and if energy costs decrease or increase less than expected, demand for these products may likewise decrease. The relative unavailability of electricity in some emerging market countries also influences demand for our electricity generating products, such as our diesel generators. If these countries add energy capacity by expanding their power grids at a rate equal to or faster than the growth in demand for energy, the demand for our generating products could also decrease or increase less than would otherwise be the case.

Significant declines in future financial and stock market conditions could diminish our pension plan asset performance and adversely impact our results of operations, financial condition and cash flow.

We sponsor both funded and unfunded domestic and foreign defined benefit pension and other retirement plans. Our pension cost and the required contributions to our pension plans are directly affected by the value of plan assets, the projected and actual rates of return on plan assets and the actuarial assumptions we use to measure our defined benefit pension plan obligations, including the discount rate at which future projected and accumulated pension obligations are discounted to a present value. We could experience increased pension cost due to a combination of factors, including the decreased investment performance of pension plan assets, decreases in the discount rate and changes in our assumptions relating to the expected return on plan assets.

Significant declines in future financial and stock market conditions could cause material losses in our pension plan assets, which could result in increased pension cost in future years and adversely impact our results of operations, financial condition and cash flow. Depending upon the severity of market declines and government regulatory changes, we may be legally obligated to make pension payments in the U.S. and perhaps other countries and these contributions could be material.

We may be adversely impacted by work stoppages and other labor matters.

As of December 31, 2014, we employed approximately 54,600 persons worldwide. Approximately 17,680 of our employees worldwide are represented by various unions under collective bargaining agreements that expire between 2015 and 2019. While we have no reason to believe that we will be materially impacted by work stoppages or other labor matters, there can be no assurance that future issues with our labor unions will be resolved favorably or that we will not encounter future strikes, work stoppages, or other types of conflicts with labor unions or our employees. Any of these consequences may have an adverse effect on us or may limit our flexibility in dealing with our workforce. In addition, many of our customers and suppliers have unionized work forces. Work stoppages or slow-downs

experienced by our customers or suppliers could result in slow-downs or closures that would have a material adverse effect on our results of operations, financial condition and cash flow.

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Our financial statements are subject to changes in accounting standards that could adversely impact our profitability or financial position.

Our financial statements are subject to the application of accounting principles generally accepted in the United States of America (GAAP), which are periodically revised and/or expanded. Accordingly, from time to time we are required to adopt new or revised accounting standards issued by recognized authoritative bodies, including the Financial Accounting Standards Board. Recently, accounting standard setters issued new guidance which further interprets or seeks to revise accounting pronouncements related to revenue recognition and lease accounting as well as to issue new standards expanding disclosures. The impact of accounting pronouncements that have been issued but not yet implemented is disclosed in our annual and quarterly reports on Form 10-K and Form 10-Q. An assessment of proposed standards is not provided, as such proposals are subject to change through the exposure process and, therefore, their effects on our financial statements cannot be meaningfully assessed. It is possible that future accounting standards we are required to adopt could change the current accounting treatment that we apply to our consolidated financial statements and that such changes could have a material adverse effect on the reported results of operations and financial position.

ITEM 1B. Unresolved Staff Comments

None.



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ITEM 2. Properties

Manufacturing Facilities

Our principal manufacturing facilities include our plants used by the following segments in the following locations:

Segment	U.S. Facilities	Facilities Outside the U.S.
Engine	Indiana: Columbus, Seymour Tennessee: Memphis New Mexico: Clovis New York: Lakewood North Carolina: Whitakers	Brazil: Sao Paulo India: Pune, Phaltan Mexico: San Luis Potosi U.K.: Darlington, Daventry, Cumbernauld
Components	Indiana: Columbus South Carolina: Charleston Tennessee: Cookeville Wisconsin: Mineral Point, Neillsville	Australia: Kilsyth Brazil: Sao Paulo China: Beijing, Shanghai, Wuxi, Wuhan France: Quimper Germany: Marktheidenfeld India: Pune, Dewas, Pithampur, Rudrapur Mexico: Ciudad Juarez, San Luis Potosi South Africa: Pietermaritzburg South Korea: Suwon Turkey: Ismir U.K.: Darlington, Huddersfield
Power Generation	Indiana: Elkhart Minnesota: Fridley	Brazil: Sao Paulo China: Wuxi, Wuhan Germany: Ingolstadt India: Pirangut, Ahmendnagar, Ranjangaon, Phaltan Mexico: San Luis Potosi Romania: Craiova U.K.: Margate, Manston, Stamford Nigeria: Lagos

In addition, engines and engine components are manufactured by joint ventures or independent licensees at manufacturing plants in the U.S., China, India, South Korea, Mexico and Sweden.

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Distribution Facilities

The principal distribution facilities used by our Distribution and Engine segments are located in the following locations:

Segment	U.S. Facilities	Facilities Outside the U.S.
Distribution	Alaska: Anchorage Arkansas: Little Rock Colorado: Commerce City, Henderson Florida: Orlando Georgia: Atlanta Illinois: Hodgkins Kansas: Wichita Louisiana: Kenner Massachusetts: Dedham Michigan: Grand Rapids Minnesota: White Bear Lake Missouri: Kansas City Nebraska: Omaha New Mexico: Farmington New York: Bronx Ohio: Hilliard Oklahoma: Oklahoma City Oregon: Portland Pennsylvania: Bristol, Harrisburg Texas: Dallas Utah: Salt Lake City Washington: Renton, Spokane	Australia: Scoresby Canada: Vancouver, Montreal Germany: Gross Gerau India: Pune Japan: Tokyo Korea: Cheonan Panama: Panama City Russia: Moscow Singapore: Singapore SG South Africa: Johannesburg U.K.: Wellingborough United Arab Emirates: Dubai
Engine	Tennessee: Memphis	Belgium: Rumst

Headquarters and Other Offices

Our Corporate Headquarters are located in Columbus, Indiana. Additional marketing and operational headquarters are in the following locations:

U.S. Facilities	Facilities Outside the U.S.
Indiana: Columbus, Indianapolis Tennessee: Nashville Washington, D.C.	China: Beijing, Shanghai, Wuhan India: Pune U.K.: Staines, Stockton

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ITEM 3. Legal Proceedings

We are subject to numerous lawsuits and claims arising out of the ordinary course of our business, including actions related to product liability; personal injury; the use and performance of our products; warranty matters; patent, trademark or other intellectual property infringement; contractual liability; the conduct of our business; tax reporting in foreign jurisdictions; distributor termination; workplace safety; and environmental matters. We also have been identified as a potentially responsible party at multiple waste disposal sites under U.S. federal and related state environmental statutes and regulations and may have joint and several liability for any investigation and remediation costs incurred with respect to such sites. We have denied liability with respect to many of these lawsuits, claims and proceedings and are vigorously defending such lawsuits, claims and proceedings. We carry various forms of commercial, property and casualty, product liability and other forms of insurance; however, such insurance may not be applicable or adequate to cover the costs associated with a judgment against us with respect to these lawsuits, claims and proceedings. We do not believe that these lawsuits are material individually or in the aggregate. While we believe we have also established adequate accruals for our expected future liability with respect to pending lawsuits, claims and proceedings, where the nature and extent of any such liability can be reasonably estimated based upon then presently available information, there can be no assurance that the final resolution of any existing or future lawsuits, claims or proceedings will not have a material adverse effect on our business, results of operations, financial condition or cash flows.

We conduct significant business operations in Brazil that are subject to the Brazilian federal, state and local labor, social security, tax and customs laws. While we believe we comply with such laws, they are complex, subject to varying interpretations and we are often engaged in litigation regarding the application of these laws to particular circumstances.

ITEM 4. Mine Safety Disclosures

Not Applicable.

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## PART II

## ITEM 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

(a) Our common stock is listed on the NYSE under the symbol "CMI." For information about the quoted market prices of our common stock, information regarding dividend payments and the number of common stock shareholders, see "Selected Quarterly Financial Data" in this report. For other matters related to our common stock and shareholders' equity, see Note 14, "SHAREHOLDERS' EQUITY," to the Consolidated Financial Statements.

(b) Use of proceeds—not applicable.

(c) The following information is provided pursuant to Item 703 of Regulation S-K:

Period	Issuer Purchases of Equity Securities			
	(a) Total Number of Shares Purchased <sup>(1)</sup>	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs <sup>(2)</sup>
September 29 - November 2, 2014	315,011	\$129.26	314,276	81,701
November 3 - November 30, 2014	867	144.83	—	84,031
December 1 - December 31, 2014	180,614	138.75	180,214	88,027
Total	496,492	132.74	494,490	

<sup>(1)</sup> Shares purchased represent shares under our Key Employee Stock Investment Plan established in 1969 (there is no maximum repurchase limitation in this plan) and the 2012 Board of Directors authorized \$1 billion share repurchase program.

<sup>(2)</sup> These values reflect the sum of shares held in loan status under our Key Employee Stock Investment Plan. The repurchase program authorized by the Board of Directors does not limit the number of shares that may be purchased and was excluded from this column.

In December 2012, the Board of Directors authorized the acquisition of \$1 billion of our common stock upon completion of the 2011 repurchase program. In 2014, we acquired \$670 million or 4.8 million shares of our common stock leaving \$174 million available for purchase under the 2012 repurchase plan at December 31, 2014. In July 2014, our Board of Directors authorized the acquisition of up to \$1 billion of additional common stock upon the completion of the 2012 repurchase plan.

During the fourth quarter of 2014, we repurchased 2,002 shares from employees in connection with the Key Employee Stock Investment Plan which allows certain employees, other than officers, to purchase shares of common stock on an installment basis up to an established credit limit. Loans are issued for five-year terms at a fixed interest rate established at the date of purchase and may be refinanced after its initial five-year period for an additional five-year period. Participants must hold shares for a minimum of six months from date of purchase and after shares are sold must wait six months before another share purchase may be made. We hold participants' shares as security for the loans and would, in effect repurchase shares if the participant defaulted in repayment of the loan. There is no maximum amount of shares that we may purchase under this plan.

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Performance Graph (Unaudited)

The following Performance Graph and related information shall not be deemed "soliciting material" or to be "filed" with the SEC, nor shall such information be incorporated by reference into any of our future filings under the Securities Act of 1933 or Securities Exchange Act of 1934, each as amended, except to the extent that we specifically incorporate it by reference into such filing.

The following graph compares the cumulative total shareholder return on our common stock for the last five years with the cumulative total return on the S&P 500 Index and an index of peer companies selected by us. Our peer group includes BorgWarner Inc, Caterpillar, Inc., Daimler AG, Danaher Corporation, Deere & Company, Donaldson Company Inc., Eaton Corporation, Emerson Electric Co., W.W. Grainger Inc., Honeywell International, Illinois Tool Works Inc., Ingersoll-Rand Company Ltd., Navistar, PACCAR, Parker-Hannifin Corporation, Textron Inc. and Volvo AB. Each of the measures of cumulative total return assumes reinvestment of dividends. The comparisons in this table are required by the SEC and are not intended to forecast or be indicative of possible future performance of our stock.

COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN  
AMONG CUMMINS INC., S&P 500 INDEX AND CUSTOM PEER GROUP

ASSUMES \$100 INVESTED ON DEC. 31, 2009  
ASSUMES DIVIDENDS REINVESTED  
FISCAL YEAR ENDING DEC. 31, 2014

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## ITEM 6. Selected Financial Data

The selected financial information presented below for each of the last five years ended December 31, beginning with 2014, was derived from our Consolidated Financial Statements. This information should be read in conjunction with our Consolidated Financial Statements and related notes and "Management's Discussion and Analysis of Financial Condition and Results of Operations."

In millions, except per share amounts	2014	2013	2012	2011	2010
For the years ended December 31,					
Net sales	\$19,221	\$17,301	\$17,334	\$18,048	\$13,226
U.S. percentage of sales	52	% 48	% 47	% 41	% 36
Non-U.S. percentage of sales	48	% 52	% 53	% 59	% 64
Gross margin <sup>(1)</sup>	4,861	4,280	4,416	4,589	3,168
Research, development and engineering expenses	754	713	728	629	414
Equity, royalty and interest income from investees	370	361	384	416	351
Interest expense <sup>(2)</sup>	64	41	32	44	40
Net income attributable to Cummins Inc. <sup>(3)</sup>	1,651	1,483	1,645	1,848	1,040
Earnings per common share attributable to Cummins Inc.					
Basic	\$9.04	\$7.93	\$8.69	\$9.58	\$5.29
Diluted	9.02	7.91	8.67	9.55	5.28
Cash dividends declared per share	2.81	2.25	1.80	1.325	0.875
Net cash provided by operating activities	\$2,266	\$2,089	\$1,532	\$2,073	\$1,006
Capital expenditures	743	676	690	622	364
At December 31,					
Cash and cash equivalents	\$2,301	\$2,699	\$1,369	\$1,484	\$1,023
Total assets	15,776	14,728	12,548	11,668	10,402
Long-term debt <sup>(2)</sup>	1,589	1,672	698	658	709
Total equity <sup>(4)</sup>	8,093	7,870	6,974	5,831	4,996

<sup>(1)</sup> We revised the classification of certain amounts for "Cost of sales" and "Selling, general and administrative expenses" for 2013 and 2012. The segment EBIT performance measure is unchanged, however, certain activities that were previously classified in "Selling, general and administrative expenses" are now classified as "Cost of sales". The reclassifications for the years ended December 31, 2013 and 2012, were \$103 million and \$92 million, respectively. The revision had no impact on reported net income, cash flows or the balance sheet. The amounts for the years ended December 31, 2011 and 2010, were not reclassified to be consistent with the current presentation. See Note 1, "SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES," to our Consolidated Financial Statements for additional detail.

<sup>(2)</sup> In September 2013, we issued \$1 billion of senior unsecured debt.

<sup>(3)</sup> For the year ended December 31, 2012, consolidated net income included \$52 million of restructuring and other charges (\$35 million after-tax) and a \$20 million charge (\$12 million after-tax) related to legal matters. For the year ended December 31, 2011, consolidated net income included a \$68 million gain (\$37 million after-tax) related to the disposition of certain assets and liabilities of our exhaust business and a \$53 million gain (\$33 million after-tax) recorded for the disposition of certain assets and liabilities of our light-duty filtration business, both from the Components segment, and a \$38 million gain (\$24 million after-tax) related to flood damage recoveries from the insurance settlement related to a June 2008 flood in Southern Indiana. For the year ended December 31, 2010, consolidated net income included \$32 million in Brazil tax recoveries (\$21 million after-tax) and \$2 million in flood damage expenses.

<sup>(4)</sup> In 2014, 2013, 2012, 2011 and 2010, we recorded non-cash charges (credits) to equity of \$78 million, \$(102) million, \$83 million, \$96 million and \$(125) million, respectively, to record net actuarial (gains) losses associated with the valuation of our pension plans. These (gains) losses include the effects of market conditions on our pension

trust assets and the effects of economic factors on the valuation of the pension liability.

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ITEM 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

ORGANIZATION OF INFORMATION

The following Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) was prepared to provide the reader with a view and perspective of our business through the eyes of management and should be read in conjunction with our Consolidated Financial Statements and the accompanying notes to those financial statements. Our MD&A is presented in the following sections:

- Executive Summary and Financial Highlights
- 2015 Outlook
- Results of Operations
- Operating Segment Results
- Liquidity and Capital Resources
- Contractual Obligations and Other Commercial Commitments
- Application of Critical Accounting Estimates
- Recently Adopted and Recently Issued Accounting Pronouncements

EXECUTIVE SUMMARY AND FINANCIAL HIGHLIGHTS

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 have long-standing relationships with many of the leading manufacturers in the markets we serve, including PACCAR Inc, Daimler Trucks North America, Chrysler Group, LLC (Chrysler), Volvo AB, Komatsu, Navistar International Corporation, Aggreko plc, Ford Motor Company and MAN Nutzfahrzeuge AG. We serve our customers through a network of approximately 600 company-owned and independent distributor locations and approximately 7,200 dealer locations in more than 190 countries and territories.

Our reportable operating segments consist of the following: Engine, Distribution, Components and Power Generation. This reporting structure is organized according to the products and markets each segment serves. The Engine segment produces engines and parts for sale to customers in on-highway and various industrial markets. Our engines are used in trucks of all sizes, buses and recreational vehicles, as well as in various industrial applications, including construction, mining, agriculture, marine, oil and gas, rail and military equipment. The Distribution segment includes wholly-owned and partially-owned distributorships engaged in wholesaling engines, generator sets and service parts, as well as performing service and repair activities on our products and maintaining relationships with various OEMs throughout the world. The Components segment sells filtration products, aftertreatment systems, turbochargers and fuel systems. The Power Generation segment is an integrated provider of power systems, which sells engines, generator sets and alternators.

Our financial performance depends, in large part, on varying conditions in the markets we serve, particularly the on-highway, construction and general industrial markets. Demand in these markets tends to fluctuate in response to overall economic conditions. Our sales may also be impacted by OEM inventory levels and production schedules and stoppages. Economic downturns in markets we serve generally result in reduced sales of our products and can result in price reductions in certain products and/or markets. As a worldwide business, our operations are also affected by currency, political, economic and regulatory matters, including adoption and enforcement of environmental and emission standards, in the countries we serve. As part of our growth strategy, we invest in businesses in certain countries that carry high levels of these risks such as China, Brazil, India, Mexico, Russia and countries in the Middle East and Africa. At the same time, our geographic diversity and broad product and service offerings have helped limit the impact from a drop in demand in any one industry or customer or the economy of any single country on our consolidated results.



Worldwide revenues improved 11 percent in 2014 compared to 2013, primarily due to the improvements in North American on-highway demand and the consolidation of partially owned North American distributors. Revenue in the U.S. and Canada improved by 20 percent primarily due to increased demand in the North American on-highway markets driving sales in both the Engine and Components segments, as well as improved Distribution segment sales related to the consolidation of partially-

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owned North American distributors since December 31, 2012. These increases were partially offset by the reduced demand in the North American power generation markets primarily due to lower military sales. Amid the continued international economic uncertainty in 2014, our international revenues remained flat compared to 2013. International revenues increased in the Components segment, especially the emission solutions business in Western Europe and China due to additional content as the result of new emission regulations, while the Distribution segment revenues improved due to demand growth in Africa and Asia Pacific. These increases were offset by decreased international on-highway demand with decreased shipments of 7 percent and 11 percent in the heavy-duty and medium-duty truck markets, respectively, and decreased demand in international power generation markets.

The following table contains sales and EBIT (defined as earnings before interest expense, taxes and noncontrolling interests) results by operating segment for the years ended December 31, 2014 and 2013. Refer to the section titled "Operating Segment Results" for a more detailed discussion of net sales and EBIT by operating segment including the reconciliation of segment EBIT to income before income taxes.

## Operating Segments

	2014			2013			Percent change 2014 vs. 2013		
	Sales	Percent of Total	EBIT	Sales	Percent of Total	EBIT	Sales	EBIT	
In millions									
Engine	\$10,962	57	% \$1,225	\$10,013	58	% \$1,041	9	% 18	%
Distribution	5,174	27	% 491	3,749	22	% 388	38	% 27	%
Components	5,118	27	% 684	4,342	25	% 527	18	% 30	%
Power Generation	2,896	15	% 168	3,031	18	% 218	(4)	% (23)	%
Intersegment eliminations	(4,929 )	(26 )	% —	(3,834 )	(23 )	% —	29	% —	
Non-segment	—	—	(70 )	—	—	(14 )	—	NM	
Total	\$19,221	100	% \$2,498	\$17,301	100	% \$2,160	11	% 16	%

"NM" - not meaningful information

Net income attributable to Cummins Inc. for 2014 was \$1,651 million, or \$9.02 per diluted share, on sales of \$19.2 billion, compared to 2013 net income attributable to Cummins Inc. of \$1,483 million, or \$7.91 per diluted share, on sales of \$17.3 billion. The increase in net income and earnings per share was driven by improved gross margin, partially offset by higher selling, general and administrative expenses. The improved gross margin was the result of higher volumes, improved Distribution segment sales related to the consolidation of partially-owned North American distributors since December 31, 2012, lower material and commodity costs and favorable mix, partially offset by unfavorable foreign currency fluctuations. Diluted earnings per share for 2014 benefited \$0.16 from lower shares outstanding, primarily due to purchases under the stock repurchase program.

We generated \$2.3 billion of operating cash flows in 2014, compared to \$2.1 billion in 2013. Refer to the section titled "Operating Activities" in the "Liquidity and Capital Resources" section for a discussion of items impacting cash flows. In September 2013, we announced our intention to acquire the equity that we do not already own in most of our partially-owned United States and Canadian distributors over the next three to five years. During 2014, we spent \$460 million on these acquisitions and the related debt retirements. We plan to spend an additional \$170 million to \$210 million on North American distributor acquisitions and the related debt retirements in 2015. Refer to Note 2, "ACQUISITIONS," to the Consolidated Financial Statements for additional information.

During 2014, we repurchased \$670 million of common stock under the 2012 Board of Directors authorized plan. In July 2014, our Board of Directors authorized the acquisition of up to \$1 billion of additional common stock upon the completion of the 2012 repurchase plan.

In the fourth quarter of 2014, we exercised our option to extend the maturity date of our revolving credit agreement by one year from November 9, 2017, to November 9, 2018.

In December 2014, Moody's Investors Service, Inc. raised our rating to 'A2' and confirmed our outlook as stable.

In July 2014, the Board of Directors authorized a dividend increase of approximately 25 percent from \$0.625 per share to \$0.78 per share on a quarterly basis.

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Our debt to capital ratio (capital is defined as debt plus equity) at December 31, 2014, was 17.3 percent, compared to 18.1 percent at December 31, 2013. As of the date of filing this Annual Report on Form 10-K, we had an 'A+' credit rating with a 'Stable' outlook from Standard & Poor's Rating Services, an 'A' credit rating with a 'Stable' outlook from Fitch Ratings and an 'A2' credit rating with a 'Stable' outlook from Moody's Investors Service, Inc. In addition to our \$2.4 billion in cash and marketable securities on hand, we have sufficient access to our credit facilities, if necessary, to meet currently anticipated investment and funding needs.

Our global pension plans, including our unfunded and non-qualified plans, were 108 percent funded at December 31, 2014. Our U.S. qualified plan, which represents approximately 56 percent of the worldwide pension obligation, was 119 percent funded and our United Kingdom (U.K.) plan was 113 percent funded. We expect to contribute \$175 million to our global pension plans in 2015. We anticipate pension and other postretirement benefit cost in 2015 to increase by approximately \$3 million pre-tax, or \$0.01 per diluted share, when compared to 2014. The increase is due to lower discount rates and unfavorable demographics mostly offset by favorable expected return on asset performance. Refer to application of critical accounting estimates within MD&A and Note 11, "PENSION AND OTHER POSTRETIREMENT BENEFITS," to the Consolidated Financial Statements, for additional information concerning our pension and other post-retirement benefit plans.

2015 OUTLOOK

Near-Term

We currently expect the following positive trends in 2015:

- We expect the North American heavy-duty and medium-duty on-highway markets to increase in 2015 as compared to the market in 2014.

- We expect the new ISG engine, which began production in the second quarter of 2014 with our Beijing Foton Cummins Engine Co., Ltd. joint venture, to continue to gain market share in China in its first full year of production.

- We plan to continue acquiring our partially-owned North American distributors, which will increase our Distribution segment revenues.

- Demand in some end markets in India are expected to begin to experience growth during the year.

We currently expect the following challenges to our business that may reduce our revenue and earnings potential in 2015:

- Power generation markets are expected to remain weak.

- Weak economic growth in Brazil could continue to negatively impact our on-highway and power generation businesses.

- We do not anticipate end markets in China to improve.

- Demand in certain European markets could remain weak due to continued political and economic uncertainty.

- Growth in emerging markets could be negatively impacted if emission regulations are not strictly enforced.

- Foreign currency volatility could continue to put pressure on revenue and earnings.

- We expect market demand to decline in the oil and gas markets as the result of the lower crude oil prices.

- Domestic and international mining markets could continue to deteriorate if commodity prices weaken.

Long-Term

We believe that, over the longer term, there will be economic improvements in most of our current markets and that our opportunities for long-term profitable growth will continue in the future as the result of the following four macroeconomic trends that will benefit our businesses:

- tightening emissions controls across the world;

- infrastructure needs in emerging markets;

- energy availability and cost issues; and

- globalization of industries like ours.



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## RESULTS OF OPERATIONS

In millions (except per share amounts)	Years ended December 31,			Favorable/(Unfavorable)			
	2014	2013	2012	2014 vs. 2013		2013 vs. 2012	
				Amount	Percent	Amount	Percent
NET SALES	\$19,221	\$17,301	\$17,334	\$1,920	11 %	\$(33 )	— %
Cost of sales	14,360	13,021	12,918	(1,339 )	(10 )%	(103 )	(1 )%
GROSS MARGIN	4,861	4,280	4,416	581	14 %	(136 )	(3 )%
OPERATING EXPENSES AND INCOME							
Selling, general and administrative expenses	2,095	1,817	1,808	(278 )	(15 )%	(9 )	— %
Research, development and engineering expenses	754	713	728	(41 )	(6 )%	15	2 %
Equity, royalty and interest income from investees	370	361	384	9	2 %	(23 )	(6 )%
Other operating income (expense), net	(17 )	(10 )	(10 )	(7 )	70 %	—	— %
OPERATING INCOME	2,365	2,101	2,254	264	13 %	(153 )	(7 )%
Interest income	23	27	25	(4 )	(15 )%	2	8 %
Interest expense	64	41	32	(23 )	(56 )%	(9 )	(28 )%
Other income (expense), net	110	32	24	78	NM	8	33 %
INCOME BEFORE INCOME TAXES	2,434	2,119	2,271	315	15 %	(152 )	(7 )%
Income tax expense	698	531	533	(167 )	(31 )%	2	— %
CONSOLIDATED NET INCOME	1,736	1,588	1,738	148	9 %	(150 )	(9 )%
Less: Net income attributable to noncontrolling interests	85	105	93	20	19 %	(12 )	(13 )%
NET INCOME ATTRIBUTABLE TO CUMMINS INC.	\$1,651	\$1,483	\$1,645	\$168	11 %	\$(162 )	(10 )%
Diluted earnings per common share attributable to Cummins Inc.	\$9.02	\$7.91	\$8.67	\$1.11	14 %	\$(0.76 )	(9 )%

"NM" - not meaningful information

Percent of sales	2014			2013			2012			Favorable/(Unfavorable)Percentage Points	
	2014	2013	2012	2014	2013	2012	2014	2013	2012	2014 vs. 2013	2013 vs. 2012
Gross margin	25.3	% 24.7	% 25.5	0.6			(0.8			)	
Selling, general and administrative expenses	10.9	% 10.5	% 10.4	(0.4			)	(0.1		)	
Research, development and engineering expenses	3.9	% 4.1	% 4.2	0.2				0.1			

2014 vs. 2013

Net Sales

Net sales increased versus 2013 primarily driven by the following:

- Distribution segment sales increased by 38 percent primarily due to the acquisitions of North American distributors.
- Engine segment sales increased by 9 percent due to higher demand in the North American on-highway markets.
- Components segment sales increased by 18 percent primarily due to higher demand in on-highway markets in North America, Europe and China.

The increases were partially offset by the following:

- Power Generation segment sales decreased by 4 percent mainly due to lower volumes within power products, alternators and power systems.

Foreign currency fluctuations unfavorably impacted sales by approximately 1 percent (primarily in Brazil and India). Sales to international markets (excluding the U.S. and Canada), based on location of customers, were 44 percent of total net sales in 2014, compared with 48 percent of total net sales in 2013. A more detailed discussion of sales by segment is presented in the “OPERATING SEGMENT RESULTS” section.

Table of Contents**Gross Margin**

Gross margin increased by \$581 million and as a percentage of sales by 0.6 percentage points as higher volumes, improved Distribution segment sales related to the consolidation of partially-owned North American distributors since December 31, 2012, lower material and commodity costs and favorable mix, were partially offset by unfavorable foreign currency fluctuations (primarily in Australia, Europe and Canada).

The provision for warranties issued, excluding campaigns, as a percentage of sales was 2.0 percent in 2014 and 2.1 percent in 2013. A more detailed discussion of margin by segment is presented in the "OPERATING SEGMENT RESULTS" section.

**Selling, General and Administrative Expenses**

Selling, general and administrative expenses increased primarily due to higher compensation and related expenses of \$118 million and increased consulting fees of \$28 million. These increases were significantly impacted by the acquisition of our partially owned North American distributors since December 31, 2012. Compensation and related expenses include salaries, fringe benefits and variable compensation. Overall, selling, general and administrative expenses, as a percentage of sales, increased to 10.9 percent in 2014 from 10.5 percent in 2013.

**Research, Development and Engineering Expenses**

Research, development and engineering expenses increased primarily due to higher compensation and related expenses of \$44 million, partially offset by decreased consulting expenses of \$7 million and increased expense recovery of \$7 million. Compensation and related expenses include salaries, fringe benefits and variable compensation. Overall, research, development and engineering expenses, as a percentage of sales, decreased to 3.9 percent in 2014 from 4.1 percent in 2013. Research activities continue to focus on development of new products to meet future emission standards around the world and improvements in fuel economy performance.

**Equity, Royalty and Interest Income From Investees**

Equity, royalty and interest income from investees increased primarily due to the following:

In millions	2014 vs. 2013 Increase/(Decrease)	
Beijing Foton Cummins Engine Co., Ltd. (Light-duty)	\$ 11	
Komatsu Cummins Chile, Ltda.	4	
Dongfeng Cummins Engine Company, Ltd.	4	
Chongqing Cummins Engine Company, Ltd.	(7	)
Beijing Foton Cummins Engine Co., Ltd. (Heavy-duty)	(9	)
North American distributors	(22	)
All other	24	
Cummins share of net income	5	
Royalty and interest income	4	
Equity, royalty and interest income from investees	\$ 9	

The increases above were primarily due to increased earnings at Beijing Foton Cummins Engine Co., Ltd. (Light-duty), Komatsu Cummins Chile, Ltda. and Dongfeng Cummins Engine Company, Ltd., partially offset by the consolidation of the partially-owned North American distributors since December 31, 2012 and losses at Beijing Foton Cummins Engine Co., Ltd. (Heavy-duty) as the result of increased expenses related to the production launch of the 2014 product in the second quarter of 2014.

As we execute our plan to acquire partially-owned distributors, we expect equity earnings for our North American distributors to decrease as the earnings will be included in our consolidated results. See Note 2, "ACQUISITIONS," to the Consolidated Financial Statements for further information.



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## Other Operating Income (Expense), Net

Other operating income (expense), net was as follows:

In millions	Years ended December 31,	
	2014	2013
Loss on write off of assets	\$(23	) \$(14
Amortization of intangible assets	(16	) (11
Royalty expense	(7	) (4
Legal matters	(3	) (2
Royalty income	34	20
Other, net	(2	) 1
Total other operating income (expense), net	\$(17	) \$(10

## Interest Income

Interest income decreased in 2014, primarily due to an interest income recovery of a loan previously deemed unrecoverable in the second quarter of 2013.

## Interest Expense

Interest expense increased as a result of the \$1 billion debt issuance in September 2013.

## Other Income (Expense), Net

Other income (expense), net was as follows:

In millions	Years ended December 31,	
	2014	2013
Gain on fair value adjustment for consolidated investee <sup>(1)</sup>	\$73	\$12
Change in cash surrender value of corporate owned life insurance	24	12
Gain on marketable securities, net	14	13
Dividend income	3	5
Foreign currency loss, net	(6	) (27
Bank charges	(12	) (10
Other, net	14	27
Total other income (expense), net	\$110	\$32

<sup>(1)</sup> See Note 2, "ACQUISITIONS," to the Consolidated Financial Statements for more details.

## Income Tax Expense

Our income tax rates are generally less than the 35 percent U.S. statutory income tax rate primarily because of lower taxes on foreign earnings and research tax credits. Our effective tax rate for 2014 was 28.7 percent compared to 25.1 percent for 2013. The 3.6 percent increase in the effective tax rate from 2013 to 2014 is partially due to a 1.2 percent net tax benefit for one-time items in 2013 that did not repeat in 2014. These 2013 one-time items consisted primarily of the 2012 federal research tax credit that was reinstated during 2013. The additional 2.4 percent increase in tax rate from 2013 to 2014 is attributable primarily to the following unfavorable items that occurred in 2014: a tax law change in the U.K. resulting in a higher limitation on the deductibility of interest; unfavorable changes in the jurisdictional mix of pretax income; and increases in state valuation allowances.

We evaluate the recoverability of our deferred tax assets each quarter by assessing the likelihood of future profitability and available tax planning strategies that could be implemented to realize our net deferred tax assets. At December 31, 2014, we recorded net deferred tax assets of \$184 million. These assets included \$190 million for the value of tax loss and credit carryforwards. A valuation allowance of \$144 million was recorded to reduce the tax assets to the net value management believed was more likely than not to be realized. In the event our operating performance deteriorates, future assessments could conclude that a larger valuation allowance will be needed to further reduce the deferred tax assets.



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We expect our 2015 effective tax rate to be 29.5 percent, excluding any discrete items that may arise. The research tax credit expired December 31, 2014, and has not yet been renewed by Congress. If the research credit is reinstated during 2015, we would anticipate the 2015 effective tax rate to be reduced to 28.5 percent, consistent with the 2014 rate of 28.7 percent.

### Noncontrolling Interests

Noncontrolling interests eliminate the income or loss attributable to non-Cummins ownership interests in our consolidated entities. Noncontrolling interests in income of consolidated subsidiaries decreased primarily due to a \$23 million decline from the acquisition of the remaining interest in previously consolidated North American distributors since December 31, 2012.

### Net Income Attributable to Cummins Inc. and Diluted Earnings Per Share Attributable to Cummins Inc.

Net income and diluted earnings per share attributable to Cummins Inc. increased primarily due to higher gross margin, mainly driven by improved volumes and improved Distribution segment sales related to the consolidation of partially-owned North American distributors since December 31, 2012. These increases were partially offset by higher selling, general and administrative expenses and a higher effective tax rate of 28.7 percent in 2014 versus 25.1 percent in 2013. Diluted earnings per share for 2014 benefited \$0.16 from lower shares outstanding, primarily due to purchases under the stock repurchase program.

### 2013 vs. 2012

#### Net Sales

Net sales decreased slightly versus 2012 and was primarily driven by the following:

Engine segment sales decreased by 7 percent due to lower demand in the power generation markets, weaker demand in the North American heavy-duty truck markets and continued weakness in industrial demand, primarily in off-highway mining markets.

Power Generation segment sales decreased by 7 percent due to lower demand in the power solutions business, primarily in the U.K., and lower demand in the power systems and the alternators businesses in international markets, partially offset by improvements in the North American power product business.

Foreign currency fluctuations unfavorably impacted sales by 1 percent.

The decreases were partially offset by the following:

Distribution segment sales increased by 14 percent primarily due to incremental sales in 2013 related to the consolidation of partially-owned North American distributors since June 2012.

Components segment sales increased by 8 percent due to higher sales within the emission solutions business, mainly related to improved on-highway OEM and aftermarket demand in North America, a full year of sales from Hilite which was acquired in the third quarter of 2012, 2013 pre-buy activity in anticipation of the Euro VI emission standards and growth in the medium-duty Brazilian truck market resulting in improved aftertreatment demand.

A more detailed discussion of sales by segment is presented in the "OPERATING SEGMENT RESULTS" section. Sales to international markets (excluding the U.S. and Canada) were 48 percent of total net sales in 2013, compared with 49 percent of total net sales in 2012.

#### Gross Margin

Gross margin decreased by \$125 million and as a percentage of sales by 0.7 percentage points. The decrease in gross margin as a percentage of sales was primarily due to a decline in demand for high-horsepower engines and gensets, partially offset by improved price realization, lower material and commodity costs and the absence of 2012 restructuring charges of \$29 million.

The provision for warranties issued, excluding campaigns, as a percentage of sales was 2.1 percent in both 2013 and 2012. A more detailed discussion of margin by segment is presented in the "OPERATING SEGMENT RESULTS" section.

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## Selling, General and Administrative Expenses

Selling, general and administrative expenses increased primarily due to incremental costs in 2013 related to the acquisition of partially owned North American distributors since June 2012. These costs primarily contributed to increased compensation and related expenses of \$57 million, partially offset by lower consulting of \$24 million, the absence of 2012 restructuring charges of \$20 million and reduced discretionary spending. Higher compensation expense was primarily due to increased headcount to support our strategic growth initiatives. Compensation and related expenses include salaries, fringe benefits and variable compensation. Overall, selling, general and administrative expenses, as a percentage of sales, increased to 11.1 percent in 2013 from 11.0 percent in 2012.

## Research, Development and Engineering Expenses

Research, development and engineering expenses decreased primarily due to lower consulting of \$30 million and decreased engineering program spending of \$23 million, partially offset by increases of \$52 million in compensation related expenses. Higher compensation expense was primarily due to increased headcount to support our strategic growth initiatives. Compensation and related expenses include salaries and fringe benefits. Overall, research, development and engineering expenses, as a percentage of sales, decreased to 4.1 percent in 2013 from 4.2 percent in 2012.

## Equity, Royalty and Interest Income From Investees

Equity, royalty and interest income from investees decreased primarily due to the following:

In millions	2013 vs. 2012 Increase/(Decrease)	
North American distributors	\$(18	)
Cummins Westport, Inc.	(10	)
Beijing Foton Cummins Engine Co., Ltd. (Heavy-duty)	(8	)
Tata Cummins, Ltd.	(6	)
Dongfeng Cummins Engine Company, Ltd.	11	
Beijing Foton Cummins Engine Co., Ltd. (Light-duty)	12	
All other	(3	)
Cummins share of net income	(22	)
Royalty and interest income	(1	)
Equity, royalty and interest income from investees	\$(23	)

The decreases above were primarily due to the consolidation of the partially-owned North American distributors acquired in 2013, unfavorable warranty accruals at Cummins Westport, Inc., an impaired equity investment within Power Generation and additional start-up costs at Beijing Foton Cummins Engine Co., Ltd. (Heavy-duty), partially offset by increased demand at Beijing Foton Cummins Engine Co., Ltd (Light-duty) and Dongfeng Cummins Engine Company, Ltd.

## Other Operating Income (Expense), Net

Other operating income (expense), net was as follows:

In millions	Years ended December 31,		
	2013	2012	
Loss on write off of assets	\$(14	) \$(6	)
Amortization of intangible assets	(11	) (8	)
Royalty expense	(4	) (3	)
Legal matters	(2	) (20	)
Royalty income	20	18	
Gain on sale of business	—	6	
Other, net	1	3	
Total other operating income (expense), net	\$(10	) \$(10	)

## Interest Income

Interest income was relatively flat compared to 2012.



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## Interest Expense

Interest expense increased primarily due to the \$1 billion debt issuance in September 2013.

## Other Income (Expense), Net

Other income (expense), net was as follows:

In millions	Years ended December 31,	
	2013	2012
Gain on marketable securities, net	\$13	\$3
Gain on fair value adjustment for consolidated investee <sup>(1)</sup>	12	7
Change in cash surrender value of corporate owned life insurance	12	5
Dividend income	5	7
Gain on sale of equity investment	—	13
Bank charges	(10	) (15
Foreign currency loss, net	(27	) (14
Other, net	27	18
Total other income (expense), net	\$32	\$24

<sup>(1)</sup> See Note 2, "ACQUISITIONS," to the Consolidated Financial Statements for more details.

## Income Tax Expense

Our income tax rates are generally less than the 35 percent U.S. statutory income tax rate primarily because of lower taxes on foreign earnings and research tax credits. Our effective tax rate for 2013 was 25.1 percent compared to 23.5 percent for 2012. As a result of a restructuring of our foreign operations in 2013, our 2013 effective tax rate was approximately 1 percent less than it would have been without restructuring. On January 2, 2013, the American Taxpayer Relief Act of 2012 was signed into law and reinstated the research tax credit back to 2012. As tax law changes are accounted for in the period of enactment, we recognized a \$28 million discrete tax benefit in the first quarter of 2013. We also recognized a discrete tax expense of \$17 million in the first quarter which primarily related to the write-off of a deferred tax asset deemed unrecoverable. Also included in 2013 was a third quarter discrete net tax expense of \$7 million primarily related to U.S. federal tax return true-up adjustments and the third quarter enactment of U.K tax law changes. Additionally, our effective tax rate for 2013 also included a fourth quarter discrete net tax benefit of \$21 million primarily due to the release of U.S. deferred tax liabilities related to prior years unremitted income of certain Indian and Mexican subsidiaries now considered to be permanently reinvested, as well as adjustments to our income tax accounts principally based on our 2012 state tax return filings. Our 2012 income tax provision included a one-time \$134 million tax benefit which resulted from tax planning strategies and tax return elections made with respect to our U.K. operations.

We evaluate the recoverability of our deferred tax assets each quarter by assessing the likelihood of future profitability and available tax planning strategies that could be implemented to realize our net deferred tax assets. At December 31, 2013, we recorded net deferred tax assets of \$177 million. These assets included \$187 million for the value of tax loss and credit carryforwards. A valuation allowance of \$101 million was recorded to reduce the tax assets to the net value management believed was more likely than not to be realized. In the event our operating performance deteriorates, future assessments could conclude that a larger valuation allowance will be needed to further reduce the deferred tax assets.

## Noncontrolling Interests

Noncontrolling interests in income of consolidated subsidiaries increased reflecting our minority's share of higher profits of \$7 million at Cummins Western Canada LP, \$6 million at Wuxi Cummins Turbo Technologies Co. Ltd. and \$4 million due to the acquisition of a majority interest in Cummins Central Power LLC (Central Power) in the third quarter of 2012. The increases were partially offset by a total decrease of \$8 million at Cummins India Ltd.

Table of Contents**Net Income Attributable to Cummins Inc. and Diluted Earnings Per Share Attributable to Cummins Inc.**

Net income and diluted earnings per share attributable to Cummins Inc. decreased primarily due to lower gross margin as a percentage of sales, mainly driven by unfavorable product mix and lower volumes, particularly in the Engine segment and Power Generation segment, a higher effective tax rate of 25.1 percent versus 23.5 percent in 2012, lower equity, royalty and interest income from investees, mainly due to the acquisition of the North American distributors, and higher selling, general and administrative expenses. These decreases were partially offset by lower research, development and engineering expenses. Diluted earnings per share for 2013 benefited \$0.06 from lower shares outstanding, primarily due to purchases under the stock repurchase program.

**OPERATING SEGMENT RESULTS**

Our reportable operating segments, which consist of the Engine, Distribution, Components and Power Generation segments, use segment EBIT (defined as earnings before interest expense, taxes and noncontrolling interests) as a primary basis for the chief operating decision-maker to evaluate the performance of each of our operating segments. Segment amounts exclude certain expenses not specifically identifiable to segments.

The accounting policies of our operating segments are the same as those applied in our Consolidated Financial Statements. We prepared the financial results of our operating segments on a basis that is consistent with the manner in which we internally disaggregate financial information to assist in making internal operating decisions. We have allocated certain common costs and expenses, primarily corporate functions, among segments differently than we would for stand-alone financial information prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). These include certain costs and expenses of shared services, such as information technology, human resources, legal and finance. We also do not allocate debt-related items, actuarial gains or losses, prior service costs or credits, changes in cash surrender value of corporate owned life insurance or income taxes to individual segments. Segment EBIT may not be consistent with measures used by other companies. Following is a discussion of operating results for each of our business segments.

**Engine Segment Results**

Financial data for the Engine segment was as follows:

In millions	Years ended December 31,			Favorable/(Unfavorable)					
	2014	2013	2012	2014 vs. 2013	2013 vs. 2012	Amount	Percent	Amount	Percent
External sales	\$8,437	\$8,270	\$9,101	\$167	2 %	\$(831)	(9)	9	%
Intersegment sales	2,525	1,743	1,632	782	45 %	111	7	7	%
Total sales	10,962	10,013	10,733	949	9 %	(720)	(7)	(7)	%
Depreciation and amortization	207	205	192	(2)	(1)	(13)	(7)	(7)	%
Research, development and engineering expenses	438	416	433	(22)	(5)	17	4	4	%
Equity, royalty and interest income from investees	147	136	127	11	8 %	9	7	7	%
Interest income	12	16	11	(4)	(25)	5	45	45	%
Segment EBIT	1,225	1,041	1,248	184	18 %	(207)	(17)	(17)	%
Segment EBIT as a percentage of total sales	11.2 %	10.4 %	11.6 %	0.8		(1.2)	(1.2)	(1.2)	

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Engine segment sales by market were as follows:

In millions	Years ended December 31,			Favorable/(Unfavorable)		2014 vs. 2013		2013 vs. 2012	
	2014	2013	2012	Amount	Percent	Amount	Percent	Amount	Percent
Heavy-duty truck	\$3,139	\$2,705	\$2,964	\$434	16	%	\$(259)	(9)	)%
Medium-duty truck and bus	2,530	2,185	2,091	345	16	%	94	4	)%
Light-duty automotive and RV	1,436	1,300	1,279	136	10	%	21	2	)%
Total on-highway	7,105	6,190	6,334	915	15	%	(144)	(2)	)%
Industrial	3,040	2,996	3,233	44	1	%	(237)	(7)	)%
Stationary power	817	827	1,166	(10)	(1)	)%	(339)	(29)	)%
Total sales	\$10,962	\$10,013	\$10,733	\$949	9	%	\$(720)	(7)	)%

Unit shipments by engine classification (including unit shipments to Power Generation) were as follows:

	Years ended December 31,			Favorable/(Unfavorable)		2014 vs. 2013		2013 vs. 2012	
	2014	2013	2012	Amount	Percent	Amount	Percent	Amount	Percent
Midrange	471,200	446,000	440,500	25,200	6	%	5,500	1	)%
Heavy-duty	122,100	105,400	119,100	16,700	16	%	(13,700)	(12)	)%
High-horsepower	14,800	14,800	19,800	—	—	%	(5,000)	(25)	)%
Total unit shipments	608,100	566,200	579,400	41,900	7	%	(13,200)	(2)	)%

2014 vs. 2013

Sales

Engine segment sales increased versus 2013. The following are the primary drivers by market:

• Heavy-duty truck engine sales increased due to improved demand in the North American heavy-duty truck market with higher engine shipments of 29 percent.

• Medium-duty truck and bus sales increased primarily due to market share gains in the North American medium-duty truck and bus markets, partially offset by weaker international demand.

• Light-duty automotive and RV sales increased primarily due to a 9 percent increase in units shipped to Chrysler. The increases above were partially offset by unfavorable foreign currency fluctuations (primarily in Brazil and India). Total on-highway-related sales for 2014 were 65 percent of total engine segment sales, compared to 62 percent in 2013.

Segment EBIT

Engine segment EBIT increased versus 2013, primarily due to higher gross margin and higher equity, royalty and interest income from investees, partially offset by higher selling, general and administrative expenses and higher research, development and engineering expenses. Major components of EBIT and related changes to segment EBIT and EBIT as a percentage of sales were as follows:

In millions	Year ended December 31, 2014 vs. 2013		
	Favorable/(Unfavorable) Change		Percentage point change as a percent of sales
	Amount	Percent	
Gross margin	\$274	13	% 0.6
Selling, general and administrative expenses	(67)	(8)	)% 0.1
Research, development and engineering expenses	(22)	(5)	)% 0.2
Equity, royalty and interest income from investees	11	8	% (0.1)



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The increase in gross margin versus 2013 was primarily due to higher volumes, favorable mix, decreased material and commodity costs and improved pricing. The increase in selling, general and administrative expenses was primarily due to increased headcount and higher variable compensation expense. The increase in research, development and engineering expenses was primarily due to lower expense recovery, increased consulting, increased variable compensation and increased investment to support new product initiatives. The increase in equity, royalty and interest income from investees was primarily due to higher earnings at Beijing Foton Cummins Engine Co., Ltd. (Light-duty). 2013 vs. 2012

**Sales**

Engine segment sales decreased versus 2012 due to lower demand in stationary power, heavy-duty truck and industrial businesses, partially offset by the medium-duty truck business. The following are the primary drivers by market:

Stationary power engine sales decreased due to lower demand in power generation markets.

Heavy-duty truck engine sales decreased due to weaker demand in North American on-highway markets during the first half of the year compared to the recovery experienced in the first half of 2012 as trucking companies replaced aging fleets.

Industrial market sales decreased primarily due to a 36 percent reduction in global mining shipments as a result of lower commodity prices and a 37 percent decline in engine shipments to North American oil and gas markets, partially offset by increased shipments to the Western European construction markets as a result of the pre-buy activity in 2013 ahead of the Tier IV emission regulations beginning in the first quarter of 2014.

Foreign currency fluctuations unfavorably impacted sales.

The decreases above were partially offset by the following:

Medium-duty truck engine sales increased due to market share gains in the North American medium-duty truck market and improved demand in the Brazilian and European truck markets. The improved sales in Brazil were primarily due to lower sales in the first half of 2012 as the result of the implementation of the Euro V emission regulations beginning in the first quarter of 2012.

Total on-highway-related sales for 2013 were 62 percent of total engine segment sales, compared to 59 percent in 2012.

**Segment EBIT**

Engine segment EBIT decreased versus 2012, primarily due to lower gross margin, partially offset by lower research, development and engineering expenses and higher equity, royalty and interest income from investees. Engine segment EBIT for 2012 included restructuring and other charges of \$20 million in the fourth quarter of 2012. Major components of EBIT and related changes to segment EBIT and EBIT as a percentage of sales were as follows:

In millions	Year ended December 31, 2013 vs. 2012		
	Favorable/(Unfavorable) Change		
	Amount	Percent	Percentage point change as a percent of sales
Gross margin	\$(237 )	(10 )%	(0.7 )
Selling, general and administrative expenses	1	—	% (0.5 )
Research, development and engineering expenses	17	4	% (0.2 )
Equity, royalty and interest income from investees	9	7	% 0.2

The decrease in gross margin versus 2012 was primarily due to unfavorable product mix and lower high-horsepower volumes, partially offset by improved price realization, decreased material and commodity costs and favorable foreign currency fluctuations. The decrease in selling, general and administrative expenses was primarily due to lower discretionary spending and the absence of restructuring charges incurred in 2012, partially offset by increased headcount. The decrease in research, development and engineering expenses was primarily due to lower discretionary spending in 2013, partially offset by increases in new product development spending and increased headcount to support our strategic growth initiatives. The increase in equity, royalty and interest income from investees was primarily due to higher earnings at Beijing Foton Cummins Engine Co., Ltd. within the light-duty business and Dongfeng Cummins Engine Company, Ltd., partially offset by lower earnings at Beijing Foton Engine Company, Ltd.

(Heavy-duty) in anticipation of production in the second quarter of 2014.

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## Distribution Segment Results

Financial data for the Distribution segment was as follows:

In millions	Years ended December 31,			Favorable/(Unfavorable)					
	2014	2013	2012	2014 vs. 2013		2013 vs. 2012			
	Amount	Amount	Amount	Amount	Percent	Amount	Percent	Amount	Percent
External sales	\$5,135	\$3,726	\$3,261	\$1,409	38 %	\$465	14 %		
Intersegment sales	39	23	16	16	70 %	7	44 %		
Total sales	5,174	3,749	3,277	1,425	38 %	472	14 %		
Depreciation and amortization	86	54	34	(32 )	(59 )%	(20 )	(59 )%		
Research, development and engineering expenses	9	6	6	(3 )	(50 )%	—	— %		
Equity, royalty and interest income from investees	148	165	188	(17 )	(10 )%	(23 )	(12 )%		
Interest income	4	2	2	2	100 %	—	— %		
Segment EBIT <sup>(1)</sup>	491	388	369	103	27 %	19	5 %		
Segment EBIT as a percentage of total sales <sup>(2)</sup>	9.5 %	10.3 %	11.3 %	Percentage Points (0.8 )		Percentage Points (1.0 )			

Segment EBIT for 2014 and 2013 included gains of \$73 million and \$12 million, respectively, resulting from <sup>(1)</sup> acquisitions of controlling interests in North American distributors. See Note 2, "ACQUISITIONS," to the Consolidated Financial Statements for further information.

<sup>(2)</sup> North American distributor acquisitions will increase Distribution segment EBIT, however the acquisitions will be dilutive to EBIT as a percentage of sales.

Sales for our Distribution segment by region were as follows:

In millions	Years ended December 31,			Favorable/(Unfavorable)					
	2014	2013	2012	2014 vs. 2013		2013 vs. 2012			
	Amount	Amount	Amount	Amount	Percent	Amount	Percent	Amount	Percent
North & Central America	\$2,765	\$1,470	\$901	\$1,295	88 %	\$569	63 %		
Europe, CIS and China	908	862	890	46	5 %	(28 )	(3 )%		
Asia Pacific	794	758	820	36	5 %	(62 )	(8 )%		
Middle East	208	198	193	10	5 %	5	3 %		
Africa	187	142	154	45	32 %	(12 )	(8 )%		
India	157	170	181	(13 )	(8 )%	(11 )	(6 )%		
South America	155	149	138	6	4 %	11	8 %		
Total sales	\$5,174	\$3,749	\$3,277	\$1,425	38 %	\$472	14 %		

Sales for our Distribution segment by product were as follows:

In millions	Years ended December 31,			Favorable/(Unfavorable)					
	2014	2013	2012	2014 vs. 2013		2013 vs. 2012			
	Amount	Amount	Amount	Amount	Percent	Amount	Percent	Amount	Percent
Parts and filtration	\$1,924	\$1,465	\$1,235	\$459	31 %	\$230	19 %		
Power generation	1,163	931	807	232	25 %	124	15 %		
Engines	1,061	713	665	348	49 %	48	7 %		
Service	1,026	640	570	386	60 %	70	12 %		
Total sales	\$5,174	\$3,749	\$3,277	\$1,425	38 %	\$472	14 %		

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## 2014 vs. 2013

## Sales

Distribution segment sales increased versus 2013 primarily due to \$1.2 billion of segment sales related to the consolidation of partially-owned North American distributors since December 31, 2012, \$290 million of organic sales growth primarily in North America, Asia Pacific, Africa, Europe and the Middle East and \$56 million of segment sales related to the acquisition of international distributors. These increases were partially offset by unfavorable foreign currency fluctuations and decreased demand in India.

## Segment EBIT

Distribution segment EBIT increased versus 2013, primarily due to the acquisitions of North American distributors, partially offset by unfavorable foreign currency fluctuations (primarily in Australia and Canada), higher selling, general and administrative expenses and lower equity, royalty and interest income from investees. The acquisitions resulted in gains of \$73 million and \$12 million for 2014 and 2013, respectively, related to the remeasurement of our pre-existing ownership interests in accordance with GAAP, which were partially offset by \$36 million and \$14 million of amortization of intangible assets in 2014 and 2013, respectively, for acquisitions since December 31, 2012. The decrease in equity, royalty and interest income from investees was the result of the acquisition of North American distributors since December 31, 2012. Major components of EBIT and related changes to segment EBIT and EBIT as a percentage of sales were as follows:

In millions	Year ended December 31, 2014 vs. 2013		
	Favorable/(Unfavorable) Change		
	Amount	Percent	Percentage point change as a percent of sales
Gross margin	\$208	31	% (0.9)
Selling, general and administrative expenses	(144)	(32)	% 0.6
Equity, royalty and interest income from investees	(17)	(10)	% (1.5)

## 2013 vs. 2012

## Sales

Distribution segment sales increased versus 2012 primarily due to \$507 million of incremental sales in 2013 related to the acquisition of partially-owned North American distributors since June 2012. These increases were partially offset by decreased engine product sales, primarily due to a significant slowdown in the North American oil and gas markets, and by unfavorable foreign currency fluctuations. Excluding acquisition related sales, all other changes were relatively flat versus 2012.

## Segment EBIT

Distribution segment EBIT increased versus 2012, primarily due to higher gross margin as a result of the acquisition and consolidation of partially owned North American distributors in 2013. This increase was partially offset by unfavorable foreign currency fluctuations, higher selling, general and administrative expenses and lower equity, royalty and interest income from investees as a result of the acquisitions. Amortization of intangible assets related to these acquisitions also negatively impacted EBIT for 2013. These acquisitions resulted in a \$12 million gain related to the remeasurement of our pre-existing ownership interest in 2013, compared to a \$7 million gain related to the remeasurement of our pre-existing 35 percent ownership in Central Power in 2012. Distribution segment EBIT also included restructuring and other charges of \$14 million in 2012. Major components of EBIT and related changes to segment EBIT and EBIT as a percentage of sales were as follows:

In millions	Year ended December 31, 2013 vs. 2012		
	Favorable/(Unfavorable) Change		
	Amount	Percent	Percentage point change as a percent of sales
Gross margin	\$75	13	% (0.3)
Selling, general and administrative expenses	(30)	(7)	% 0.8
Equity, royalty and interest income from investees	(23)	(12)	% (1.3)



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## Components Segment Results

Financial data for the Components segment was as follows:

In millions	Years ended December 31,			Favorable/(Unfavorable)		2014 vs. 2013		2013 vs. 2012	
	2014	2013	2012	Amount	Percent	Amount	Percent	Amount	Percent
External sales	\$3,791	\$3,151	\$2,809	\$640	20 %	\$342	12 %		
Intersegment sales	1,327	1,191	1,203	136	11 %	(12 )	(1 )%		
Total sales	5,118	4,342	4,012	776	18 %	330	8 %		
Depreciation and amortization	106	96	82	(10 )	(10 )%	(14 )	(17 )%		
Research, development and engineering expenses	230	218	213	(12 )	(6 )%	(5 )	(2 )%		
Equity, royalty and interest income from investees	36	28	29	8	29 %	(1 )	(3 )%		
Interest income	4	3	3	1	33 %	—	— %		
Segment EBIT	684	527	426	157	30 %	101	24 %		
Segment EBIT as a percentage of total sales	13.4 %	12.1 %	10.6 %					1.3 Percentage Points	1.5 Percentage Points

Sales for our Components segment by business were as follows:

In millions	Years ended December 31,			Favorable/(Unfavorable)		2014 vs. 2013		2013 vs. 2012	
	2014	2013	2012	Amount	Percent	Amount	Percent	Amount	Percent
Emission solutions	\$2,343	\$1,791	\$1,415	\$552	31 %	\$376	27 %		
Turbo technologies	1,222	1,115	1,106	107	10 %	9	1 %		
Filtration	1,075	1,028	1,048	47	5 %	(20 )	(2 )%		
Fuel systems	478	408	443	70	17 %	(35 )	(8 )%		
Total sales	\$5,118	\$4,342	\$4,012	\$776	18 %	\$330	8 %		

2014 vs. 2013

Sales

Components segment sales increased versus 2013 in all lines of business and across most markets. The following were the primary drivers by business:

Emission solutions business sales increased primarily due to improved demand in the North American on-highway markets and increased demand for our products in Europe and China to meet new emission requirements. The increases were partially offset by lower demand in Brazil.

Turbo technologies business sales increased as a result of improved on-highway demand in North America and Europe, partially offset by lower demand in Brazil.

Fuel systems business sales increased due to improved demand in the North American on-highway markets, the new Beijing Foton ISG engine that went into production during the second quarter of 2014 in China and increased aftermarket demand.

The increases above were partially offset by unfavorable foreign currency fluctuations primarily in Brazil and South Africa, partially offset by Europe.

Segment EBIT

Components segment EBIT increased versus 2013, primarily due to higher gross margin and higher equity, royalty and interest income from investees, partially offset by higher selling, general and administrative expenses and higher research, development and engineering expenses. Major components of EBIT and related changes to segment EBIT and EBIT as a percentage of sales were as follows:



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In millions	Year ended December 31, 2014 vs. 2013		
	Favorable/(Unfavorable) Change		
	Amount	Percent	Percentage point change as a percent of sales
Gross margin	\$ 191	19	% 0.3
Selling, general and administrative expenses	(51)	(19)	% —
Research, development and engineering expenses	(12)	(6)	% 0.5
Equity, royalty and interest income from investees	8	29	% 0.1

The increase in gross margin was primarily due to higher volumes, mainly in the emission solutions business and lower material and commodity costs, partially offset by unfavorable pricing and unfavorable foreign currency adjustments (primarily in Europe). The increase in selling, general and administrative expenses was primarily due to higher headcount to support business growth. The increase in research, development and engineering expenses was primarily due to higher headcount to support our strategic growth initiatives, partially offset by increased expense recovery.

2013 vs. 2012

#### Sales

Components segment sales increased versus 2012 primarily due to increased sales within the emission solutions business, mainly related to the following:

- Improved on-highway OEM and aftermarket demand in North America.

- The impact of our 2012 acquisition of Hilite experienced in Western Europe, which resulted in \$77 million of related incremental sales in 2013 compared to 2012.

- Western European pre-buy activity in anticipation of the Euro VI emission standards beginning in the first quarter of 2014.

- Growth in the medium-duty Brazilian truck market which resulted in improved aftertreatment demand.

The increases above were partially offset by the following:

- Foreign currency fluctuations unfavorably impacted sales results.

- Fuel systems business sales decreased primarily due to lower demand in North American on-highway markets and lower demand in Europe, partially offset by increased aftermarket demand.

#### Segment EBIT

Components segment EBIT increased versus 2012, primarily due to higher gross margin. Components segment EBIT for 2012 included restructuring and other charges of \$6 million in the fourth quarter. Major components of EBIT and related changes to segment EBIT and EBIT as a percentage of sales were as follows:

In millions	Year ended December 31, 2013 vs. 2012		
	Favorable/(Unfavorable) Change		
	Amount	Percent	Percentage point change as a percent of sales
Gross margin	\$ 112	13	% 0.9
Selling, general and administrative expenses	7	3	% 0.7
Research, development and engineering expenses	(5)	(2)	% 0.3
Equity, royalty and interest income from investees	(1)	(3)	% (0.1)

The increase in gross margin was primarily due to higher volumes in the emission solutions business and lower material and commodity costs in several businesses, partially offset by increased warranty costs and unfavorable foreign currency fluctuations. The decrease in selling, general and administrative expenses was primarily due to lower discretionary spending in 2013, partially offset by increased compensation and variable compensation expense. The increase in research, development and engineering expenses was primarily due to higher headcount to support our strategic growth initiatives and new product development spending, partially offset by lower consulting expenses.





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## Power Generation Segment Results

Financial data for the Power Generation segment was as follows:

In millions	Years ended December 31,			Favorable/(Unfavorable)			
	2014	2013	2012	2014 vs. 2013		2013 vs. 2012	
				Amount	Percent	Amount	Percent
External sales	\$1,858	\$2,154	\$2,163	\$(296)	(14)%	\$(9)	—%
Intersegment sales	1,038	877	1,105	161	18%	(228)	(21)%
Total sales	2,896	3,031	3,268	(135)	(4)%	(237)	(7)%
Depreciation and amortization	53	50	47	(3)	(6)%	(3)	(6)%
Research, development and engineering expenses	77	73	76	(4)	(5)%	3	4%
Equity, royalty and interest income from investees	39	32	40	7	22%	(8)	(20)%
Interest income	3	6	9	(3)	(50)%	(3)	(33)%
Segment EBIT	168	218	285	(50)	(23)%	(67)	(24)%

				Percentage Points		Percentage Points	
Segment EBIT as a percentage of total sales	5.8	% 7.2	% 8.7	%	(1.4)	(1.5)	

Sales for our Power Generation segment by business were as follows:

In millions	Years ended December 31,			Favorable/(Unfavorable)			
	2014	2013	2012	2014 vs. 2013		2013 vs. 2012	
				Amount	Percent	Amount	Percent
Power products	\$1,669	\$1,725	\$1,654	\$(56)	(3)%	\$71	4%
Power systems	631	656	757	(25)	(4)%	(101)	(13)%
Alternators	449	496	566	(47)	(9)%	(70)	(12)%
Power solutions	147	154	291	(7)	(5)%	(137)	(47)%
Total sales	\$2,896	\$3,031	\$3,268	\$(135)	(4)%	\$(237)	(7)%

2014 vs. 2013

Sales

Power Generation segment sales decreased in all lines of business and across most markets versus 2013, primarily due to lower industrial activity. The following are the primary drivers by business:

• Power products sales decreased primarily due to lower demand in North America driven by declining military sales and lower demand in India, Mexico and Russia, partially offset by increases in China, Africa and Western Europe.

• Alternators sales decreased due to lower demand in Western Europe, India and Asia, partially offset by increased demand in the U.K. and China.

• Power systems sales decreased primarily due to reduced demand in North America and Western Europe, partially offset by higher demand in Latin America and Brazil.

• Foreign currency fluctuations unfavorably impacted sales (primarily in India and Brazil).

## Operating Actions

Power Generation took multiple actions in the fourth quarter of 2014 to reduce its future cost structure. Costs associated with these actions were \$32 million and are primarily related to the closure of a plant in Germany. We also initiated other targeted actions throughout the business including various headcount reductions to better align capacity with the current levels of demand. These actions resulted in a Power Generation headcount reduction of approximately 250 employees and unfavorable impacts to gross margin of \$22 million, selling, general and administrative expense of \$6 million and research and development expenses of \$4 million. The majority of these costs were accrued as of December 31, 2014, and will be paid in 2015.



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## Segment EBIT

Power Generation segment EBIT decreased versus 2013, primarily due to lower gross margin, higher selling, general and administrative expenses and higher research, development and engineering expenses, partially offset by higher equity, royalty and interest income from investees. Major components of EBIT and related changes to segment EBIT and EBIT as a percentage of sales were as follows:

In millions	Year ended December 31, 2014 vs. 2013		
	Favorable/(Unfavorable) Change		
	Amount	Percent	Percentage point change as a percent of sales
Gross margin	\$(32)	(6)	% (0.2)
Selling, general and administrative expenses	(16)	(5)	% (1.0)
Research, development and engineering expenses	(4)	(5)	% (0.3)
Equity, royalty and interest income from investees	7	22	% 0.2

The decrease in gross margin versus 2013 was primarily due to lower volume, operating actions taken in the fourth quarter of 2014 and unfavorable foreign currency fluctuations (primarily in Europe), partially offset by higher warranty costs and favorable mix. The increase in selling, general and administrative expenses and research, development and engineering expenses was primarily due to operating actions taken in the fourth quarter of 2014 and higher compensation expenses. The favorable increase in equity, royalty and interest income from investees was due to an \$8 million impairment charge of an equity method investment in 2013.

2013 vs. 2012

## Sales

Power Generation segment sales decreased versus 2012, primarily due to lower demand in the power solutions and power systems businesses. The following are the primary drivers by business:

• Power solutions sales decreased primarily due to lower volumes in the U.K., partially offset by increased sales in Asia.

• Power systems sales decreased primarily due to reduced demand in India, the Middle East, China, Asia and Russia, partially offset by increased sales in Western Europe.

• Alternators sales decreased primarily due to demand reductions in Europe, the U.K. and India.

The decreases above were partially offset by power products as sales increased primarily due to higher volumes in North America and improved price realization. These increases were partially offset by demand reductions in India and Asia and unfavorable foreign currency fluctuations.

## Segment EBIT

Power Generation segment EBIT decreased versus 2012, primarily due to lower gross margin, partially offset by lower selling, general and administrative expenses. Power Generation segment EBIT for 2013 included an \$8 million legal settlement and an \$8 million impairment charge for the write-off of an equity method investment, while segment EBIT for 2012 included restructuring and other charges of \$12 million. Major components of EBIT and related changes to segment EBIT and EBIT as a percentage of sales were as follows:

In millions	Year ended December 31, 2013 vs. 2012		
	Favorable/(Unfavorable) Change		
	Amount	Percent	Percentage point change as a percent of sales
Gross margin	\$(70)	(11)	% (0.9)
Selling, general and administrative expenses	14	4	% (0.3)
Research, development and engineering expenses	3	4	% (0.1)
Equity, royalty and interest income from investees	(8)	(20)	% (0.1)

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The decrease in gross margin versus 2012 was due to lower volumes, partially offset by improved price realization and favorable foreign currency fluctuations. The decreases in selling, general and administrative expenses and research, development and engineering expenses were primarily due to the absence of restructuring charges incurred in the fourth quarter of 2013 and lower discretionary spending to align with slowing demand in key markets. The decrease in equity, royalty and interest income from investees was due to an \$8 million impairment charge of an equity method investment in 2013.

## Reconciliation of Segment EBIT to Income Before Income Taxes

The table below reconciles the segment information to the corresponding amounts in the Consolidated Statements of Income.

In millions	Years ended December 31,		
	2014	2013	2012
Total segment EBIT	\$2,568	\$2,174	\$2,328
Non-segment EBIT <sup>(1)</sup>	(70	) (14	) (25
Total EBIT	2,498	2,160	2,303
Less: Interest expense	64	41	32
Income before income taxes	\$2,434	\$2,119	\$2,271

<sup>(1)</sup> Includes intersegment sales and profit in inventory eliminations and unallocated corporate expenses. The year ended December 31, 2012, included a \$20 million charge (\$12 million after-tax) related to legal matters. The gains and losses have been excluded from segment results as they were not considered in our evaluation of operating results for the year ended December 31, 2012.

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## LIQUIDITY AND CAPITAL RESOURCES

## Management's Assessment of Liquidity

Our financial condition and liquidity remain strong. Our solid balance sheet and credit ratings enable us to have ready access to credit and the capital markets.

We assess our liquidity in terms of our ability to generate adequate cash to fund our operating, investing and financing activities. We generate significant ongoing cash flow, which has been used, in part, to fund repurchases of common stock, capital expenditures, dividends on our common stock and acquisitions. Cash provided by operations is our principal source of liquidity. As of December 31, 2014, other sources of liquidity included:

- cash and cash equivalents of \$2.3 billion, of which approximately 41 percent was located in the U.S. and 59 percent was located outside the U.S., primarily in the U.K., China, Singapore and Belgium,
- revolving credit facility with \$1.73 billion available, net of letters of credit,
- international and other domestic short-term credit facilities with \$261 million available and
- marketable securities of \$93 million, of which 65 percent is located in India, 29 percent is located in the U.S., and 6 percent is located in Brazil and the majority of which could be liquidated into cash within a few days.

Our revolving credit agreement provides us with a \$1.75 billion unsecured revolving credit facility, the proceeds of which are to be used for our general corporate purposes. In the fourth quarter of 2014, we exercised our option to extend the maturity date of our revolving credit agreement by one year from November 9, 2017, to November 9, 2018. See Note 9, "DEBT," to our Consolidated Financial Statements for further information. The credit agreement includes one financial covenant: a leverage ratio. The required leverage ratio, which measures the sum of total debt plus securitization financing to consolidated earnings before interest, taxes, depreciation and amortization (EBITDA) for the four fiscal quarters may not exceed 3.25 to 1.0. At December 31, 2014, our leverage ratio was 0.6 to 1.0.

We have a current shelf registration filed with the Securities and Exchange Commission under which we may offer, from time to time, debt securities, common stock, preferred and preference stock, depositary shares, warrants, stock purchase contracts and stock purchase units.

We believe our liquidity provides us with the financial flexibility needed to fund working capital, common stock repurchases, capital expenditures, dividend payments, acquisitions of our North American distributors, projected pension obligations and debt service obligations. We continue to generate cash from operations in the U.S. and maintain access to \$1.7 billion of our revolver as noted above.

A significant portion of our cash flow is generated outside the U.S. As of December 31, 2014, the total of cash, cash equivalents and marketable securities held by foreign subsidiaries was \$1.4 billion, the vast majority of which was located in the U.K., China, Singapore, Belgium and India. The geographic location of our cash and marketable securities aligns well with our business growth strategy. We manage our worldwide cash requirements considering available funds among the many subsidiaries through which we conduct our business and the cost effectiveness with which those funds can be accessed. As a result, we do not anticipate any local liquidity restrictions to preclude us from funding our targeted expansion or operating needs with local resources.

If we distribute our foreign cash balances to the U.S. or to other foreign subsidiaries, we could be required to accrue and pay U.S. taxes. For example, we would be required to accrue and pay additional U.S. taxes if we repatriated cash from certain foreign subsidiaries whose earnings we have asserted are permanently reinvested outside of the U.S. Foreign earnings for which we assert permanent reinvestment outside the U.S. consist primarily of earnings of our China and U.K. domiciled subsidiaries. At present, we do not foresee a need to repatriate any earnings from these subsidiaries for which we have asserted permanent reinvestment. However, to help fund cash needs of the U.S. or other international subsidiaries as they arise, we repatriate available cash from certain foreign subsidiaries whose earnings are not permanently reinvested when it is cost effective to do so. Earnings generated after 2011 from our China operations are considered permanently reinvested, while earnings generated prior to 2012, for which U.S. deferred tax liabilities have been recorded, are expected to be repatriated in future years.

The maturity schedule of our existing long-term debt does not require significant cash outflows in the intermediate term. Required annual principal payments range from \$11 million to \$28 million over each of the next five years.



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## Working Capital Summary

We fund our working capital with cash from operations and short-term borrowings when necessary. Various assets and liabilities, including short-term debt, can fluctuate significantly from month to month depending on short-term liquidity needs. As a result, working capital is a prime focus of management attention.

In millions	2014	2013	Change 2014 vs. 2013		
			Amount	Percent	
Cash and cash equivalents	\$2,301	\$2,699	\$(398)	(15)	%
Marketable securities	93	150	(57)	(38)	%
Accounts and notes receivable, net	2,946	2,649	297	11	%
Inventories	2,866	2,381	485	20	%
Prepaid expenses and other current assets	849	760	89	12	%
Current assets	9,055	8,639	416	5	%
Current maturity of long-term debt, accounts and loans payable	1,990	1,625	365	22	%
Current portion of accrued product warranty	363	360	3	1	%
Accrued compensation, benefits and retirement costs	508	433	75	17	%
Taxes payable (including taxes on income)	70	99	(29)	(29)	%
Other accrued expenses	1,090	851	239	28	%
Current liabilities	4,021	3,368	653	19	%
Working capital	\$5,034	\$5,271			
Current ratio	2.25	2.57			
Days' sales in receivables	53	54			
Inventory turnover	5.3	5.4			

Current assets increased 5 percent compared to 2013, primarily due to increases in inventories and accounts and notes receivable principally due to the acquisitions of North American distributors in 2014. The increases were partially offset by a decrease in cash and marketable securities, primarily due to lower proceeds from borrowings and \$670 million of share repurchases in 2014.

Current liabilities increased 19 percent compared to 2013, primarily due to an increase in trade accounts payable and an increase in other accrued expenses.

Inventory turnover decreased 0.1 turns compared to 2013. The decrease was primarily due to higher inventory balances related to the consolidation of six North American distributors in 2014, which added \$379 million of inventory at December 31, 2014.

## Cash Flows

Cash and cash equivalents decreased \$398 million during 2014, compared to an increase of \$1,330 million during the comparable period in 2013. The changes impacting cash and cash equivalents were as follows:



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## Operating Activities

In millions	Years ended December 31,			Change	
	2014	2013	2012	2014 vs. 2013	2013 vs. 2012
Consolidated net income	\$1,736	\$1,588	\$1,738	\$148	\$(150)
Depreciation and amortization	455	407	361	48	46
Gain on fair value adjustment for consolidated investees	(73)	(12)	(7)	(61)	(5)
Deferred income taxes	31	100	116	(69)	(16)
Equity in income of investees, net of dividends	(100)	(62)	(15)	(38)	(47)
Pension contributions in excess of expense	(148)	(82)	(68)	(66)	(14)
Other post-retirement benefits payments in excess of expense	(27)	(25)	(21)	(2)	(4)
Stock-based compensation expense	36	37	36	(1)	1
Translation and hedging activities	(13)	17	—	(30)	17
Changes in current assets and liabilities, net of acquisitions					
Accounts and notes receivable	(89)	(148)	87	59	(235)
Inventories	(256)	(46)	(32)	(210)	(14)
Other current assets	1	212	(60)	(211)	272
Accounts payable	244	163	(256)	81	419
Accrued expenses	168	(246)	(514)	414	268
Changes in other liabilities and deferred revenue	282	211	214	71	(3)
Other, net	19	(25)	(47)	44	22
Net cash provided by operating activities	\$2,266	\$2,089	\$1,532	\$177	\$557

## 2014 vs. 2013

Net cash provided by operating activities increased versus 2013 primarily due to higher consolidated net income and favorable working capital fluctuations, partially offset by unfavorable deferred income taxes and higher pension contributions in excess of expense. During 2014, the lower working capital resulted in a cash inflow of \$68 million compared to a cash outflow of \$65 million in 2013. This change of \$133 million was primarily driven by an increase in accrued expenses and accounts payable, partially offset by an increase in other current assets and inventories in 2014, versus the comparable period in 2013. The increase in accrued expenses was primarily due to higher income taxes payable, while the change in other current assets was largely due to the receipt of an income tax refund in 2013.

## Pensions

The funded status of our pension plans is dependent upon a variety of variables and assumptions including return on invested assets, market interest rates and levels of voluntary contributions to the plans. In 2014, the investment return on our U.S. pension trust was 13.3 percent while our U.K. pension trust return was 16.8 percent. Approximately 78 percent of our pension plan assets are held in highly liquid investments such as fixed income and equity securities. The remaining 22 percent of our plan assets are held in less liquid, but market valued investments, including real estate, private equity and insurance contracts. We made \$205 million of pension contributions in 2014, including \$111 million of voluntary contributions. Claims and premiums for other postretirement benefits approximated \$45 million, net of reimbursements, in 2014. These contributions and payments include transfers from our funds either to increase pension plan assets or to make direct payments to plan participants. We anticipate making total contributions of \$175 million to our defined benefit pension plans in 2015. Expected contributions to our defined benefit pension plans in 2015 will meet or exceed the current funding requirements.

## 2013 vs. 2012

Net cash provided by operating activities increased versus 2012 primarily due to favorable working capital fluctuations, partially offset by lower consolidated net income and lower dividends received from equity investees. During 2013, the net increase in working capital resulted in a cash outflow of \$65 million compared to a cash outflow of \$775 million in 2012. This change of \$710 million was primarily driven by an increase in accounts payable due to timing differences, lower net tax payments of \$311 million due to the receipt of income tax refunds in 2013, which were partially offset by tax payments, and a smaller decrease in accrued expenses, partially offset by an increase in

accounts and notes receivable in 2013 as a result of higher sales in the fourth quarter of 2013 versus 2012.

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## Investing Activities

In millions	Years ended December 31,			Change	
	2014	2013	2012	2014 vs. 2013	2013 vs. 2012
Capital expenditures	\$(743 )	\$(676 )	\$(690 )	\$(67 )	\$14
Investments in internal use software	(55 )	(64 )	(87 )	9	23
Investments in and advances to equity investees	(60 )	(42 )	(70 )	(18 )	28
Acquisitions of businesses, net of cash acquired	(436 )	(147 )	(215 )	(289 )	68
Investments in marketable securities—acquisitions	(275 )	(418 )	(561 )	143	143
Investments in marketable securities—liquidations	336	525	585	(189 )	(60 )
Purchases of other investments	—	(40 )	—	40	(40 )
Cash flows from derivatives not designated as hedges	(14 )	1	12	(15 )	(11 )
Other, net	13	15	44	(2 )	(29 )
Net cash used in investing activities	\$(1,234 )	\$(846 )	\$(982 )	\$(388 )	\$136

## 2014 vs. 2013

Net cash used in investing activities increased versus 2013 primarily due to higher cash investment for the acquisition of businesses in 2014 and higher capital expenditures, partially offset by reduced purchases of corporate owned life insurance.

In 2014, we spent \$436 million, net of cash acquired, on acquisitions of businesses in the Distribution segment. We plan to spend an additional \$170 million to \$210 million on North American distributor acquisitions and related debt retirements in 2015.

Capital expenditures were \$743 million in 2014 compared to \$676 million in 2013. Despite the challenging international economies, we continue to invest in new product lines and targeted capacity expansions. We plan to spend between \$750 million and \$850 million in 2015 as we continue with product launches, facility improvements and prepare for future emission standards. Approximately 50 percent of our capital expenditures are expected to be invested outside of the U.S. in 2015.

## 2013 vs. 2012

Net cash used in investing activities decreased versus 2012 primarily due to lower net investments in marketable securities, lower cash investments in acquisitions of businesses and lower investments in and advances to equity investees, partially offset by purchases of corporate owned life insurance.

## Financing Activities

In millions	Years ended December 31,			Change	
	2014	2013	2012	2014 vs. 2013	2013 vs. 2012
Proceeds from borrowings	\$55	\$1,004	\$64	\$(949 )	\$940
Payments on borrowings and capital lease obligations	(94 )	(90 )	(145 )	(4 )	55
Distributions to noncontrolling interests	(83 )	(75 )	(62 )	(8 )	(13 )
Dividend payments on common stock	(512 )	(420 )	(340 )	(92 )	(80 )
Repurchases of common stock	(670 )	(381 )	(256 )	(289 )	(125 )
Other, net	(39 )	14	45	(53 )	(31 )
Net cash (used in) provided by financing activities	\$(1,343 )	\$52	\$(694 )	\$(1,395 )	\$746

## 2014 vs. 2013

Net cash used in financing activities increased versus 2013 primarily due to lower proceeds from borrowings. In September 2013, we issued \$1 billion aggregate principal amount of senior notes consisting of \$500 million aggregate principal amount of 3.65% senior unsecured notes due in 2023 and \$500 million aggregate principal amount of 4.875% senior unsecured notes due in 2043. Net proceeds from the issuance were \$979 million.

Our total debt was \$1.7 billion at December 31, 2014, compared with \$1.7 billion at December 31, 2013. Total debt as a percent of our total capital (total capital defined as debt plus equity) was 17.3 percent at December 31, 2014, compared with 18.1 percent at December 31, 2013.



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## 2013 vs. 2012

Net cash provided by financing activities increased versus 2012 primarily due to proceeds from the issuance of senior notes and lower payments on borrowings and capital lease obligations, partially offset by higher repurchases of common stock and higher dividend payments.

Our total debt was \$1.7 billion as of December 31, 2013, compared with \$775 million as of December 31, 2012. Total debt as a percent of our total capital was 18.1 percent at December 31, 2013, compared with 10.0 percent at December 31, 2012.

## Repurchase of Common Stock

We repurchased \$670 million of common stock under the 2012 Board of Directors authorized plan during 2014.

Quarterly purchases were as follows:

In millions (except per share amounts) For each quarter ended	Shares Purchased	Average Cost Per Share	Total Cost of Repurchases	Remaining Authorized Capacity <sup>(1)</sup>
March 30	3.0	\$139.70	\$419	\$425
June 29	0.1	148.11	11	415
September 28	1.2	139.76	175	240
December 31	0.5	132.66	65	174
Total	4.8	\$139.12	\$670	\$174

<sup>(1)</sup> The remaining authorized capacity is calculated based on the cost to purchase the shares, but excludes commission expenses according to the Board of Directors authorization.

In July 2014, our Board of Directors authorized the acquisition of up to \$1 billion of additional common stock upon the completion of the 2012 repurchase plan.

## Quarterly Dividends

Total dividends paid to common shareholders in 2014, 2013 and 2012 were \$512 million, \$420 million and \$340 million respectively. Declaration and payment of dividends in the future depends upon our income and liquidity position, among other factors, and is subject to declaration by our Board of Directors, who meet quarterly to consider our dividend payment. We expect to fund dividend payments with cash from operations.

In July 2014, the Board of Directors authorized a dividend increase of approximately 25 percent from \$0.625 per share to \$0.78 per share on a quarterly basis. In July 2013, the Board of Directors authorized a 25 percent increase to our quarterly cash dividend on our common stock from \$0.50 per share to \$0.625 per share. In July 2012, the Board of Directors authorized a 25 percent increase to our quarterly cash dividend on our common stock from \$0.40 per share to \$0.50 per share. Cash dividends per share paid to common shareholders for the last three years were as follows:

	Quarterly Dividends		
	2014	2013	2012
First quarter	\$0.625	\$0.50	\$0.40
Second quarter	0.625	0.50	0.40
Third quarter	0.78	0.625	0.50
Fourth quarter	0.78	0.625	0.50
Total	\$2.81	\$2.25	\$1.80

## Credit Ratings

A number of our contractual obligations and financing agreements, such as our revolving credit facility, have restrictive covenants and/or pricing modifications that may be triggered in the event of downward revisions to our corporate credit rating. There were no downgrades of our credit ratings in 2014 that have impacted these covenants or pricing modifications. In December 2014, Moody's Investors Service, Inc. raised our rating to 'A2' and confirmed our outlook as stable. In October 2014, Fitch Ratings reaffirmed our rating and outlook. In August 2014, Standard & Poor's Ratings Services raised our rating to 'A+' and confirmed our outlook as stable.



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Credit ratings are not recommendations to buy, are subject to change and each rating should be evaluated independently of any other rating. In addition, we undertake no obligation to update disclosures concerning our credit ratings, whether as a result of new information, future events or otherwise. Our ratings and outlook from each of the credit rating agencies as of the date of filing are shown in the table below.

Credit Rating Agency	Senior L-T Debt Rating	Outlook
Standard & Poor's Rating Services	A+	Stable
Fitch Ratings	A	Stable
Moody's Investors Service, Inc.	A2	Stable

**CONTRACTUAL OBLIGATIONS AND OTHER COMMERCIAL COMMITMENTS**

A summary of payments due for our contractual obligations and commercial commitments, as of December 31, 2014, is as follows:

**Contractual Cash Obligations**

In millions	2015	2016-2017	2018-2019	After 2019	Total
Loans payable	\$86	\$—	\$—	\$—	\$86
Long-term debt and capital lease obligations <sup>(1)</sup>	121	225	194	3,010	3,550
Operating leases	152	223	152	105	632
Capital expenditures	218	53	—	—	271
Purchase commitments for inventory	644	—	—	—	644
Other purchase commitments	378	85	16	11	490
Pension funding <sup>(2)</sup>	87	—	—	—	87
Other postretirement benefits	40	74	64	230	408
Total	\$1,726	\$660	\$426	\$3,356	\$6,168

<sup>(1)</sup> Includes principal payments and expected interest payments based on the terms of the obligations.

<sup>(2)</sup> We are contractually obligated in the U.K. to fund \$87 million in 2015; however, our expected total pension contributions for 2015, including the U.K., are approximately \$175 million.

The contractual obligations reported above exclude our unrecognized tax benefits of \$174 million as of December 31, 2014. We are not able to reasonably estimate the period in which cash outflows relating to uncertain tax contingencies could occur. See Note 4, "INCOME TAXES," to the Consolidated Financial Statements for further details.

Our other commercial commitments as of December 31, 2014, are as follows

**Other Commercial Commitments**

In millions	2015	2016-2017	2018-2019	After 2019	Total
Standby letters of credit under revolving credit agreements	\$23	\$1	\$—	\$—	\$24
International and other domestic letters of credit	46	30	—	7	83
Performance and excise bonds	70	6	—	—	76
Guarantees, indemnifications and other commitments	4	1	—	—	5
Total	\$143	\$38	\$—	\$7	\$188

**APPLICATION OF CRITICAL ACCOUNTING ESTIMATES**

A summary of our significant accounting policies is included in Note 1, "SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES," of our Consolidated Financial Statements which discusses accounting policies that we have selected from acceptable alternatives.

Our Consolidated Financial Statements are prepared in accordance with GAAP which often requires management to make judgments, estimates and assumptions regarding uncertainties that affect the reported amounts presented and disclosed in the financial statements. Management reviews these estimates and assumptions based on historical experience, changes in business conditions and other relevant factors they believe to be reasonable under the circumstances. In any given reporting period, our actual results may differ from the estimates and assumptions used in

preparing our Consolidated Financial Statements.

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Critical accounting estimates are defined as follows: the estimate requires management to make assumptions about matters that were highly uncertain at the time the estimate was made; different estimates reasonably could have been used; or if changes in the estimate are reasonably likely to occur from period to period and the change would have a material impact on our financial condition or results of operations. Our senior management has discussed the development and selection of our accounting policies, related accounting estimates and the disclosures set forth below with the Audit Committee of our Board of Directors. We believe our critical accounting estimates include those addressing the estimation of liabilities for warranty programs, accounting for income taxes and pension benefits.

Warranty Programs

We estimate and record a liability for base warranty programs at the time our products are sold. Our estimates are based on historical experience and reflect management's best estimates of expected costs at the time products are sold and subsequent adjustment to those expected costs when actual costs differ. As a result of the uncertainty surrounding the nature and frequency of product recall programs, the liability for such programs is recorded when we commit to a recall action or when a recall becomes probable and estimable, which generally occurs when it is announced. Our warranty liability is generally affected by component failure rates, repair costs and the point of failure within the product life cycle. Future events and circumstances related to these factors could materially change our estimates and require adjustments to our liability. New product launches require a greater use of judgment in developing estimates until historical experience becomes available. Product specific experience is typically available four or five quarters after product launch, with a clear experience trend evident eight quarters after launch. We generally record warranty expense for new products upon shipment using a preceding product's warranty history and a multiplicative factor based upon preceding similar product experience and new product assessment until sufficient new product data is available for warranty estimation. We then use a blend of actual new product experience and preceding product historical experience for several subsequent quarters, and new product specific experience thereafter. Note 10, "PRODUCT WARRANTY LIABILITY," to our Consolidated Financial Statements contains a summary of the activity in our warranty liability account for 2014 and 2013 including adjustments to pre-existing warranties.

Accounting for Income Taxes

We determine our income tax expense using the asset and liability method. Under this method, deferred tax assets and liabilities are recognized for the future tax effects of temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future tax benefits of tax loss and credit carryforwards are also recognized as deferred tax assets. We evaluate the recoverability of our deferred tax assets each quarter by assessing the likelihood of future profitability and available tax planning strategies that could be implemented to realize our net deferred tax assets. At December 31, 2014, we recorded net deferred tax assets of \$184 million. These assets included \$190 million for the value of tax loss and credit carryforwards. A valuation allowance of \$144 million was recorded to reduce the tax assets to the net value management believed was more likely than not to be realized. In the event our operating performance deteriorates, future assessments could conclude that a larger valuation allowance will be needed to further reduce the deferred tax assets. In addition, we operate within multiple taxing jurisdictions and are subject to tax audits in these jurisdictions. These audits can involve complex issues, which may require an extended period of time to resolve. We accrue for the estimated additional tax and interest that may result from tax authorities disputing uncertain tax positions we have taken and we believe we have made adequate provision for income taxes for all years that are subject to audit based upon the latest information available. A more complete description of our income taxes and the future benefits of our tax loss and credit carryforwards is disclosed in Note 4, "INCOME TAXES," to our Consolidated Financial Statements.

Pension Benefits

We sponsor a number of pension plans primarily in the U.S. and the U.K. and to a lesser degree in various other countries. In the U.S. and the U.K. we have several major defined benefit plans that are separately funded. We account for our pension programs in accordance with employers' accounting for defined benefit pension and other postretirement plans under GAAP. GAAP requires that amounts recognized in financial statements be determined using an actuarial basis. As a result, our pension benefit programs are based on a number of statistical and judgmental assumptions that attempt to anticipate future events and are used in calculating the expense and liability related to our plans each year at December 31. These assumptions include discount rates used to value liabilities, assumed rates of

return on plan assets, future compensation increases, employee turnover rates, actuarial assumptions relating to retirement age, mortality rates and participant withdrawals. The actuarial assumptions we use may differ significantly from actual results due to changing economic conditions, participant life span and withdrawal rates. These differences may result in a material impact to the amount of net periodic pension cost to be recorded in our Consolidated Financial Statements in the future.

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The expected long-term return on plan assets is used in calculating the net periodic pension cost. We considered several factors in developing our expected rate of return on plan assets. The long-term rate of return considers historical returns and expected returns on current and projected asset allocations and is generally applied to a five-year average market value of return. Projected returns are based primarily on broad, publicly traded fixed income and equity indices and forward-looking estimates of active portfolio and investment management. As of December 31, 2014, based upon our target asset allocations, it is anticipated that our U.S. investment policy will generate an average annual return over the 10-year projection period equal to or in excess of 7.5 percent approximately 20 percent of the time while returns of 8.0 percent or greater are anticipated 15 percent of the time. We expect additional positive returns from active investment management. The 2014 one-year return of 13.3 percent, combined with the very favorable returns since 2010, has resulted in approximately \$470 million of actuarial gains in accumulated other comprehensive income over the past five years. Based on the historical returns and forward-looking return expectations, we believe an investment return assumption of 7.5 percent per year in 2015 for U.S. pension assets is reasonable.

The methodology used to determine the rate of return on pension plan assets in the U.K. was based on establishing an equity-risk premium over current long-term bond yields adjusted based on target asset allocations. As of December 31, 2014, based upon our target asset allocations, it is anticipated that our U.K. investment policy will generate an average annual return over the 20-year projection period equal to or in excess of 5.2 percent approximately 50 percent of the time while returns of 6.1 percent or greater are anticipated 25 percent of the time. We expect additional positive returns from active investment management. The one-year return for our U.K. plan was 16.8 percent for 2014, and similar to our U.S. plan, the strong returns over the past five years have resulted in approximately \$285 million of actuarial gains in accumulated other comprehensive income. Our strategy with respect to our investments in pension plan assets is to be invested with a long-term outlook. Therefore, the risk and return balance of our asset portfolio should reflect a long-term horizon. Based on the historical returns and forward-looking return expectations, we believe an investment return assumption of 5.8 percent in 2015 for U.K. pension assets is reasonable. Our pension plan asset allocations at December 31, 2014 and 2013 and target allocation for 2015 are as follows:

Investment description	U.S. Plans			U.K. Plans			
	Target Allocation	Percentage of Plan Assets at December 31,		Target Allocation	Percentage of Plan Assets at December 31,		
	2015	2014	2013	2015	2014	2013	
Fixed income	64.0	% 65.7	% 57.4	% 50.0	% 56.0	% 46.9	%
Equity securities	22.0	% 22.9	% 30.5	% 25.5	% 32.0	% 39.5	%
Real estate/other	14.0	% 11.4	% 12.1	%			