Cummins

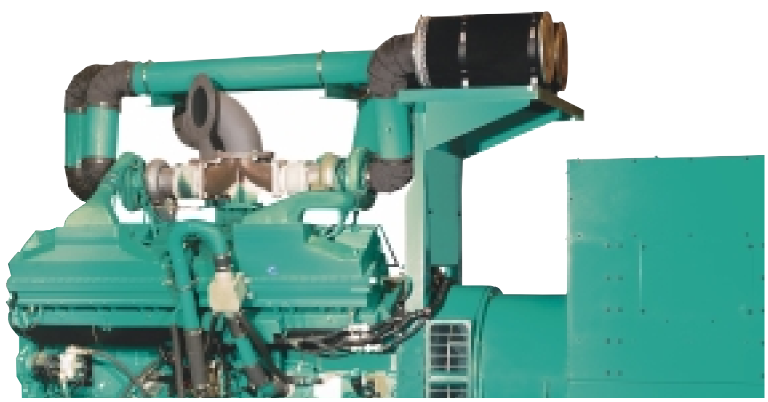
Annual Report
1999

Business Unit	Products	Customers and Markets
Engine Business Largest supplier of diesel engines for the North American heavy-duty truck market and leading global supplier of diesel and natural gas engines for heavy-duty trucks, medium-duty trucks, buses, and recreational vehicles (RVs). Exclusive supplier of diesel engines for the Dodge Ram pickup truck. A leading global supplier of engines for the agriculture, construction, government, mining, rail and marine markets.	• **Medium-duty engines** ISB and ISC for light commercial automotive, truck, transit bus, RVs, and specialty vehicles. Automotive applications are available in diesel and alternate-fueled versions from 175 horsepower to 350 horsepower. B3.3, B3.9, B5.9, QSB, QSC for agriculture, construction and marine applications from 55 to 340 horsepower. • **Heavy-duty engines** ISL, ISM, N14, ISX and Signature Series for trucking applications from 280 to 650 horsepower. QSM, M11, N14 and QSX15 engines for construction, mining, marine, and agriculture applications from 225 to 600 horsepower. • **High-horsepower engines** QSK19, V903, QST30, K38/50, QSK45 and QSK60 for marine, rail, mining and government applications from 295 to 2,700 horsepower.	• Two broad classes of customers: Original equipment manufacturers (OEMs) who install Cummins engines in their vehicles and equipment, and end-use customers who use the Cummins-powered equipment in their business endeavors.
Power Generation Global supplier of diesel and natural gas-powered generator sets and generator set components from 5kW to multi-megawatt installations. North American market leader in auxiliary generator sets for recreational vehicles (RVs) and recreational marine applications.	• **Power Systems** Diesel and natural gas-powered generator sets; digital control systems; paralleling switchgear. • **Mobile Systems** Onan gasoline, liquified propane, and diesel-fueled auxiliary generator sets from 3kW to 12.5kW and associated controls. • **Alternators** Newage synchronous AC alternators and associated control systems.	• Public- and investor-owned utilities; telecommunications providers; self-generating manufacturers; any business or public facility with a need for self-generated or standby power. • RV, specialty vehicle and marine pleasurecraft OEMs. • Alternators for industrial, marine, commercial, construction, telecommunications, mining and other standby or continuous power applications.
Filtration and Other Global leader of advanced integrated filtration systems for heavy-duty equipment, both on- and off-highway. Leading North American supplier of filtration and silencing systems for gas turbine, industrial, small engine and passenger car applications. "Other" includes Holset turbochargers and company-owned distributorships.	• **Heavy-Duty Systems** Air intake filtration, emission and noise reduction, engine filtration and mobile hydraulic filtration systems. • **Small Engine Systems** Air intake filtration and exhaust systems. • **Other Systems** Air intake and silencing systems for gas turbine applications, in-tank filtration for passenger cars and hydraulic filtration for industrial applications. • All integrated systems sold under the Fleetguard and Nelson brand names. • **Turbochargers** Holset variable geometry, variable wastegate, power turbine, high pressure ratio and multi-stage solutions.	• OEMs, distributors, dealers and end users of heavy-duty on- and off-highway diesel-powered equipment. • OEMs of small engine systems for recreational, and lawn and garden equipment, both gasoline- and diesel-powered. • OEMs of gas turbine generators, industrial machinery, passenger cars and industrial hydraulic equipment including distribution. • Turbochargers for Cummins, Cummins joint ventures and selected OEM customers. • Cummins ownership of 16 distributorships links us closely to our end-use customers in strategic locations worldwide.

1999 Highlights

- Completed the replacement of the entire automotive product line as part of a $1.7 billion investment from 1994–1999, which included the ISB, ISC, ISL, ISM, ISX and Signature 600 engines.
- Introduced the QSM full authority electronic engine for marine markets.
- Introduced the QSK60 engine with up to 2,700 horsepower for powering mine haul trucks up to 300 tons and 90 cubic yard front-end loaders.
- Supplied a record number of ISB engines for the Dodge Ram pickup, powering over 100,000 trucks.
- Supplied 800 natural gas-powered engines for Beijing city buses.
- Expanded the QuickServe program to provide superior parts and service support to customers in all market segments.

- Profitability growth in excess of 100 percent due to restructuring steps taken during 1998.
- Introduced new generator set rental program in North America.
- Introduced new 2,000 kW generator set.
- Opened new national RV service center concept facility in North America.
- Unveiled natural gas-powered 81 and 91 liter engines to tap a market for clean, cost-effective heat and power systems.



- Launched global original equipment sales program, which led to increased market penetration in heavy-duty systems.
- Expanded small engine business by 27 percent.
- Introduced on-line catalogs, and continued to provide support from 12 worldwide customer service centers, capable of speaking 16 languages.
- Offered new million-mile exhaust system and coolant packages extending performance for the long term.

A powerful *performance*...

Cummins Engine Company, Inc. is a leading worldwide designer and manufacturer of diesel engines from 55 to 2,700 horsepower and the world's largest producer of diesel engines above 200 horsepower. The company provides products and services for customers in markets worldwide for engines, power generation and filtration, including engine components, natural gas engines, filtration systems and information products and services. In 1999, Cummins reported sales of $6.6 billion and employed 28,500 people.

Highlights

Cummins Engine Company, Inc.

$ Millions, except per share amounts	1999	1998
Net sales	$ 6,639	$ 6,266
Gross profit	1,418	1,249
Selling and administrative expenses	781	787
Research and engineering expenses	245	255
Other expense (income), net	8	(13)
Earnings before interest and taxes:		
Before unusual charges	356	282
As reported	296	65
Net earnings (loss)	160	(21)
Basic earnings (loss) per share	4.16	(0.55)
Diluted earnings (loss) per share	4.13	(0.55)
Dividends per share	1.125	1.10

Contents

Dear Fellow Shareholders:

Our 1998 Annual Report emphasized VALUE, the fundamental by which any endeavor is judged. At Cummins we recognize that companies delivering superior value to their shareholders over time are the ones that deliver superior value to their customers. To increase the value we deliver to shareholders and customers, we focused on PERFORMANCE throughout 1999.

Cummins 1999 performance represents a significant step toward achieving our financial goals. Revenue grew by six percent to $6.6 billion, thereby setting a record for the eighth consecutive year. Exclusive of a $60 million charge associated with the dissolution of our joint venture with Wärtsilä, Cummins Earnings Before Interest and Tax (EBIT) of $356 million were a record, and net earnings per share were $5.29, a 46 percent increase over 1998, excluding unusual charges. As reported, Cummins' EBIT was $296 million and net earnings per share were $4.13 in 1999.

As a result of stronger profits and a significant reduction in capital spending, free cash flow was $84 million, and we reduced our debt-to-capital ratio by three percentage points to 46 percent. We also returned value to our shareholders in 1999 by increasing our dividend, and we repurchased 650,000 shares of Cummins stock.

Our revenue and profit diversification continues to pay off. In 1999, strength in the North American heavy-duty truck market, record sales to DaimlerChrysler and improved profitability in power generation offset weakness in agricultural and mining markets. On the following pages, leaders of our three businesses — Engine, Power Generation, and Filtration — describe results and the outlook for their organizations.

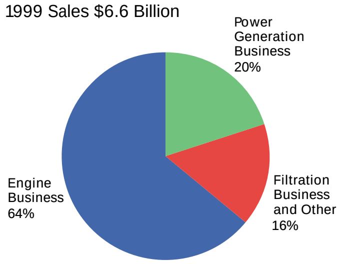
Performance for Our Shareholders
Our emphasis on performance enabled us to move toward our financial goal of earning nine percent before interest and taxes.

In 1998, we introduced several initiatives which were designed to improve profitability. These initiatives included improvement in product cost, operating expense and cash flow. Our people have made solid progress towards each intiative. We have benefited from lower production costs as volumes increase for our new engines. We have achieved substantial savings in material costs and we continue to work hard to improve product coverage costs. We have completed a highly successful program to reduce the costs of goods and services like office supplies, computers, freight, travel and health care, and teams are now cycling through the categories again, seeking further savings.

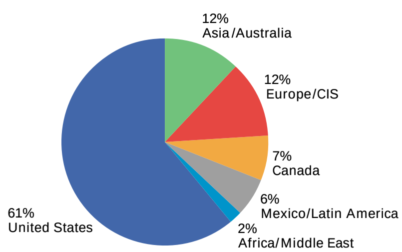
The restructuring we announced in the third quarter of 1998 was nearly complete by year-end 1999. Late in 1999, we concluded the sale of Atlas Crankshaft to ThyssenKrupp Automotive, one of the world's leading automotive suppliers. As a major supplier of crankshafts and camshafts, the new company, known as TKA Atlas, will continue to be an important supplier to Cummins.

Focused on *performance,*

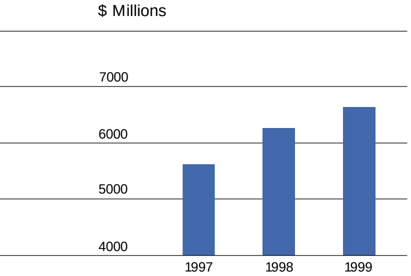
Sales by Segment
1999 Sales $6.6 Billion



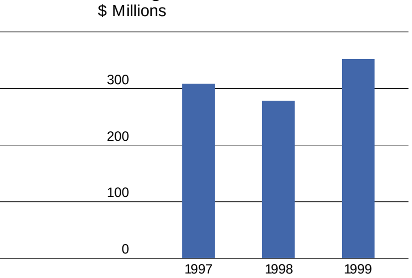
Sales by Geographic Region



Sales
$ Millions



Earnings Before Interest and Tax*
$ Millions



*Excludes unusual charges

In addition, as we announced in December, Cummins and Wärtsilä NSD of Finland have agreed to dissolve the joint venture formed in 1995 to design and develop two families of high-speed, high-horsepower engines. Now that engine development has been completed, each company will focus its sales and distribution network on the engines that have the greatest potential for growth in its own markets. Cummins will retain responsibility for diesel and natural gas engines produced at our plant in Daventry, England, and Cummins and Wärtsilä will continue to be customers and suppliers of each other.

We continue to be pleased with the growth prospects and profit opportunities of our other joint ventures around the world.

Information technology, which is revolutionizing business, is enabling Cummins to create a comparative advantage for our customers. We are the exclusive supplier of software for the electronic control modules on all our engines, and we are actively devising more ways to offer value over the product lifecycle by using the Internet and increasingly sophisticated communication methods and service tools. We continue to use information technology to operate more efficiently, improve customer service and accelerate growth in business and consumer markets, thereby creating sustainable value for our shareholders.

In addition, we are working hard to build on our alliances with OEM customers, moving beyond simple buy-sell relationships to partnerships which involve, in many cases, product design, manufacturing and distribution. One successful example is our partnership with Iveco and CNH Global NV (formerly Case and New Holland) through the European Engine Alliance (EEA), which was formed to design and manufacture midrange engines, as well as a new generation of one-litre-per-cylinder diesel engines. Another important alliance partner is Komatsu Ltd., with whom we have three joint ventures, the scope of which includes the joint manufacture of midrange and high-horsepower engines as well as technical collaboration regarding the design and development of new engines for industrial markets.

People — the Key to Performance
As a global company, we understand that having a diverse, achievement-oriented workforce is the key to continuously improving performance. Our people in plants, offices and distributorships around the world are extraordinarily talented and dedicated. To enable them to give their best, we are committed to providing a safe working environment, clear performance expectations and two-way communication which enables them to share ideas.

Performance for the Future
Around the world, businesses in the industries which we supply, including many of our customers, are consolidating. In addition, many countries are mandating that diesel engines meet increasingly stringent emissions requirements, and natural gas-fueled engines are emerging as an attractive option for more and more customers. As a global, independent engine manufacturer, Cummins is uniquely well equipped to thrive in this new environment. Our comprehensive product line, which includes natural gas engines over a wide range of horsepower levels, is the most advanced in the industry. Our leadership in air-handling systems, fuel systems, electronics and emissions control makes Cummins a logical supplier and alliance partner to companies in many markets worldwide.

driven by results.

Performance for Our Customers
Cummins has the most advanced and complete engine product line in the industry. In 1999, we completed the major cycle of product development which we began in 1994 — upgrading or replacing every engine in our product line and adding new engines at both ends of our horsepower spectrum. Our engines, which range from 55 to 2,700 horsepower, feature advanced electronics, combustion, and fluid- and air-handling technology. Our engines, generator sets, turbochargers and filtration technologies give our customers cost-effective performance while contributing to a cleaner environment. As the industry's technical leader, we will continue to invest substantial resources to meet increasingly tough emissions standards and rising customer expectations.

The Policy Committee leads the focus
on performance.

Members of the Committee:
(from left to right) Christine Vujovich,
Kiran Patel, Jack Edwards, Jean Blackwell,
Tim Solso, Mark Gerstle, Joe Loughrey,
Pamela Carter, Frank McDonald, Rick Mills

Today's global business environment is fiercely competitive. Tomorrow's will be even more so. We believe that this environment is tailor-made for Cummins' continued success.

We are focused on continuing to improve our financial performance in 2000. While there is uncertainty and possible decline in the North American heavy-duty truck market, we expect to offset any revenue and margin loss with gains from our power generation, filtration, and international markets. We also expect continuing, intense cost reduction efforts to contribute to higher margins.

Cummins enters the new millennium as a balanced, global company positioned well to weather downturns. We have a diverse, seasoned group of managers in place, and we are focusing relentlessly on performance for our customers and our shareholders.

The Cummins management team invites you to join us on Tuesday, April 4 for our annual shareholders' meeting to learn more about today's performance and tomorrow's potential.

Tim Solso

Tim Solso
Chairman and
Chief Executive Officer
Cummins Engine Company, Inc.
March 1, 2000

Transition

Cummins' entry into the twenty-first century is marked by some significant transitions, including the retirement of three members of our Board of Directors.

At the end of 1999, Jim Henderson retired from Cummins after serving five years as Chairman and Chief Executive Officer, eighteen as President and Chief Operating Officer and twenty-six as a member of the Board of Directors. Throughout his thirty-five years with the company, Jim has been dedicated to innovation and involving Cummins people in improvement for our customers. In the 1970s, Jim led the way in introducing team-based work systems to U.S. industry. Faced with competition from Japan in the 1980s, Jim initiated a Total Quality Systems approach, Customer Led Quality, which achieved substantial gains in both quality and productivity. During his tenure as Chief Executive, Jim brought a renewed focus on shareholder value as he led the most aggressive investment in Cummins history to modernize and expand the company's product line.
We would not have achieved the record results or be positioned as well as we are for the future without Jim's leadership and vision. On behalf of the company and its customers, I thank Jim for his contributions and wish him the very best in retirement.

Two other directors will be retiring from the Board in April.

Henry Schacht, Director and Senior Advisor of E.M. Warburg, Pincus & Co., formerly Chairman and CEO of Lucent Technologies and a member of the Cummins Board since 1969, has decided not to stand for re-election in April. Henry has been associated with Cummins for 35 years, serving as President from 1969 to 1977, as CEO from 1973 to 1994 and as Chairman of the Board from 1977 to early 1995. Throughout his career, Henry has demonstrated foresight, wisdom and courage in the face of tough challenges, and he will be remembered, along with Irwin Miller and Jim Henderson, as a builder of Cummins' reputation for business excellence and ethical behavior in the latter half of the twentieth century.

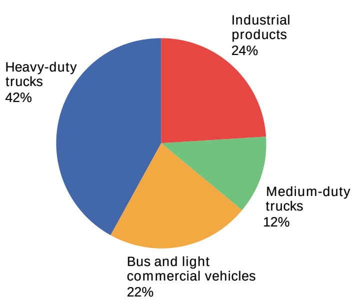
Harold Brown, Counselor at the Center for Strategic and International Studies, a partner in E.M. Warburg, Pincus & Co., and formerly U.S. Secretary of Defense, has reached age 72, the mandatory age for retirement from the Cummins Board. During his fifteen years as a member of the Board, Harold's profound grasp of science, technology and world affairs has been of inestimable value to Cummins. In addition to serving as Chair of the Board's Technology Committee, Harold has been Chairman of Cummins Science and Technology Advisory Council, a group of eminent scientists whose expertise encompasses a wide range of technical developments. We are pleased that we will continue to benefit from Harold's leadership of the Council after his retirement from the Board.

Gulf Freight Services, based in Australia, depends on Cummins automotive and industrial engines to move mountains.

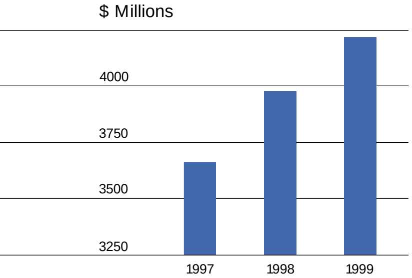

Performance required. Road optional.

Engine Business

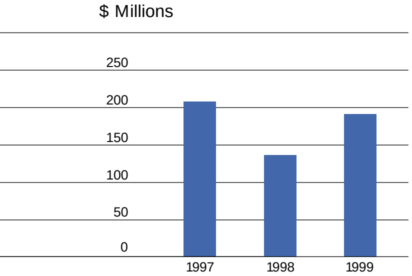
1999 Sales $4.2 Billion



Sales
$ Millions



Earnings Before Interest and Tax*
$ Millions



*Excludes unusual charges

Engine Business revenues of $4.2 billion grew by six percent in 1999. Profitability increased 34 percent compared to 1998. Shipments of engines to the heavy-duty truck market increased by 18 percent while unit sales to the medium-duty truck markets also increased by eight percent in 1999, reflecting strong market conditions.

Shipments of engines in industrial markets declined by six percent in 1999 as agriculture and mining markets fell sharply, driven by generally lower commodity prices. Shipments to the construction markets remained near 1998 levels as a result of strong sales in North America, offsetting continued weakness in Asian markets. The number of engine shipments to the marine segment increased by 16 percent, reflecting strong demand for recreational marine products.

Cummins continues to expand the availability of information products in all markets, in order to help our customers manage their businesses more successfully. During 1999, we released updated versions of our Inform and Insite software and a new version of our in-cab computer, RoadRelay4, which assist customers with the service and business management of their engines.

In addition, Advisor software assists industrial OEMs in designing more reliable equipment with our engines, and INTERCEPT provides comprehensive parts and service information, reducing search times by up to 90 percent.

Throughout the world, Cummins supplies engines for buses in urban areas that demand the least possible emissions. In Beijing, China, we will supply 800 natural gas-powered engines for buses, and Cummins powers over 3,000 low emissions diesels in Hong Kong.

Performance for our

DaimlerChrysler, Cummins' largest customer, for the first time purchased more than 100,000 ISB engines for the Dodge Ram pickup truck. In addition, Cummins expanded its overall share in the Class A recreational vehicle market from 18 percent to 24 percent, reflecting the trend from gasoline-powered vehicles to diesel. Cummins maintains a 75 percent share of the diesel segment as a result of strong customer preference.

1999 marked the 27th consecutive year of market leadership in the North American heavy-duty truck market. Two new engine platforms, the ISL and ISX, were introduced in 1999, completing the Interact System automotive engine product line and positioning Cummins as the industry leader in technology, fuel economy and performance.

Cummins' investment in new products provides the best capability for current and future emissions requirements, consistent with our long-standing commitment to the environment.

The B3.3 engine, available from 55–85 horsepower, further extends the product range in the industrial markets and builds upon the introduction of the QSB, QSC, and QSK60 electronic engines, completed in 1999. Cummins continues to offer the broadest product range of any manufacturer in industrial markets.

In addition to sales growth, reduced levels of expense on selling, research and engineering, and manufacturing costs helped to offset the start-up costs on new products. Initiatives to reduce material and plant conversion costs, launched in 1999, provided additional benefits but will have even more significant favorable impact in 2000.

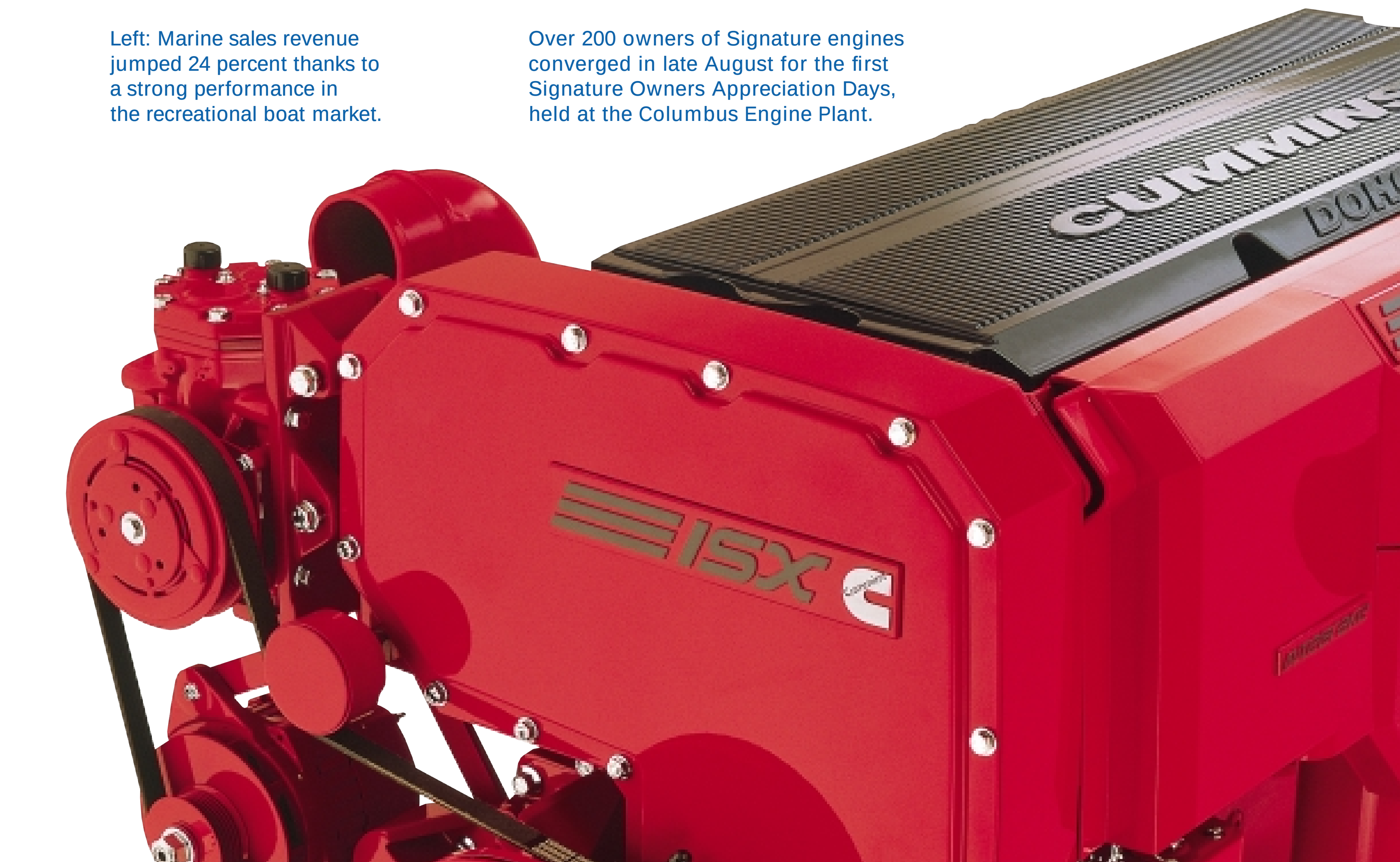
Cummins continued to expand QuickServe in order to provide superior support to customers in all market segments. By providing the best products and outstanding customer support we will earn the customer loyalty we aspire to achieve.

Joe Loughrey
Executive Vice President
President, Engine Business

customers to run hard and dream big.

Left: Marine sales revenue jumped 24 percent thanks to a strong performance in the recreational boat market.

Over 200 owners of Signature engines converged in late August for the first Signature Owners Appreciation Days, held at the Columbus Engine Plant.

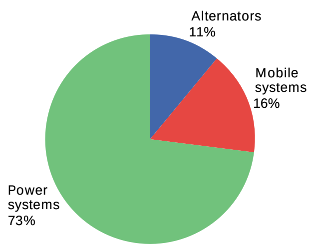


Nedalo, an ESCO (Energy Supply Company), specializes in greenhouse systems and uses Cummins Power Generation natural gas generating sets to maximize efficiency and minimize environmental impact. Carbon dioxide and heat, both normally waste by-products of generating electricity, are instead used to promote plant growth. With electricity being sold into the grid, this makes a beautiful environmental solution.

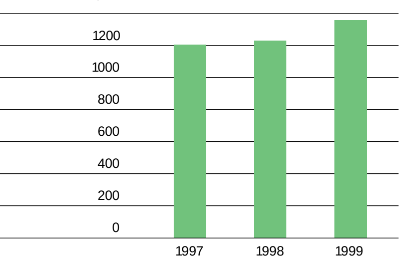
Power Generation growth in profits...

Power Generation Business

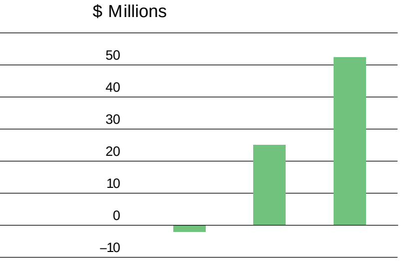
1999 Sales $1.3 Billion



Sales
$ Millions



Earnings Before Interest and Tax*
$ Millions



*Excludes unusual charges

…led by an outstanding

In 1999, the Power Generation Business made an outstanding improvement in performance for shareholders by doubling profits on relatively flat sales.

Our strong performance was led by the major turnaround in North America where we reaped the benefits from our restructuring, the immediate acceptance of our new products and a buoyant marketplace.

The robust North American economy boosted the recreational vehicle market where our Onan brand of mobile generator sets has over 80 percent market share. Our 1998 consolidation of two plants into one resulted in the most cost-effective product offerings in the booming mobile market.

Cummins also introduced PowerRent, a power generator rental business in North America targeted at providing responsive temporary power to a broad range of customers—from industrial and commercial businesses to large event organizers.

While Asian markets remained flat, down from record sales levels in 1997, Cummins continued to hold its strong market share position in both India and China.

Newage, our UK-based alternator subsidiary, contributed an excellent year by providing our customers with improved efficiencies on our traditionally high performance products. In 1999, Newage introduced a new high output range of alternators, extending the product range well beyond its previous levels.

Left: Strong performance by employees at our Fridley, Minnesota facility has led to a turnaround in North America.

In 1999, Cummins Power Generation introduced a new generator set range with outputs up to two megawatts. These generator sets are based on the new Cummins QSK60 engine. Also unveiled in 1999 were the new 81 and 91 liter gas generator sets, which deliver clean, cost-effective power to a growing market segment. The market for natural gas-fueled power will grow more rapidly than the overall power generation markets in the coming years as customers (such as the greenhouse on the previous page) look for clean, cost-effective power and heat recovery systems.

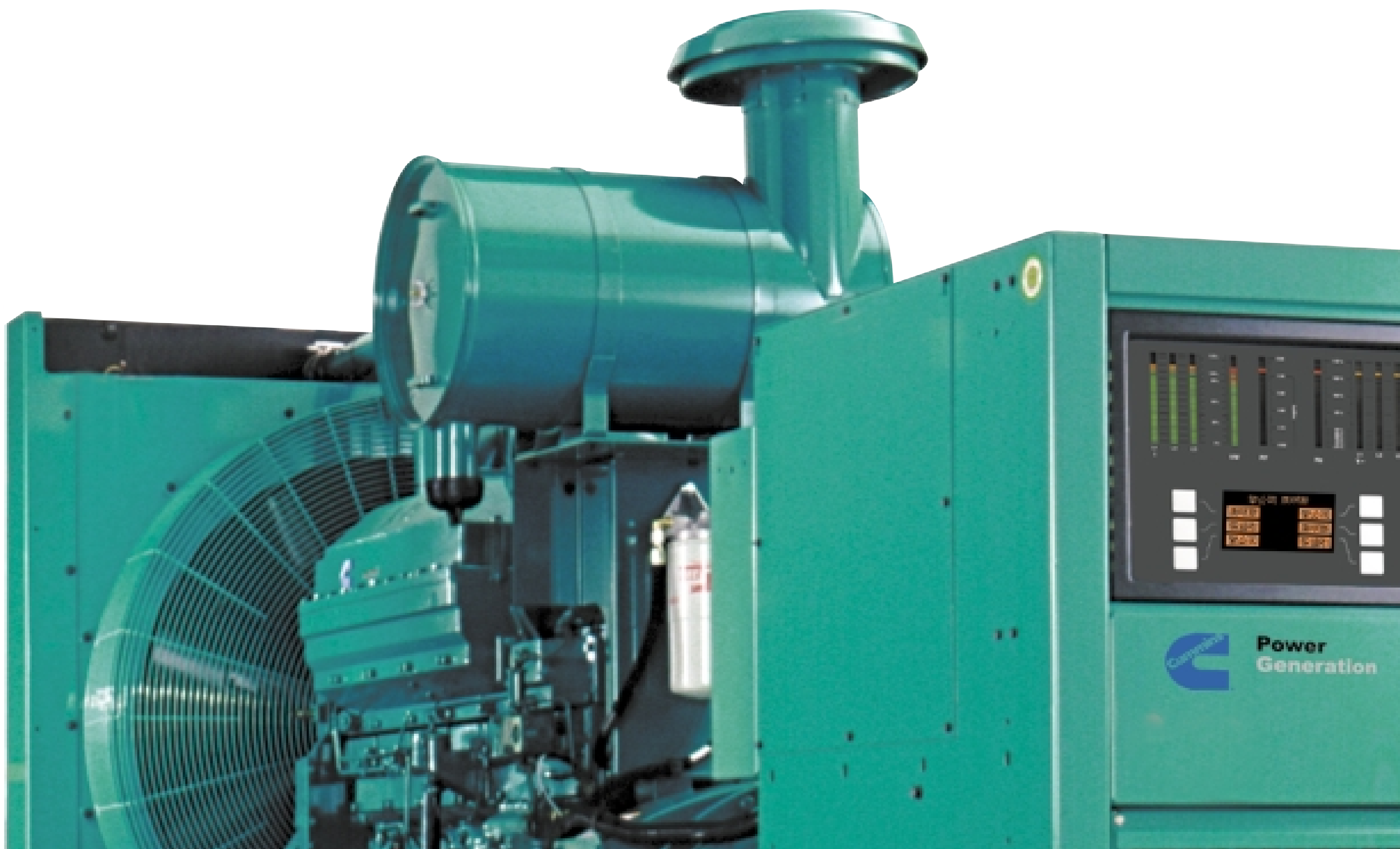
We improved our performance significantly in 1999 by making decisions closer to customers, focusing on the vital few projects around the globe, involving our people and providing customers better products and support.

The future is bright for Cummins Power Generation Group; the restructuring is complete and most markets remain healthy.

We look forward to improving our performance for our customers and shareholders with excitement and anticipation.

Jack K. Edwards
Executive Vice President
Group President, Power Generation

performance in North America.



Our Filtration business

Cummins' commitment to joint ventures, such as Tata Cummins, provides the access to developing markets for the company's entire product range. In India, our engine joint venture established in 1992 has been a springboard for other joint ventures in filtration and exhaust products.

improves equipment *performance*...

Filtration Business and Other

At 11.5 percent of sales, earnings before interest and taxes for the segment continued to be strong in 1999 despite level sales.

Filtration Business

Certain sectors remained strong all year. Sales to lawn and garden equipment and recreational vehicle manufacturers increased 27 percent. Sales grew seven percent in the North American heavy- and medium-duty truck markets. Japan and Africa continued to be robust, finishing up 16 percent from 1998. Agricultural equipment markets, however, together with mining and some construction markets, continued to be depressed throughout 1999, with sales declining by five percent.

Volumes for our China joint venture finished the year up 45 percent. Our Kuss subsidiary set another record for both sales and profits.

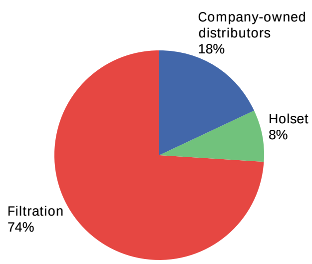
Last year, we successfully completed the integration of Nelson Industries. The acquisition has been accretive to earnings from the start, and all of the objectives we set have been achieved. By combining the leading supplier of exhaust systems and the leading supplier of filtration systems, Cummins' Filtration Business has created a product platform that positions us for continued growth.

During 1999, we developed new products and technologies to enhance vehicle performance and increase customer value. Our innovative Open Flow air filtration system, for example, increases filtration capacity 30 percent while reducing airflow restriction.

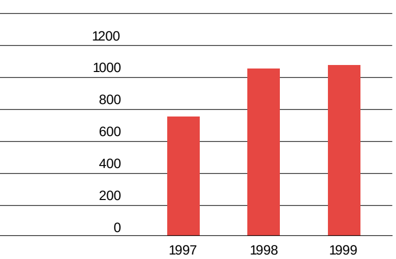
In addition, we developed new applications of our proprietary StrataPore-filtration media, introduced advanced high-pressure spin-on filters for hydraulic applications, developed a new abrasivity sensor, and introduced our new million-mile exhaust system and million-mile coolant package.

... by providing a single

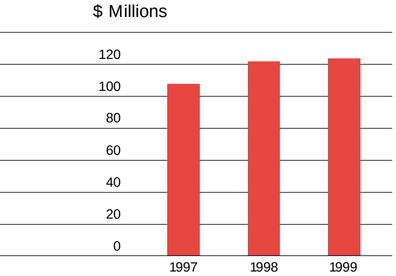
1999 Sales $1.1 Billion



Sales
$ Millions

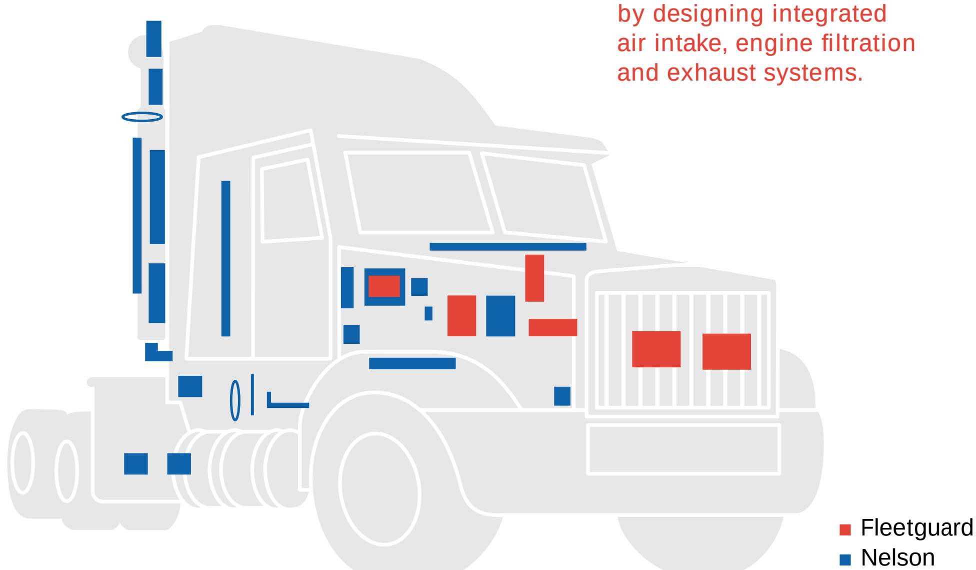


Earnings Before Interest and Tax*
$ Millions



*Excludes unusual charges

The Filtration Business provides superior performance by designing integrated air intake, engine filtration and exhaust systems.



To reduce emissions, we continue to aggressively invest in advanced aftertreatment technologies. The new aftertreatment system we developed in 1999 enables our customers to meet stringent emissions standards worldwide. This system can be expected to add to future volumes.

We are constantly improving customer service worldwide through our new Internet catalogs and our customer assistance centers providing support in 16 languages to customers worldwide.

Our ability to manufacture more cost effectively by localizing production around the world grew in 1999. Our acquisition of Tubengineers Pty. Ltd., Australia's leading exhaust system manufacturer, was accretive in its first year. In addition, we extended our global manufacturing base through building or expanding plants in India, Mexico, Brazil and South Africa.

Our global capability gives customers a single supplier that can provide broad product platforms and support services worldwide. Intensive global OEM sales efforts with our new product platforms are expected to deliver additional sales growth in the years ahead.

Today, Cummins Filtration Business is better positioned than any of our major competitors to capitalize on the coming decade's global economy and market expansion. Going forward, we are focused on execution — performance for our customers and performance for our shareholders. We expect to grow and maintain global leadership, and we face the future with confidence.

Rick Mills

Rick Mills
Vice President, Filtration
President, Fleetguard, Inc.

Distributorships and Holset

The Holset Turbocharger Business supplies state-of-the-art turbochargers to Cummins, Cummins Joint Ventures and selected OEM customers to meet their increasingly stringent performance, durability and emissions requirements.

Cummins' ownership of 16 distributorships links us closely to our end-user customers in strategic locations worldwide.

source for integrated product platforms.

Management's Discussion and Analysis of Results of Operations and Financial Condition

Overview

Net sales were a record $6.6 billion in 1999, 6 percent higher than in 1998, and 18 percent higher than in 1997. Earnings before interest and taxes of $356 million in 1999, or 5.4 percent of sales, were also a record, excluding a $60 million pretax charge in connection with the dissolution of the Cummins Wärtsilä joint venture. This compares to $282 million in 1998, excluding charges of $217 million pretax for product coverage costs, restructuring and exit activities and a settlement with the U.S. Environmental Protection Agency. As reported, earnings before interest and taxes were $296 million in 1999, $65 million in 1998 and $312 million in 1997. Net earnings in 1999 were $160 million or $4.13 per share compared to a net loss of $21 million or $(.55) per share in 1998 and net earnings of $212 million or $5.48 per share in 1997.

Results of Operations

Net Sales:

In 1999, the Company attained its eighth consecutive year of record sales, totaling $6.6 billion. Revenues from sales of engines were 55 percent of the Company's net sales in 1999, with engine revenues 6 percent higher than in 1998 and 15 percent above 1997. The Company shipped a record 426,100 engines in 1999, compared to 403,300 in 1998 and 369,800 in 1997 as follows:

Unit shipments	1999	1998	1997
Midrange engines	298,400	287,400	264,300
Heavy-duty engines	117,900	106,100	94,900
High-horsepower engines	9,800	9,800	10,600
	426,100	403,300	369,800

Revenues from non-engine products, which were 45 percent of net sales in 1999, were 6 percent higher than in 1998. The major increases within non-engine revenues were achieved in sales of generator sets and PowerCare sales (which include new parts and remanufactured engines and parts). Sales of the remaining non-engine products, in the aggregate, were essentially level with 1998.

The Company's net sales for each of its key segments during the last 3 years were:

$ Millions	1999	1998	1997
Automotive markets	$ 3,203	$ 2,928	$2,622
Industrial markets	1,022	1,054	1,044
Engine Business	4,225	3,982	3,666
Power Generation Business	1,356	1,230	1,205
Filtration Business and Other	1,058	1,054	754
	$ 6,639	$ 6,266	$5,625

Cummins' Engine Business, the Company's largest business segment, produces engines and parts for sale to customers in both automotive and industrial markets. Engine Business customers are each serviced through the Company's worldwide distributor network. The engines are used in trucks of all sizes, buses and recreational vehicles, as well as a variety of industrial applications including construction, mining, agriculture, marine, rail and military. Engine Business revenues were $4.2 billion in 1999, a 6 percent increase over 1998 and 15 percent over 1997.

Sales of $3.2 billion in 1999 for automotive markets were 9 percent higher than in 1998 and 22 percent higher than in 1997. In 1999, heavy-duty truck engine revenues were 18 percent higher than in 1998 due to the strong market in North America, partially offset by reduced demand in international heavy-duty truck markets. Within the North American heavy-duty truck market, unit shipments were up 21 percent over 1998, and Cummins continued to be the market leader. International unit shipments for the heavy-duty market in 1999 were 7 percent lower than in 1998 due primarily to reduced demand in Mexico.

Revenues from the sales of engines for medium-duty trucks in 1999 were 1 percent lower than in 1998 on an 8 percent increase in units. This variance reflected a mix shift towards smaller 4-cylinder engines, which have a lower selling price and margin, as well as the impact of the devaluation of the Brazilian Real, which reduced revenues in this market.

For the bus and light commercial vehicle market, engine revenues in 1999 were 7 percent higher than in 1998, on a 7 percent increase in unit shipments. Record unit shipments to DaimlerChrysler for the Dodge Ram pickup were 3 percent higher than in 1998 and 30 percent higher than in 1997. The Company also had record shipments to the North American bus and recreational vehicle market, where volumes were 30 percent higher than in 1998 and 39 percent higher than in 1997. Shipments for international bus markets declined 10 percent from 1998, due to lower sales into Mexico.

In 1999, revenues of $1.0 billion from industrial markets were 3 percent lower than in 1998 and 2 percent lower than in 1997, due to decreased volume and a shift in product mix. Engine revenues for this market were down 6 percent on a 6 percent decrease in units. Construction equipment business was 2 percent higher than the year-ago level, while agricultural equipment demand decreased 46 percent from 1998 as a result of very weak markets. Sales to marine markets increased 24 percent from 1998, with strength in both North American and international markets. Mining market sales declined 8 percent as compared to last year.

Revenues of $1.3 billion in 1999 for the Power Generation Business were 10 percent higher than in 1998 and 13 percent higher than in 1997. Approximately $40 million of the sales increase in 1999 related to demand for stand-by power in case of Year 2000 problems; however, the Company expects that nearly half of this increase is sustainable with revenues from new markets, including the rental and home stand-by power businesses. Sales of the Company's generator sets in 1999 increased 21 percent from 1998, continuing to reflect growth in North America, which more than offset declines in demand for generator sets in Asia and Latin America. Engine sales to generator set assemblers were down 8 percent from the prior year, due primarily to lower demand in Asia. Alternator sales decreased 2 percent as compared to 1998. Sales of small generator sets for recreational vehicles and other consumer markets remained strong in North America, increasing 12 percent from 1998.

Sales of $1.1 billion in 1999 for the Filtration Business and Other were essentially flat with 1998 and 40 percent higher than in 1997, with Nelson Industries, acquired in January 1998, accounting for the majority of the increase from 1997. In 1999, new business at small equipment, truck and agricultural equipment manufacturers offset a decrease in sales resulting from the end of a specific catalyst business, which totaled $35 million.

International distributor sales included in this segment decreased 1 percent from 1998, while sales of Holset turbochargers increased 13 percent as compared to a year ago.

Net sales by marketing territory for each of the last 3 years were:

$ Millions	1999	1998	1997
United States	$4,064	$3,595	$3,123
Asia/Australia	818	806	898
Europe/CIS	800	791	796
Canada	473	459	318
Mexico/Latin America	375	468	364
Africa/Middle East	109	147	126
	$6,639	$6,266	$5,625

In total, international markets accounted for 39 percent of the Company's revenues in 1999. Europe and the CIS, representing 12 percent of the Company's sales in 1999, were 1 percent higher than in 1998 and 1997. Sales to Canada, representing 7 percent of sales in 1999, were 3 percent higher than in 1998. Asian and Australian markets, in total, represented 12 percent of the Company's sales in 1999, with increases in sales to Asia more than offsetting a decline in sales to Australia. In Asia, sales to Southeast Asia increased 28 percent, sales to Korea were 25 percent higher and sales to Japan were 9 percent above 1998 levels, while sales to China decreased 6 percent and India was essentially flat compared to 1998. Business in Mexico and Latin America, representing 6 percent of sales in 1999, was 20 percent lower than in 1998. This decrease was due, in part, to the devaluation of the Brazilian Real.

Gross Margin:
As disclosed in Note 3 to the Consolidated Financial Statements, the Company recorded special charges of $92 million in 1998 for product coverage costs and inventory write-downs. The product coverage special charges of $78 million include $43 million primarily attributable to base warranty costs and $35 million for extended warranty programs. The special charges recorded in 1998 also included $14 million for inventory write-downs associated with the Company's restructuring and exit activities. These write-downs reflected amounts of inventory rendered excess or unusable due to the closing or consolidation of facilities.

The Company's gross margin percentage was 21.4 percent in 1999, and 21.4 percent in 1998, excluding the special charges recorded for product coverage and inventory write-downs, and 22.8 percent in 1997. Gross margin percentage in 1998 including the special charges was 19.9 percent. Gross margins in 1999 benefited from higher volumes and product cost improvements, offset by higher product coverage costs. Product coverage costs were 3.7 percent of net sales in 1999, compared to 3.3 percent in 1998, excluding the special charges, and 2.6 percent in 1997.

Operating Expenses:
Selling and administrative expenses were 11.8 percent of net sales in 1999, compared to 12.5 percent in 1998 and 13.2 percent in 1997. On the 6-percent sales increase in 1999, these expenses, which include volume-variable components, decreased 1 percent in absolute dollars. This improvement reflects benefits of the Company's cost reduction programs and restructuring actions.

Research and engineering expenses were 3.7 percent of net sales in 1999, compared to 4.1 percent in 1998 and 4.6 percent in 1997. This decrease is primarily due to new products moving into production and the Company's cost reduction and productivity initiatives.

The Company's losses from joint ventures and alliances were $28 million in 1999, compared to losses of $30 million in 1998 and income of $10 million in 1997. In 1999, higher losses at the Company's joint venture with Wärtsilä were more than offset by improved performance at the Company's other joint ventures. The difference from 1997 was due primarily to the consolidation of Cummins India Limited in the fourth quarter of 1997 and increased losses at the Company's joint venture with Wärtsilä.

In December 1999, the Company recorded a charge of $60 million in connection with the dissolution of the Cummins Wärtsilä joint venture. The charge included $17 million to write off the Company's remaining investment in the joint venture, $29 million for impairment of assets transferred from the joint venture and $14 million for additional warranty and other liabilities assumed by the Company. The joint venture termination was effective December 31, 1999, with the Company taking over the operations and assets of the product line manufactured in Daventry, England. The asset impairment loss was calculated according to the provisions of SFAS No. 121, using expected discounted cash flows as the estimate of fair value. The majority of the impaired assets are to be held and used in the Company's Power Generation Business, with depreciation continuing on such assets.

As disclosed in Note 4 to the Consolidated Financial Statements, the Company recorded charges in 1998 totaling $125 million, comprised of $100 million of costs associated with the Company's plan to restructure, consolidate and exit certain business activities and $25 million for a civil penalty resulting from an agreement reached with the U.S. Environmental Protection Agency and the Department of Justice regarding diesel engine emissions.

The Company is continuing the restructuring plan implemented in the third quarter of 1998. As of December 31, 1999, approximately $81 million had been charged against the liabilities associated with these actions. The Company funded the restructuring actions using cash generated from operations. Of the planned workforce reduction of 1,100 employees, approximately 900 people left the Company prior to December 31, 1999. The remaining actions to be completed consist primarily of the outsourcing of certain manufacturing operations and payment of severance commitments to terminated employees. The program is expected to be essentially complete in early 2000 and yield approximately $50 million in annual savings at completion. The Company does not currently anticipate any material changes in the original charges recorded for these actions.

Other:
Interest expense of $75 million was $4 million higher than in 1998 and $49 million higher than in 1997. Lower capitalization of interest in 1999 accounted for the increase as compared to 1998. The increase from 1997 was due to the increased level of borrowings to support working capital on the higher sales level and to complete the acquisition of Nelson. Other expense went from $13 million of income in 1998 to $8 million of expense in 1999, primarily due to increased non-operating partnership costs and lower interest income in 1999, and certain tax refunds and other non-recurring transactions recorded in 1998.

Provision for Income Taxes:
The Company's income tax provision in 1999 was $55 million, an effective tax rate of 25 percent, reflecting reduced taxes on export sales and research tax credits. In 1998, the Company's tax provision was $4 million, with the tax benefits from export sales and the research credit more than offset by the unfavorable tax effects of nondeductible losses in foreign joint ventures and nondeductible EPA penalty and goodwill amortization. The Company's effective tax rate in 1997 was 26 percent.

Minority Interest:
Minority interest in net earnings of consolidated entities was $6 million in 1999, a decrease of $5 million from 1998 and an increase of $6 million from 1997. The decrease from 1998 was primarily due to lower net earnings of Cummins India Limited in 1999 and the partner's share of losses from the joint venture with Scania. The change in minority interest from 1997 was due to the consolidation of Cummins India Limited beginning in the fourth quarter of 1997, when the Company increased its ownership interest to 51 percent.

Year 2000:
The Company experienced no negative effects on customers, employees or suppliers from the Year 2000 date change. No problems with the Company's products were reported. The Company monitored the status of its worldwide sites during the "millennium rollover" through the operation of three communication centers located in Australia, England and Columbus, Indiana. Teams of experts were on-hand and additional resources were available on a stand-by basis to assist sites, if needed. Service and engineering groups were available on-call in case customer requests arose. The Company's sites, including its manufacturing facilities and distribution channels, are working without any disruptive impact from the Year 2000 date change.

The Company also participated in an information gathering process designed by the Automotive Industry Action Group (AIAG) and reported a "green" status throughout the requested Year 2000 AIAG reporting phase in early January.

While Year 2000 results to-date are positive, there are key dates yet to monitor. The communication centers will watch Leap Year Day, February 29, and financial closes during the first quarter. The Company continues its preventive approach to Year 2000 issues. Sites continue to conduct process verifications that critical systems are operating properly.

Costs and Risks of Company's Year 2000 Issues:
The Company will incur total expenditures of approximately $45 million in connection with its Year 2000 program and remediation efforts. The Company is funding its Year 2000 costs with its normal operating cashflow.

There can be no assurances that the systems or products of third parties relied upon by the Company, such as suppliers, vendors or significant customers, were timely converted or that a failure by such third parties, or a conversion that is incompatible with the Company's systems, would not have a material adverse effect on the Company. Other undiscovered factors related to the Year 2000 issue may also have potential for an adverse effect on the Company. Such adverse effects may include an adverse effect on the Company's revenues. The time of completion and success of the Company's Year 2000 program and compliance efforts, and the related expenses, are based upon management's best estimates, which in turn are based on assumptions about future events, including the availability of certain resources, third party modification plans and other factors. There can be no assurances that these results and estimates will be achieved, and the actual results could materially differ from those anticipated. Specific factors that might cause such material differences include, but are not limited to, the availability of trained personnel, the ability to locate and correct all relevant computer code, and the failure by third parties to address their Year 2000 problems.

Cash Flow and Financial Condition
Key elements of cash flows were:

$ Millions	1999	1998	1997
Net cash provided by operating activities	$307	$271	$200
Net cash used in investing activities	(166)	(752)	(354)
Net cash (used in) provided by financing activities	(105)	471	96
Effect of exchange rate changes on cash	—	(1)	(1)
Net change in cash	$ 36	$ (11)	$ (59)

During 1999, net cash provided from operating activities was $307 million, reflecting the Company's strong net earnings and the non-cash effect of depreciation and amortization, reduced by increases in working capital. Net working capital as a percent of sales was 13.0 percent in 1999, compared to 12.8 percent in 1998 and 11.6 percent in 1997. Net cash used in investing activities in 1999 of $166 million included planned capital expenditures of $215 million, partially offset by $54 million of proceeds from the sale of the Company's Atlas Crankshaft business. Capital expenditures were $271 million in 1998 and $405 million in 1997, during the Company's peak product development period. The higher level of net cash requirements in 1998 was due primarily to the acquisition of Nelson. Investments in joint ventures and alliances in 1999 of $36 million reflected the net effect of capital contributions and cash generated by certain joint ventures.

Net cash used in financing activities was $105 million in 1999. This cash was used for dividend payments, repurchases of the Company's stock and payments on borrowings. As disclosed in Note 7 to the Consolidated Financial Statements, the Company issued $765 million face amount of notes and debentures in 1998 under a $1 billion registration statement filed with the Securities and Exchange Commission in December 1997. Net proceeds were used to finance the acquisition of Nelson and to pay down other indebtedness outstanding at December 31, 1997. Based on the Company's projected cash flow from operations and existing credit facilities, management believes that sufficient liquidity is available to meet anticipated capital and dividend requirements in the foreseeable future.

Legal/Environmental Matters:
The Company and its subsidiaries are defendants in a number of pending legal actions that arise in the normal course of business, including environmental claims and actions related to use and performance of the Company's products. Such matters are more fully described in Note 17 to the Consolidated Financial Statements. In the event the Company is determined to be liable for damages in connection with such actions or proceedings, the unreserved portion of such liability is not expected to have a material adverse effect on the Company's results of operations, cash flows or financial condition.

Market Risk:
The Company is exposed to financial risk resulting from volatility in foreign exchange rates, interest rates and commodity prices. This risk is closely monitored and managed through the use of derivative contracts. As clearly stated in the Company's policies and procedures, financial derivatives are used expressly for hedging purposes, and under no circumstances are they used for speculating or for trading. Transactions are entered into only with banking institutions with strong credit ratings, and thus the credit risk associated with these contracts is considered immaterial. Hedging program results and status are reported to senior management on a monthly and quarterly basis.

The following section describes the Company's risk exposures and provides results of sensitivity analyses performed on December 31, 1999. The sensitivity tests assumed instantaneous, parallel shifts in foreign currency exchange rates, commodity prices and interest rate yield curves.

A. Foreign Exchange Rates
Due to its international business presence, the Company transacts extensively in foreign currencies. As a result, corporate earnings experience some volatility related to movements in exchange rates. In order to exploit the benefits of global diversification and naturally offsetting currency positions, foreign exchange balance sheet exposures are aggregated and hedged at the corporate level through the use of foreign exchange forward contracts. The objective of the foreign exchange hedging program is to reduce earnings volatility resulting from the translation of net foreign exchange balance sheet positions. A hypothetical, instantaneous, 10 percent adverse movement in the foreign currency exchange rates would decrease earnings by approximately $4 million in the current reporting period. The sensitivity analysis ignores the impact of foreign exchange movements on Cummins' competitive position as well as the remoteness of the likelihood that all foreign currencies will move in tandem against the U.S. dollar. The analysis also ignores the offsetting impact on income of the revaluation of the underlying balance sheet exposures.

B. Interest Rates
The Company currently has in place three interest rate swaps that effectively convert fixed-rate debt into floating-rate debt. The objective of the swaps is to more efficiently balance borrowing costs and interest rate risk. A sensitivity analysis assumed a hypothetical, instantaneous, 100 basis-point parallel increase in the floating interest rate yield curve, after which rates remained fixed at the new, higher level for a one-year period. This change in yield curve would correspond to a $4 million increase in interest expense for the one-year period. This sensitivity analysis does not account for the change in the Company's competitive environment indirectly related to changes in interest rates and the potential managerial action taken in response to these changes.

C. Commodity Prices
The Company is exposed to fluctuation in commodity prices through the purchase of raw materials as well as contractual agreements with component suppliers. Given the historically volatile nature of commodity prices, this exposure can significantly impact product costs. The Company uses commodity swap agreements to partially hedge exposures to changes in copper and aluminum prices. Given a hypothetical, instantaneous 10-percent depreciation of the underlying commodity price, with prices then remaining fixed for a 12-month period, the Company would experience a loss of approximately $3 million for the annual reporting period. This amount excludes the offsetting impact of decreases in commodity costs.

Forward-looking Statements:
This Management's Discussion and Analysis of Results of Operations and Financial Condition, other sections of this Annual Report and the Company's press releases, teleconferences and other external communications contain forward-looking statements that are based on current expectations, estimates and projections about the industries in which Cummins operates and management's beliefs and assumptions. Words, such as "expects," "anticipates," "intends," "plans," "believes," "seeks," "estimates," variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions ("Future Factors") which are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed or forecasted in such forward-looking statements. Cummins undertakes no obligation to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

Future Factors include increasing price and product competition by foreign and domestic competitors, including new entrants; rapid technological developments and changes; the ability to continue to introduce competitive new products on a timely, cost-effective basis; the mix of products; the achievement of lower costs and expenses; domestic and foreign governmental and public policy changes, including environmental regulations; protection and validity of patent and other intellectual property rights; reliance on large customers; technological, implementation and cost/financial risks in increasing use of large, multi-year contracts; the cyclical nature of Cummins' business; the outcome of pending and future litigation and governmental proceedings; and continued availability of financing, financial instruments and financial resources in the amounts, at the times and on the terms required to support Cummins' future business.

These are representative of the Future Factors that could affect the outcome of the forward-looking statements. In addition, such statements could be affected by general industry and market conditions and growth rates, general domestic and international economic conditions, including interest rate and currency exchange rate fluctuations, and other Future Factors.

Cummins Engine Company, Inc.
Consolidated Statement of Earnings

Millions, except per share amounts	1999	1998	1997
Net sales	$6,639	$ 6,266	$5,625
Cost of goods sold	5,221	4,925	4,345
Special charges	—	92	—
Gross profit	1,418	1,249	1,280
Selling and administrative expenses	781	787	744
Research and engineering expenses	245	255	260
Net expense (income) from joint ventures and alliances	28	30	(10)
Interest expense	75	71	26
Other expense (income), net	8	(13)	(26)
Restructuring and other non-recurring charges	60	125	—
Earnings (loss) before income taxes	221	(6)	286
Provision for income taxes	55	4	74
Minority interest	6	11	—
Net earnings (loss)	$ 160	$ (21)	$ 212
Basic earnings (loss) per share	$ 4.16	$ (.55)	$ 5.55
Diluted earnings (loss) per share	4.13	(.55)	5.48

The accompanying notes are an integral part of this statement.

Cummins Engine Company, Inc.
Consolidated Statement of Financial Position

Millions, except per share amounts — December 31,	1999	1998
Assets		
Current assets:		
Cash and cash equivalents	$ 74	$ 38
Receivables, net of allowance of $9 and $13	1,026	833
Inventories	787	731
Other current assets	293	274
	2,180	1,876
Investments and other assets:		
Investments in joint ventures and alliances	131	136
Other assets	143	144
	274	280
Property, plant and equipment:		
Land and buildings	577	590
Machinery, equipment and fixtures	2,375	2,320
Construction in process	168	185
	3,120	3,095
Less accumulated depreciation	1,490	1,424
	1,630	1,671
Goodwill, net of amortization of $28 and $17	364	384
Other intangibles, deferred taxes and deferred charges	249	331
Total assets	$4,697	$4,542
Liabilities and shareholders' investment		
Current liabilities:		
Loans payable	$ 113	$ 64
Current maturities of long-term debt	10	26
Accounts payable	411	340
Accrued salaries and wages	88	99
Accrued product coverage and marketing expenses	246	209
Income taxes payable	40	13
Other accrued expenses	406	320
	1,314	1,071
Long-term debt	1,092	1,137
Other liabilities	788	1,000
Minority interest	74	62
Shareholders' investment:		
Common stock, $2.50 par value, 48.3 and 48.1 shares issued	121	120
Additional contributed capital	1,129	1,121
Retained earnings	760	648
Accumulated other comprehensive income	(109)	(167)
Common stock in treasury, at cost, 6.8 and 6.1 shares	(274)	(240)
Common stock held in trust for employee benefit plans, 3.4 and 3.6 shares	(163)	(172)
Unearned compensation	(35)	(38)
	1,429	1,272
Total liabilities and shareholders' investment	$4,697	$4,542

The accompanying notes are an integral part of this statement.

Cummins Engine Company, Inc.
Consolidated Statement of Cash Flows

Millions	1999	1998	1997
Cash flows from operating activities:			
Net earnings (loss)	$ 160	$ (21)	$ 212
Adjustments to reconcile net earnings (loss) to net cash from operating activities:			
Depreciation and amortization	233	199	158
Restructuring and other non-recurring actions	38	110	(24)
Equity in (earnings) losses of joint ventures and alliances	35	38	(1)
Receivables	(200)	(10)	(80)
Inventories	(60)	(26)	(65)
Accounts payable and accrued expenses	162	56	(18)
Deferred income taxes	(31)	(65)	22
Other	(30)	(10)	(4)
Total adjustments	147	292	(12)
	307	271	200
Cash flows from investing activities:			
Property, plant and equipment:			
Additions	(215)	(271)	(405)
Disposals	22	7	21
Investments in joint ventures and alliances	(36)	(22)	(47)
Acquisitions and dispositions of business activities	57	(468)	76
Other	6	2	1
	(166)	(752)	(354)
Net cash provided by (used in) operating and investing activities	141	(481)	(154)
Cash flows from financing activities:			
Proceeds from borrowings	28	711	281
Payments on borrowings	(90)	(161)	(50)
Net borrowings (payments) under short-term credit agreements	49	(30)	(12)
Repurchases of common stock	(34)	(14)	(75)
Dividend payments	(47)	(46)	(45)
Other	(11)	11	(3)
	(105)	471	96
Effect of exchange rate changes on cash	—	(1)	(1)
Net change in cash and cash equivalents	36	(11)	(59)
Cash and cash equivalents at beginning of year	38	49	108
Cash and cash equivalents at end of year	$ 74	$ 38	$ 49
Cash payments during the year for:			
Interest	$ 82	$ 56	$ 21
Income taxes	56	73	42

The accompanying notes are an integral part of this statement.

Cummins Engine Company, Inc.
Consolidated Statement of Shareholders’ Investment

Millions, except per share amounts	1999		1998		1997	
Common stock:						
Balance at beginning of year	$ 120		$ 120		$ 110	
Issued to trust for employee benefit plans	—		—		9	
Other	1		—		1	
Balance at end of year	121		120		120	
Additional contributed capital:						
Balance at beginning of year	1,121		1,119		929	
Issued to trust for employee benefit plans	—		—		171	
Other	8		2		19	
Balance at end of year	1,129		1,121		1,119	
Retained earnings:						
Balance at beginning of year	648		715		548	
Net earnings (loss)	160	$160	(21)	$(21)	212	$212
Cash dividends	(47)		(46)		(45)	
Other	(1)		—		—	
Balance at end of year	760		648		715	
Accumulated other comprehensive income:						
Balance at beginning of year	(167)		(70)		(60)	
Foreign currency translation adjustments		4		(43)		(21)
Minimum pension liability adjustments		55		(54)		12
Unrealized losses on securities		(1)		—		(1)
Other comprehensive income	58	58	(97)	(97)	(10)	(10)
Comprehensive income		$218		$(118)		$202
Balance at end of year	(109)		(167)		(70)	
Common stock in treasury:						
Balance at beginning of year	(240)		(245)		(169)	
Repurchased	(34)		(14)		(76)	
Issued	—		19		—	
Balance at end of year	(274)		(240)		(245)	
Common stock held in trust for employee benefit plans:						
Balance at beginning of year	(172)		(175)		—	
Issued	—		—		(180)	
Shares allocated to benefit plans	9		3		5	
Balance at end of year	(163)		(172)		(175)	
Unearned compensation:						
Balance at beginning of year	(38)		(42)		(46)	
Shares allocated to participants	3		4		4	
Balance at end of year	(35)		(38)		(42)	
Shareholders’ investment	$1,429		$1,272		$1,422	
Shares of stock						
Common stock, $2.50 par value, 150.0 shares authorized						
Balance at beginning of year	48.1		48.1		43.9	
Shares issued	.2		—		4.2	
Balance at end of year	48.3		48.1		48.1	
Common stock in treasury						
Balance at beginning of year	6.1		6.0		4.5	
Shares repurchased	.7		.4		1.5	
Shares issued	—		(.3)		—	
Balance at end of year	6.8		6.1		6.0	
Common stock held in trust for employee benefit plans						
Balance at beginning of year	3.6		3.7		—	
Shares issued	—		—		3.8	
Shares allocated to benefit plans	(.2)		(.1)		(.1)	
Balance at end of year	3.4		3.6		3.7	

The accompanying notes are an integral part of this statement.

Note 1. Accounting Policies:

Principles of Consolidation: The consolidated financial statements include all significant majority-owned subsidiaries. Affiliated companies in which Cummins does not have a controlling interest, or for which control is expected to be temporary, are accounted for using the equity method. Use of estimates and assumptions as determined by management is required in the preparation of consolidated financial statements in conformity with generally accepted accounting principles. Actual results could differ from these estimates and assumptions.

Revenue Recognition: The Company recognizes revenues on the sale of its products, net of estimated costs of returns, allowances and sales incentives, when the products are shipped to customers. The Company generally sells its products on open account under credit terms customary to the region of distribution. The Company performs ongoing credit evaluations of its customers and generally does not require collateral to secure its customers' receivables.

Foreign Currency: Assets and liabilities of foreign entities, where the local currency is the functional currency, have been translated at year-end exchange rates, and income and expenses have been translated to U.S. dollars at average-period rates. Adjustments resulting from translation have been recorded in shareholders' investment and are included in net earnings only upon sale or liquidation of the underlying foreign investment.

For foreign entities where the U.S. dollar is the functional currency, including those operating in highly inflationary economies, inventory, property, plant and equipment balances and related income statement accounts have been translated using historical exchange rates. The resulting gains and losses have been credited or charged to net earnings and were net losses of $2 million in 1999, $5 million in 1998 and $1 million in 1997.

Derivative Instruments: The Company makes use of derivative instruments in its foreign exchange, commodity price and interest rate hedging programs. Derivatives currently in use are commodity and interest rate swaps, as well as foreign currency forward contracts. These contracts are used strictly for hedging and not for speculative purposes. Refer to Note 10 for more information on derivative financial instruments.

The Company enters into commodity swaps to offset the Company's exposure to price volatility for certain raw materials used in the manufacturing process. As the Company has the discretion to settle these transactions either in cash or by taking physical delivery, these contracts are not considered financial instruments for accounting purposes. These commodity swaps are accounted for as hedges.

In June 1998, the Financial Accounting Standards Board issued SFAS No. 133 on accounting for derivative instruments and hedging activities. The statement is effective for fiscal years beginning after June 15, 2000. The Company plans to adopt this statement at the beginning of fiscal 2001 and is currently evaluating its hedging strategy as it applies to the new statement. The statement is not expected to have a material effect on the Company's results of operations.

Other Costs: Estimated costs of commitments for product coverage programs are charged to earnings at the time the Company sells its products.

Research & development expenditures, net of contract reimbursements, are expensed when incurred and were $218 million in 1999, $228 million in 1998 and $250 million in 1997.

Maintenance and repair costs are charged to earnings as incurred.

Cash Equivalents: Cash equivalents include all highly liquid investments with an original maturity of three months or less at the time of purchase.

Inventories: Inventories are stated at the lower of cost or net realizable value. Approximately 23 percent of domestic inventories (primarily heavy-duty and high-horsepower engines and engine parts) are valued using the last-in, first-out (LIFO) cost method. All other inventories are valued using the first-in, first-out (FIFO) method. Inventories at December 31 were as follows:

$ Millions	1999	1998
Finished products	$ 402	$ 400
Work-in-process and raw materials	440	387
Inventories at FIFO cost	842	787
Excess of FIFO over LIFO	(55)	(56)
	$ 787	$ 731

Property, Plant and Equipment: Property, plant and equipment are stated at cost. A modified units-of-production method, which is based upon units produced subject to a minimum level, is used to depreciate substantially all engine production equipment. The straight-line depreciation method is used for all other equipment. The estimated depreciable lives range from 20 to 40 years for buildings and 3 to 20 years for machinery, equipment and fixtures.

Long-Lived Assets: The Company evaluates the carrying value of its long-lived assets for impairment whenever adverse events or changes in circumstances indicate that the carrying value of an asset may be impaired. In accordance with SFAS No.121, if the quoted market price, or if not available the undiscounted cash flows, are not sufficient to support the recorded asset value, an impairment loss is recorded to reduce the carrying value of the asset to the amount of expected discounted cash flows. This same policy is followed for goodwill.

Software: Internal and external software costs (excluding research, reengineering and training) are capitalized and amortized generally over 5 years. Capitalized software, net of amortization, was $110 million at December 31, 1999, and $75 million at December 31, 1998.

Earnings Per Share: Basic earnings per share of common stock are computed by dividing net earnings by the weighted-average number of shares outstanding for the period. Diluted earnings per share are computed by dividing net earnings by the weighted-average number of shares, assuming the exercise of stock options when the effect of their exercise is dilutive. Shares of stock held by the employee benefits trust are not included in outstanding shares for EPS until distributed from the trust.

Millions, except per share amounts	Net Earnings (Loss)	Weighted Average Shares	Per Share
1999			
Basic	$160	38.3	$4.16
Options	—	.3	
Diluted	$160	38.6	$4.13
1998			
Basic	$ (21)	38.5	$ (.55)
Options	—	—	
Diluted	$ (21)	38.5	$ (.55)
1997			
Basic	$212	38.2	$5.55
Options	—	.5	
Diluted	$212	38.7	$5.48

Note 2. Acquisition: In January 1998, the Company completed the acquisition of the stock of Nelson Industries, Inc., for $453 million. Nelson, a filtration and exhaust systems manufacturer, was consolidated from the date of its acquisition. On a pro forma basis, if the Company had acquired Nelson on January 1, 1997, consolidated net sales for 1997 would have been $5.9 billion and consolidated earnings would not have been materially different. In accordance with APB Opinion No. 16, Nelson's net assets were recorded at fair value at the date of acquisition. The purchase price in excess of net assets will be amortized over 40 years.

Note 3. Special Charges: In 1998, the Company recorded special charges of $92 million for product coverage costs and inventory write-downs. The product coverage special charges of $78 million included $43 million primarily attributable to the recent experience of higher-than-anticipated base warranty costs to repair certain automotive engines manufactured in previous years, and $35 million related to a revised estimate of product coverage cost liability primarily for extended warranty programs. The special charges also included $14 million for inventory write-downs associated with the Company's restructuring and exit activities. These write-downs related to amounts of inventory rendered excess or unusable due to the closing or consolidation of facilities.

Note 4. Restructuring and Other Non-Recurring Charges: In December 1999, the Company recorded a charge of $60 million in connection with the dissolution of the Cummins Wärtsilä joint venture. The charge included $17 million to write off the Company's remaining investment in the joint venture, $29 million for impairment of assets transferred from the joint venture and $14 million for additional warranty and other liabilities assumed by the Company. The joint venture termination was effective December 31, 1999, with the Company taking over the operations and assets of the product line manufactured in Daventry, England.

The asset impairment loss was calculated according to the provisions of SFAS No. 121, using expected discounted cash flows as the estimate of fair value. The majority of the impaired assets are to be held and used in the Company's Power Generation Business, with depreciation continuing on such assets.

In the third quarter of 1998, the Company recorded charges of $125 million, comprised of $100 million for costs to reduce the worldwide workforce by approximately 1,100 people, as well as costs associated with streamlining certain majority-owned and international joint venture operations and $25 million for a civil penalty to be paid by the Company as a result of an agreement reached with the U.S. Environmental Protection Agency (EPA) regarding diesel engine emissions. In addition, the Company recorded special charges of $14 million for inventory write-downs associated with restructuring actions.

The Company is continuing the restructuring plan implemented in the third quarter of 1998. As of December 31, 1999, approximately $81 million has been charged against the liabilities associated with these actions. The Company has funded the restructuring actions using cash generated from operations. Of the planned workforce reduction of 1,100 employees, approximately 900 people left the Company prior to December 31, 1999. The remaining actions to be completed consist primarily of the outsourcing of certain manufacturing operations and payment of severance commitments to terminated employees. The program is expected to be essentially complete in early 2000 and yield approximately $50 million in annual savings at completion. The Company does not currently anticipate any material changes in the original charges recorded for these actions. Activity in the major components of these charges is as follows:

$ Millions	Original Provision	Charges 1998	Charges 1999	Dec. 31, 1999
Restructuring of majority-owned operations:				
Workforce reductions	$ 38	$ (12)	$ (14)	$ 12
Asset impairment loss	22	—	(7)	15
Facility consolidations and other	17	(8)	(4)	5
	77	(20)	(25)	32
Restructuring of joint venture operations:				
Workforce reductions	11	—	(10)	1
Tax asset impairment loss	7	—	(7)	—
Facility and equipment-related costs	5	—	(5)	—
	23	—	(22)	1
Inventory write-downs associated with restructuring actions	14	(5)	(9)	—
Total restructuring charges	114	(25)	(56)	33
EPA penalty	25	—	(8)	17
Total	$139	$ (25)	$ (64)	$ 50

Note 5. Other Expense (Income): The major components of other expense (income) include the following:

$ Millions	1999	1998	1997
Amortization of intangibles	$15	$14	$ 2
Interest income	(7)	(9)	(5)
Loss (gain) on sale of businesses	1	(7)	(13)
Rental income	(5)	(6)	(3)
Royalty income	(4)	(5)	(12)
Foreign currency losses	2	5	1
Non-operating partnership costs	6	3	—
Social tax refunds	—	(3)	—
Other	—	(5)	4
Total	$ 8	$(13)	$(26)

Note 6. Investments in Joint Ventures and Alliances: Investments in joint ventures and alliances at December 31 were as follows:

$ Millions	1999	1998
Tata Cummins	$ 22	$ 22
Komatsu alliances	18	17
Chongqing Cummins	16	15
Behr America	15	14
European Engine Alliance	14	5
Consolidated Diesel	11	39
Dong Feng	10	8
Cummins Wärtsilä	—	(6)
Other	25	22
	$131	$136

Summary financial information for the joint ventures and alliances was as follows:

	December 31,		
$ Millions	1999	1998	1997
Net sales	$1,334	$1,245	$1,307
Gross profit	101	25	111
Net earnings (loss)	(64)	(105)	5
Cummins' share	(32)	(52)	2
Current assets	$ 302	$ 527	
Noncurrent assets	485	613	
Current liabilities	(223)	(406)	
Noncurrent liabilities	(284)	(455)	
Net assets	$ 280	$ 279	
Cummins' share	$ 131	$ 136	

The Company has guaranteed $52 million in outstanding debt of the Cummins Wärtsilä joint venture as of December 31, 1999. As disclosed in Note 4, the Cummins Wärtsilä joint venture was terminated effective December 31, 1999.

In connection with various joint venture agreements, Cummins is required to purchase products from the joint ventures in amounts to provide for the recovery of specified costs of the ventures. Under the agreement with Consolidated Diesel, Cummins' purchases were $513 million in 1999 and $535 million in 1998.

Note 7. Borrowings: Long-term debt at December 31 was:

$ Millions	1999	1998
7.125% debentures due 2028	$ 249	$ 249
6.45% notes due 2005	224	224
Commercial paper	168	142
5.65% debentures due 2098, net of unamortized discount of $40 (effective interest rate 7.48%)	125	125
6.25% notes due 2003	125	125
6.75% debentures due 2027	120	120
Guaranteed notes of ESOP Trust due 2010	61	63
8.2% notes through 2003	—	79
Other	30	36
Total	1,102	1,163
Current maturities	(10)	(26)
Long-term debt	$1,092	$1,137

Maturities of long-term debt for the 5 years subsequent to December 31, 1999 are $10 million, $8 million, $9 million, $131 million and $7 million. At December 31, 1999 and 1998, the weighted-average interest rate on loans payable and current maturities of long-term debt approximated 6 percent and 7 percent, respectively.

The Company maintains a $500 million revolving credit agreement, maturing in 2003, under which there were no outstanding borrowings at December 31, 1999 or 1998. The revolving credit agreement supports the Company's commercial paper borrowings. In February 1998, the Company issued $765 million face amount of notes and debentures under a $1 billion Registration Statement filed with the Securities and Exchange Commission in 1997. Net proceeds were used to finance the acquisition of Nelson and to pay down other indebtedness outstanding at December 31, 1997. The Company also has other domestic and international credit lines with approximately $116 million available at December 31, 1999.

The Company's debt agreements have several covenants which require maintenance of a certain level of net worth, place restrictions on the amount of additional debt the Company may incur and require maintenance of minimum leverage ratios.

In December 1999, the Company paid off the 8.2 percent notes due in 2003 using cash generated from operations and additional commercial paper borrowings.

At December 31, 1999 and 1998, loans payable included $100 million and $54 million, respectively, of notes payable to banks and $13 million and $10 million, respectively, of bank overdrafts.

The Company has guaranteed the outstanding borrowings of its ESOP Trust. Cash contributions to the Trust, together with the dividends accumulated on the common stock held by the Trust, are used to pay interest and principal. Cash contributions and dividends to the Trust approximated $10 million in each year. The unearned compensation, which is reflected as a reduction to shareholders' investment, represents the historical cost of the shares of common stock that have not yet been allocated by the Trust to participants.

Note 8. Other Liabilities: Other liabilities at December 31 included the following:

$ Millions	1999	1998
Accrued retirement & post-employment benefits	$511	$ 720
Accrued product coverage & marketing expenses	175	156
Accrued compensation	42	38
Deferred income taxes	1	17
Other	59	69
	$788	$1,000

Note 9. Income Taxes: The provision for income taxes was as follows:

$ Millions	1999	1998	1997
Current:			
U.S. Federal and state	$43	$16	$16
Foreign	43	41	32
	86	57	48
Deferred:			
U.S. Federal and state	(17)	(34)	26
Foreign	(14)	(19)	—
	(31)	(53)	26
	$55	$ 4	$74

Significant components of net deferred tax assets related to the following tax effects of differences between financial and tax reporting at December 31:

$ Millions	1999	1998
Employee benefit plans	$282	$ 300
Product coverage & marketing expenses	126	106
Restructuring charges	34	14
U.S. plant & equipment	(182)	(176)
Net foreign taxable differences, primarily plant & equipment	9	6
U.S. Federal carryforward benefits:		
General business tax credits, expiring 2018 to 2019	22	43
Minimum tax credits, no expiration	15	12
Other net differences	13	12
	$319	$ 317
Balance Sheet Classification		
Current assets	$210	$ 203
Noncurrent assets	110	131
Noncurrent liabilities	(1)	(17)
	$319	$ 317

The Company expects to realize all of its tax assets, including the use of all carryforwards, before any expiration.

Earnings before income taxes and differences between the effective tax rate and U.S. Federal income tax rate were:

$ Millions	1999	1998	1997
Earnings (loss) before income taxes:			
U.S.	$232	$(21)	$205
Foreign	(11)	15	81
	$221	$ (6)	$286
Tax at 35 percent U.S. statutory rate	$ 77	$ (2)	$100
Nondeductible EPA penalty	—	9	—
Nondeductible goodwill amortization	3	3	—
Research tax credits	(15)	(10)	(11)
Foreign sales corporation benefits	(18)	(9)	(11)
Differences in rates and taxability of foreign subsidiaries	10	15	(3)
All other, net	(2)	(2)	(1)
	$ 55	$ 4	$ 74

Note 10. Financial Instruments and Risk Management: The Company is exposed to financial risk resulting from volatility in foreign exchange rates and interest rates. This risk is closely monitored and managed through the use of financial derivative contracts. As clearly stated in the Company's policies and procedures, financial derivatives are used expressly for hedging purposes, and under no circumstances are they used for speculating or trading. Transactions are entered into only with banking institutions with strong credit ratings, and thus the credit risk associated with these contracts is considered immaterial. Hedging program results and status are reported to senior management on a periodic basis.

Foreign Exchange Rates

Due to its international business presence, the Company uses foreign exchange forward contracts to manage its exposure to exchange rate volatility. Foreign exchange balance sheet exposures are aggregated and hedged at the corporate level. Maturities on these instruments generally fall within the 1-month and 6-month range. The objective of the hedging program is to reduce earnings volatility resulting from the translation of net foreign exchange balance sheet positions. The total notional amount of these forward contracts outstanding at December 31 was as follows:

$ Millions	1999	1998
Currency:		
British Pound	$ 120	$ 86
Euro	47	—
Australian Dollar	19	13
Hong Kong Dollar	8	8
Japanese Yen	7	6
Canadian Dollar	3	11
French Franc	—	23
German Mark	—	19
Other	2	8
	$ 206	$ 174

Interest Rates

The Company manages its exposure to interest rate fluctuations through the use of interest rate swaps. Currently the Company has in place three interest rate swaps that effectively convert fixed-rate debt into floating-rate debt. The objective of the swaps is to more efficiently balance borrowing costs and interest rate risk. The contracts were established during 1998 and 1999 and have a total notional value of $350 million.

Fair Value of Financial Instruments

Based on borrowing rates currently available to the Company for bank loans with similar terms and average maturities, the fair value of total debt, including current maturities, at December 31, 1999, approximated $1,104 million. The carrying value at that date was $1,215 million. At December 31, 1998, the fair and carrying values of total debt, including current maturities, were $1,214 and $1,227 million, respectively. The carrying values of all other receivables and liabilities approximated fair values.

Note 11. Retirement Plans: The Company has various contributory and noncontributory pension plans covering substantially all employees. Cummins common stock represented 11 percent of pension plan assets at December 31, 1999.

Cummins also provides various health care and life insurance benefits to eligible retirees and their dependents but reserves the right to change benefits covered under these plans. The plans are contributory with retirees' contributions adjusted annually, and they contain other cost-sharing features, such as deductibles, coinsurance and spousal contributions. The general policy is to fund benefits as claims and premiums are incurred.

The projected benefit obligation, accumulated benefit obligation and fair value of plan assets for plans with accumulated benefit obligations in excess of plan assets were $651 million, $636 million, and $513 million, respectively, as of December 31, 1999, and $1,296 million, $1,251 million, and $999 million, respectively, as of December 31, 1998. The assumed long-term rate of compensation increase for salaried plans was 5.25 percent in 1999 and 4.25 percent in 1998. Other significant assumptions for the Company's principal plans were:

	Pension Benefits		Other Benefits	
	1999	1998	1999	1998
Weighted-average discount rate	7.5%	6.5%	7.5%	6.5%
Long-term rate of return on plan assets	9.0%	10.0%		

For measurement purposes a 7 percent annual increase in health care costs was assumed for 2000, decreasing gradually to 5.25 percent in 10 years and remaining constant thereafter.

Increasing the health care cost trend rate by 1 percent would increase the obligation by $43 million and annual expense by $4 million. Decreasing the health care cost trend rate by 1 percent would decrease the obligation by $42 million and annual expense by $4 million.

The Company's net periodic benefit cost under these plans was as follows:

	Pension Benefits			Other Benefits		
$ Millions	1999	1998	1997	1999	1998	1997
Service cost	$ 53	$ 47	$ 41	$ 8	$ 8	$ 8
Interest cost	116	123	115	40	44	41
Expected return on plan assets	(161)	(153)	(134)	—	—	—
Amortization of transition asset	(3)	(4)	(9)	—	—	—
Other	12	12	13	4	3	9
	$ 17	$ 25	$ 26	$ 52	$ 55	$ 58

	Pension Benefits		Other Benefits	
$ Millions	1999	1998	1999	1998
Change in benefit obligation:				
Benefit obligation at beginning of year	$1,907	$1,693	$ 640	$ 596
Service cost	53	47	8	8
Interest cost	116	123	40	44
Plan participants' contributions	7	7	1	1
Amendments	14	2	—	—
Experience (gain) loss	(103)	161	(21)	20
Benefits paid	(119)	(123)	(31)	(29)
Other	(10)	(3)	—	—
Benefit obligation at end of year	$1,865	$1,907	$ 637	$ 640
Change in plan assets:				
Fair value of plan assets at beginning of year	$1,692	$1,905	$ —	$ —
Actual return on plan assets	331	(129)	—	—
Employer contribution	20	34	30	28
Plan participants' contributions	7	7	1	1
Benefits paid	(119)	(123)	(31)	(29)
Other	(9)	(2)	—	—
Fair value of plan assets at end of year	$1,922	$1,692	$ —	$ —
Funded status	$ 57	$ (215)	$ (637)	$ (640)
Unrecognized:				
Experience (gain) loss (a)	(103)	172	55	80
Prior service cost (b)	51	55	(12)	(11)
Transition asset (c)	(5)	(7)	—	—
Net amount recognized	$ —	$ 5	$ (594)	$ (571)
Amounts recognized in the statement of financial position:				
Prepaid benefit cost	$ 102	$ 50	$ —	$ —
Accrued benefit liability	(114)	(232)	(594)	(571)
Intangible asset	12	104	—	—
Accumulated other comprehensive income	—	83	—	—
Net amount recognized	$ —	$ 5	$ (594)	$ (571)

(a) The net deferred (gain) loss resulting from investments, other experience and changes in assumptions.
(b) The prior service effect of plan amendments deferred for recognition over remaining service.
(c) The balance of the initial difference between assets and obligations deferred for recognition over a 15-year period.

Note 12. Common Stock: The Company increased its quarterly common stock dividend from 27.5 cents per share to 30.0 cents, effective with the dividend payment in December 1999.

The Company repurchased 0.7 million shares on the open market at an aggregate purchase price of $34 million in 1999 and 0.4 million shares on the open market at an aggregate purchase price of $14 million in 1998. In 1997, the Company repurchased 1.3 million shares from Ford Motor Company and another 0.2 million shares on the open market at an aggregate purchase price of $75 million. All of the acquired shares are held as common stock in treasury.

In 1997, the Company issued 3.75 million shares of its common stock to an employee benefits trust to fund obligations of employee benefit and compensation plans, principally retirement savings plans. Shares of the stock held by this trust are not used in the calculation of earnings per share until allocated to a benefit plan.

Note 13. Shareholders' Rights Plan: The Company has a Shareholders' Rights Plan which it first adopted in 1986. The Rights Plan provides that each share of the Company's common stock has associated with it a stock purchase right. The Rights Plan becomes operative when a person or entity acquires 15 percent of the Company's common stock or commences a tender offer to purchase 20 percent or more of the Company's common stock without the approval of the Board of Directors.

Note 14. Employee Stock Plans: Under the Company's stock incentive and option plans, officers and other eligible employees may be awarded stock options, stock appreciation rights and restricted stock. Under the provisions of the stock incentive plan, up to 1 percent of the Company's outstanding shares of common stock at the end of the preceding year is available for issuance under the plan each year. At December 31, 1999, there were no shares of common stock available for grant and 1,732,875 options exercisable under the plans.

The Company accounts for stock options in accordance with APB Opinion No. 25 and related interpretations. No compensation expense has been recognized for stock options since the options have exercise prices equal to the market price of the Company's common stock at the date of grant.

Options	Number of Shares	Weighted-average exercise price
Dec. 31, 1996	1,510,150	38.88
Granted	766,500	60.61
Exercised	(294,025)	35.85
Cancelled	(61,775)	42.66
Dec. 31, 1997	1,920,850	46.08
Granted	703,660	45.34
Exercised	(54,075)	36.36
Cancelled	(27,425)	53.80
Dec. 31, 1998	2,543,010	48.08
Granted	886,900	39.74
Exercised	(196,500)	39.71
Cancelled	(40,275)	43.99
Dec. 31, 1999	3,193,135	46.65

Options outstanding at December 31, 1999, have exercise prices between $15.94 and $79.81 and a weighted-average remaining life of 7 years. The weighted-average fair value of options granted was $13.76 per share in 1999 and $18.61 per share in 1998. The fair value of each option was estimated on the date of grant using a risk-free interest rate of 5.6 percent in 1999 and 1998, current annual dividends, expected lives of 10 years and expected volatility of 34 percent. A fair-value method of accounting for awards subsequent to January 1, 1997, would have resulted in an increase in compensation expense of $8 million, net of tax ($.20 per share) in 1999, $8 million, net of tax ($.20 per share) in 1998 and $6 million, net of tax ($.14 per share) in 1997.

Note 15. Comprehensive Income: Comprehensive income includes net income and all other nonowner changes in equity during a period.

The tax effect on other comprehensive income is as follows:

$ Millions	Foreign Currency Translation Adjustments	Unrealized Losses on Securities	Minimum Pension Liability Adjustments	Total Other Comprehensive Income
1999				
Pre-tax amount	$ 5	$ (1)	$ 84	$ 88
Tax (expense) benefit	(1)	—	(29)	(30)
Net amount	$ 4	$ (1)	$ 55	$ 58
1998				
Pre-tax amount	$ (44)	$ (1)	$ (83)	$ (128)
Tax (expense) benefit	1	1	29	31
Net amount	$ (43)	$ —	$ (54)	$ (97)
1997				
Pre-tax amount	$ (21)	$ (1)	$ 12	$ (10)
Tax (expense) benefit	—	—	—	—
Net amount	$ (21)	$ (1)	$ 12	$ (10)

The components of accumulated other comprehensive income are as follows:

$ Millions	Foreign Currency Translation Adjustments	Unrealized Losses on Securities	Minimum Pension Liability Adjustments	Accumulated Other Comprehensive Income
Balance at December 31, 1996	$ (47)	$ —	$ (13)	$ (60)
Change in 1997	(21)	(1)	12	(10)
Balance at December 31, 1997	(68)	(1)	(1)	(70)
Change in 1998	(43)	—	(54)	(97)
Balance at December 31, 1998	(111)	(1)	(55)	(167)
Change in 1999	4	(1)	55	58
Balance at December 31, 1999	$ (107)	$ (2)	$ —	$ (109)

Note 16. Segments of the Business:
The Company has three operating segments: Engine, Power Generation, and Filtration and Other. The engine segment produces engines and parts for sale to customers in automotive and industrial markets. The engines are used in trucks of all sizes, buses and recreational vehicles, as well as various industrial applications including construction, mining, agriculture, marine, rail and military. The power generation segment is the Company's power systems supplier, selling engines, generator sets and alternators and providing temporary power through rentals of generator sets. The filtration and other segment includes sales of filtration products and exhaust systems, turbochargers and company-owned distributors.

The Company's operating segments are organized according to products and the markets they each serve. This business structure was designed to focus efforts on providing enhanced service to a wide range of customers.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies except that the Company evaluates performance based on earnings before interest and income taxes and on net assets; therefore, no allocation of debt-related items and income taxes is made to the individual segments.

Operating segment information is as follows:

$ Millions	Engine	Power Generation	Filtration and Other	Total
1999				
Net sales	$ 4,225	$1,356	$1,058	$ 6,639
Depreciation and amortization	146	47	40	233
Income (expense) from joint ventures and alliances	(4)	(25)	1	(28)
Earnings before interest, income taxes and unusual charges	182	52	122	356
Unusual charges	18	42	—	60
Earnings before interest and income taxes	164	10	122	296
Net assets	1,015	553	868	2,436
Investment in joint ventures and alliances	112	11	8	131
Capital expenditures	130	49	36	215
1998				
Net sales	$ 3,982	$1,230	$1,054	$ 6,266
Depreciation and amortization	120	40	39	199
Income (expense) from joint ventures and alliances	(4)	(25)	(1)	(30)
Earnings before interest, income taxes and unusual charges	136	25	121	282
Unusual charges	165	50	2	217
Earnings (loss) before interest and income taxes	(29)	(25)	119	65
Net assets	946	511	803	2,260
Investment in joint ventures and alliances	132	3	1	136
Capital expenditures	172	67	32	271
Additions to goodwill	12	2	370	384
1997				
Net sales	$ 3,666	$1,205	$ 754	$ 5,625
Depreciation and amortization	102	34	22	158
Income (expense) from joint ventures and alliances	12	(2)	—	10
Earnings (loss) before interest and income taxes	207	(2)	107	312
Net assets	1,074	531	312	1,917
Investment in joint ventures and alliances	133	65	6	204
Capital expenditures	304	79	22	405

Reconciliation to Consolidated Financial Statements:

$ Millions	1999	1998	1997
Earnings before interest and income taxes for operating segments	$ 296	$ 65	$ 312
Interest expense	75	71	26
Income tax expense	55	4	74
Minority interest	6	11	—
Net earnings (loss)	$ 160	$ (21)	$ 212
Net assets for operating segments	$2,436	$2,260	$1,917
Liabilities deducted in arriving at net assets	1,922	1,926	1,583
Deferred tax assets not allocated to segments	320	334	256
Debt-related costs not allocated to segments	19	22	9
Total assets	$4,697	$4,542	$3,765

Summary geographic information is listed below:

$ Millions	US	UK	Canada	All Other	Total
1999					
Net sales(a)	$4,064	$400	$473	$1,702	$6,639
Long-lived assets	$1,434	$206	$ —	$ 264	$1,904
1998					
Net sales(a)	$3,595	$389	$459	$1,823	$6,266
Long-lived assets	$1,470	$209	$ —	$ 272	$1,951
1997					
Net sales(a)	$3,123	$384	$318	$1,800	$5,625
Long-lived assets	$1,360	$251	$ —	$ 267	$1,878

(a) Net sales are attributed to countries based on location of customer.

Revenues from the Company's largest customer represent approximately $1.3 billion of the Company's net sales in 1999. These sales are included in the engine and filtration and other segments.

Note 17. Guarantees, Commitments and Other Contingencies: At December 31, 1999, the Company had the following minimum rental commitments for noncancelable operating leases: $47 million in 2000, $38 million in 2001, $30 million in 2002, $26 million in 2003, $18 million in 2004 and $70 million thereafter. Rental expense under these leases approximated $75 million in 1999, $70 million in 1998 and $60 million in 1997.

Commitments under outstanding letters of credit, guarantees and contingencies at December 31, 1999, approximated $159 million.

Cummins and its subsidiaries are defendants in a number of pending legal actions, including actions related to use and performance of the Company's products. The Company carries product liability insurance covering significant claims for damages involving personal injury and property damage. In the event the Company is determined to be liable for damages in connection with actions and proceedings, the unreserved portion of such liability is not expected to be material.
The Company also has been identified as a potentially responsible party at several waste disposal sites under U.S. and related state environmental statutes and regulations and has joint and several liability for any investigation and remediation costs incurred with respect to such sites. The Company denies liability with respect to many of these legal actions and environmental proceedings and vigorously is defending such actions or proceedings. The Company has established reserves that it believes are adequate for its expected future liability in such actions and proceedings where the nature and extent of such liability can be estimated reasonably based upon presently available information.

Note 18. Quarterly Financial Data (Unaudited):

$ Millions, except per share amounts	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Full Year
1999					
Net sales	$1,505	$1,667	$1,631	$1,836	$6,639
Gross profit	301	371	361	385	1,418
Net earnings	24	58	53	25	160
Basic earnings per share	$ .63	$ 1.51	$ 1.37	$ .65	$ 4.16
Diluted earnings per share	.63	1.50	1.35	.65	4.13
1998					
Net sales	$1,500	$1,635	$1,525	$1,606	$6,266
Gross profit	297	369	258	325	1,249
Net earnings (loss)	7	53	(110)	29	(21)
Basic earnings (loss) per share	$ .18	$ 1.39	$ (2.86)	$ .75	$ (.55)
Diluted earnings (loss) per share	.18	1.38	(2.86)	.75	(.55)

Fourth quarter 1999 net earnings included a charge of $45 million, net of tax ($60 million pretax), or $1.17 per share, for the termination of the Cummins Wärtsilä joint venture.

First quarter 1998 gross profit included a $43 million special charge for product coverage costs. The special charge, net of taxes, included in net earnings was $30 million or $.78 per share.

Third quarter 1998 gross profit included special charges of $49 million for product coverage costs and inventory write-downs. Net loss for the period also included charges for restructuring, EPA penalties and other non-recurring items. The total charges, net of tax, included in net loss were $130 million or $3.38 per share.

Responsibility for Financial Statements

Management is responsible for the preparation of the Company's consolidated financial statements and all related information appearing in this Report. The statements and notes have been prepared in conformity with generally accepted accounting principles and include some amounts which are estimates based upon currently available information and management's judgment of current conditions and circumstances. The Company engaged Arthur Andersen LLP, independent public accountants, to examine the consolidated financial statements. Their report appears on this page.

To provide reasonable assurance that assets are safeguarded against loss from unauthorized use or disposition and that accounting records are reliable for preparing financial statements, management maintains a system of accounting and controls, including an internal audit program. The system of accounting and controls is improved and modified in response to changes in business conditions and operations and recommendations made by the independent public accountants and the internal auditors.

The Board of Directors has an Audit Committee whose members are not employees of the Company. The committee meets periodically with management, internal auditors and representatives of the Company's independent public accountants to review the Company's program of internal controls, audit plans and results, and the recommendations of the internal and external auditors and management's responses to those recommendations.

Report of Independent Public Accountants

To the Shareholders and Board of Directors of Cummins Engine Company, Inc.:

We have audited the accompanying consolidated statement of financial position of Cummins Engine Company, Inc., (an Indiana corporation) and subsidiaries as of December 31, 1999 and 1998, and the related consolidated statements of earnings, cash flows and shareholders' investment for each of the three years in the period ended December 31, 1999. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Cummins Engine Company, Inc., and subsidiaries as of December 31, 1999 and 1998, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1999, in conformity with generally accepted accounting principles.

Arthur Andersen LLP

Chicago, Illinois
January 26, 2000

Cummins Engine Company, Inc.
Five-Year Supplemental Data

$ Millions, except per share amounts	1999	1998	1997	1996	1995
Net sales	$ 6,639	$ 6,266	$ 5,625	$ 5,257	$ 5,245
Cost of goods sold	5,221	4,925	4,345	4,072	3,974
Special charges	—	92	—	—	—
Gross profit	1,418	1,249	1,280	1,185	1,271
Selling and administrative expenses	781	787	744	725	692
Research and engineering expenses	245	255	260	252	263
Expense (income) from joint ventures and alliances	28	30	(10)	—	2
Interest expense	75	71	26	18	13
Other expense (income), net	8	(13)	(26)	(24)	6
Restructuring and other non-recurring charges	60	125	—	—	118
Earnings (loss) before income taxes	221	(6)	286	214	177
Provision (benefit) for income taxes	55	4	74	54	(47)
Minority interest	6	11	—	—	—
Net earnings (loss)	$ 160	$ (21)	$ 212	$ 160	$ 224
Net earnings (loss) per share:					
Basic	$ 4.16	$ (.55)	$ 5.55	$ 4.02	$ 5.53
Diluted	4.13	(.55)	5.48	4.01	5.52
Number of shares for EPS:					
Basic	38.3	38.5	38.2	39.8	40.6
Diluted	38.6	38.5	38.7	39.9	40.7
Cash dividends per share	$ 1.125	$ 1.10	$ 1.075	$ 1.00	$ 1.00
Shareholders' investment per share	37.44	33.11	37.05	33.24	29.39
Working capital	$ 866	$ 805	$ 655	$ 532	$ 335
Property, plant and equipment, net	1,630	1,671	1,532	1,286	1,148
Total assets	4,697	4,542	3,765	3,369	3,056
Total debt	1,215	1,227	654	415	219
Shareholders' investment	1,429	1,272	1,422	1,312	1,183
Property, plant and equipment additions	$ 215	$ 271	$ 405	$ 304	$ 223
Depreciation and amortization	233	199	158	149	143
Shareholders of record	4,800	5,200	4,700	4,800	5,000
Number of employees[a]	28,500	28,300	26,300	23,500	24,300

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

Earnings per share for 1995–1996 have been restated to reflect the adoption of SFAS No. 128.

The Cummins Board of Directors is pictured at our Charlotte, North Carolina distributorship, one of 129 distributorships worldwide.

Top row: (from left to right)
Robert J. Darnall, Tim Solso,
William I. Miller, William D. Ruckelshaus

Bottom row: (from left to right)
Harold Brown, Franklin A. Thomas,
J. Lawrence Wilson, Hanna H. Gray,
James A. Johnson, Walter Y. Elisha,
Henry B. Schacht, John Deutch

Directors and Committees

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

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

Policy Committee

Tim Solso	Chairman and Chief Executive Officer
Jean Blackwell	Vice President, Human Resources
Pamela Carter	Vice President, General Counsel and Corporate Secretary
Jack Edwards	Executive Vice President, Group President, Power Generation
Mark Gerstle	Vice President, Cummins Business Services
Joe Loughrey	Executive Vice President, President, Engine Business
Frank McDonald	Vice President, Quality
Rick Mills	Vice President, Filtration, President, Fleetguard, Inc.
Kiran Patel	Executive Vice President and Chief Financial Officer
Christine Vujovich	Vice President, Environmental Policy and Product Strategy

Executives and Officers

Engine Business

Martha F. Brooks	Vice President and General Manager	Truck and Bus Engine Business
Richard Gold	Vice President and General Manager	PowerCare and Distribution
James D. Kelly	Vice President and General Manager	Industrial Engine Business
Mark Levett	Vice President and General Manager	High-Horsepower Business
Larry Moore	Vice President and General Manager	Light-Duty Automotive Business
Iain M. Barrowman	Vice President	High-Horsepower Operations
Charlie Bumb	Vice President	National Accounts
Al Dohner	Vice President	Fuel Systems
Patrick F. Flynn	Vice President	Research
Rich Freeland	Vice President	Heavy-Duty Engine Operations and Fuel Systems
Dale F. Good	Vice President	Sales and Marketing, Truck and Bus Engine Business
Sam Hires	Vice President	High-Horsepower Engineering
Jeffrey D. Jones	Vice President	National Accounts
Tom Linebarger	Vice President	Supply Chain Management
Peter McDowell	Vice President	European Automotive Business
George L. Muntean	Vice President	Fuel Systems Engineering
Ed Pence	Vice President	OEM Business
John H. Stang	Vice President	Automotive Engineering
Bryan Swank	Vice President	Midrange Engineering
Ronald H. Temple	Vice President	Electronic Technology
Bharat Vedak	Vice President	Industrial Customer Engineering
Mark Yragui	Vice President	Industrial Marketing
John C. Wall	Vice President	Chief Technical Officer
Bill Wolpert	General Manager	Marine Business

Power Generation Business

R. Siisi Adu-Gyamfi	Vice President	Marketing, Power Generation Business
Mike F. Mitchell	Vice President	Power Generation Group Operations
Ron Moore	Vice President and General Manager	Power Generation Americas
Tony Satterthwaite	Managing Director	Cummins Power Generation Limited
Steven L. Zeller	Vice President and Managing Director	Newage International Limited

International

Steve Chapman	Vice President	International
Derek Boulton	General Manager	Japan
Ricardo Chuahy	General Manager	Latin America
	President	Cummins Brasil
Tom Dewing	Vice President and Managing Director	Central Area Business Organization
Hugh Foden	General Manager	Southeast Asia
Mike Green	Managing Director	South Pacific
Jong S. Kim	Managing Director	Korea
Steve Knaebel	Vice President	Cummins Mexico Operations
	President and General Manager	Cummins, S. de R.L. de C.V.
Ravi Venkatesan	General Manager	India

Corporate Support

John Crowther	Vice President	Information Technology and Chief Information Officer
George Fauerbach	Vice President	Business Development
Jeff Hamilton	Vice President	Business Process Improvement
Bob Crane	Vice President	Corporate Controller
Donald Trapp	Vice President	Treasurer
Bob Weimer	Vice President	Customer Support
Chip Wochomurka	Vice President	Investor Relations and Strategic Planning

Shareholder Information

Annual Meeting
Shareholders are invited to attend the Company's Annual Meeting on April 4, 2000, at 10:00 a.m. (Eastern Standard Time) in Columbus, Indiana. The meeting will be held in the Robbins Auditorium of Columbus East High School.

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

Dividend Reinvestment
As an added service to shareholders, Cummins has a Dividend Reinvestment Plan, administered by Norwest Shareowner Services. This plan gives shareholders of record the option of having their cash dividends and optional cash payments applied toward the purchase of additional shares. Shareholders desiring information about this plan may contact Norwest Shareowner Services (see right), or request information from Cummins through the Company's website.

Further Information
Shareholders and others are invited to visit Cummins on the Worldwide Web for further information of interest to investors. Visit www.cummins.com and click on Investor Information. SEC filings, press releases, stock quotes and other information are available there. On the site, you can request a printed copy of the 10-K, 10-Q, annual report and dividend reinvestment literature, and you can request e-mail alerts to advise you when new information is posted to the site. Shares may be voted by mail, by a toll-free telephone call or on the Internet. Please see the simple instructions on the proxy card.

Investors may also contact:
Chip Wochomurka
Vice President—Investor Relations and Strategic Planning
Cummins Engine Company, Inc.
Box 3005 (Mail Code 60118)
Columbus, IN 47202-3005
Phone: 812-377-3121
Fax: 812-377-4937
Investor_relations@cummins.com
The Company's press releases by fax may be requested by calling News on Demand at 888-329-2305.

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

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

Stock Transfer Agent, Registrar, and Dividend Disbursing Agent
Norwest Shareowner Services is Cummins' stock transfer agent and registrar. Norwest maintains the Company's shareholder records, disburses dividend checks and administers the Company's Dividend Reinvestment Program.

General correspondence (address change, name change, notification of lost securities, transfers, inquiries about transfer requirements and correspondence relating to the Dividend Reinvestment Program) should be directed to Norwest:

By mail:
Norwest Shareowner Services
P.O. Box 64854
St. Paul, MN 55164-0854

By hand or overnight:
Norwest Shareowner Services
161 North Concord Exchange
South St. Paul, MN 55075

By phone:
1-800-468-9716
1-651-450-4064

By fax:
1-651-450-4033

By e-mail:
StockTransfer@Norwest.com

Printed on recycled paper

Cummins Worldwide Locations

	Location	Products
Operations		
BMC Sanayi ve Ticaret A.S.**	Izmir, Turkey	B3.9/5.9 C8.3
Chongqing Cummins Engine Company Ltd.*	Chongqing, China	NT L10/M11 K19/38/50
Columbus Midrange Engine Plant	Columbus, Indiana	B5.9 ISB
Columbus Engine Plant	Columbus, Indiana	N14/NT Signature 600 ISX
Consolidated Diesel Company*	Rocky Mount, North Carolina	B3.9/5.9 C8.3 ISB ISC
Cummins Brasil Ltda.	Sao Paulo, Brazil	B3.9/5.9 C8.3 NT/N14
Cummins India Ltd.	Pune, India	C8.3 NT/N14 V28 K38/50
Cummins Industrial Center	Seymour, Indiana	K19 V903 QSK19
Cummins Komatsu Engine Co.*	Seymour, Indiana	QST30
Cummins Natural Gas Engines, Inc.	Forth Worth, Texas	G-K19 G-V28 G-NT
Darlington Engine Plant	Darlington, England	B3.9/5.9 C8.3
Daventry Engine Plant	Daventry, England	K38/50 QSK45/60 QSV81/91
Dongfeng Cummins Engine Co. Ltd*	Xiangfan, China	C8.3
Dongfeng Motor Corporation**	Xiangfan, China	B3.9/5.9
Jamestown Engine Plant	Jamestown, New York	ISM L10 G-L10
Komatsu Cummins Engine Company, Ltd*	Oyama, Japan	B3.3 B3.9/5.9
Onan Corporation	Fridley, Minnesota	Generator sets and electronic controls
Onan Corporation	St Peter, Minnesota	Generator sets and electronic controls
Cummins Power Generation Limited	Ramsgate, England	Generator sets and electronic controls
SsangYong Heavy Industries Co., Ltd**	Seoul, South Korea	K19 V903
Tata Cummins Limited*	Jamshedpur, India	B3.9/5.9
Components		
Cummins S.A.	San Luis Potosi, Mexico	Engine components and remanufactured engines
Diesel ReCon Company	Memphis, Tennessee	Remanufactured engines and components
Fleetguard Brasil	Bonsucesso, Brazil	Filtration systems
Fleetguard Filters Ltd.*	Pune, India	Filtration systems
Fleetguard France	Quimper, France	Filtration systems
Fleetguard, Inc.	Nashville, Tennessee	Filtration systems
Fleetguard South Africa	Pietermaritzburg, South Africa	Filtration systems
Fuel Systems Division	Columbus, Indiana	Fuel system design and manufacture
Holset Engineering Company Ltd.	Charleston, South Carolina	Turbochargers
Holset Engineering Company Ltd.	Huddersfield, England	Turbochargers
Nelson Engine Systems India Ltd.	Daman, India	Filtration systems
Nelson Industries	Stoughton, Wisconsin	Filtration systems
Newage International Limited	Stamford, England	Alternators
Wuxi Newage Alternators Ltd*	Wuxi, China	Alternators
Shanghai Fleetguard Ltd.*	Shanghai, China	Filtration systems
Tata Holset Ltd*	Dewas, India	Turbochargers
Tubengineers Pty. Ltd.	Scoresby, Australia	Filtration systems
Wuxi Holset Ltd*	Wuxi, China	Turbochargers
Technical Centers		
	Columbus, Indiana Darlington, England European Engine Alliance,* High Wycombe, England Fridley, Minnesota Industrial Power Alliance,* Oyama, Japan Pune, India Sao Paulo, Brazil	
Parts Distribution Centers		
	Beijing, China Mechelen, Belgium Memphis, Tennessee Pune, India San Luis Potosi, Mexico Sao Paulo, Brazil Scoresby, Australia Singapore	
Sales and Service	Over 500 distributorships and branches worldwide	

* Joint Venture
** Licensee

...to a worldwide audience.

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