

CATERPILLAR INC
Form 10-Q
October 30, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2009

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number: 1-768

CATERPILLAR INC.
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation)

37-0602744
(IRS Employer I.D. No.)

100 NE Adams Street, Peoria, Illinois
(Address of principal executive offices)

61629
(Zip Code)

Registrant's telephone number, including area code:
(309) 675-1000

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

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

[]

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

Large accelerated filer	<input checked="" type="checkbox"/>	Accelerated filer
Non-accelerated filer		Smaller reporting company

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

At September 30, 2009, 622,727,557 shares of common stock of the registrant were outstanding.

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* Item omitted because no answer is called for or item is not applicable.

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Part I. FINANCIAL INFORMATION

Item 1. Financial Statements

Caterpillar Inc.
 Consolidated Statement of Results of Operations
 (Unaudited)
 (Dollars in millions except per share data)

	Three Months Ended September 30,	
	2009	2008
Sales and revenues:		
Sales of Machinery and Engines	\$ 6,583	\$ 12,148
Revenues of Financial Products	715	833
Total sales and revenues	7,298	12,981
Operating costs:		
Cost of goods sold	5,255	9,704
Selling, general and administrative expenses	907	1,061
Research and development expenses	327	437
Interest expense of Financial Products	256	291
Other operating (income) expense	276	315
Total operating costs	7,021	11,808
Operating profit	277	1,173
Interest expense excluding Financial Products	91	59
Other income (expense)	66	146
Consolidated profit before taxes	252	1,260
Provision (benefit) for income taxes	(139)	395
Profit of consolidated companies	391	865
Equity in profit (loss) of unconsolidated affiliated companies	1	11
Profit of consolidated and affiliated companies	392	876
Less: Profit (loss) attributable to noncontrolling interests	(12)	8
Profit 1	\$ 404	\$ 868
Profit per common share	\$ 0.65	\$ 1.43

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Profit per common share – diluted 2	\$	0.64	\$	1.39
Weighted-average common shares outstanding (millions)				
- Basic		622.4		607.0
- Diluted 2		635.5		624.8
Cash dividends declared per common share	\$	—	\$	—

- 1 Profit attributable to common stockholders.
2 Diluted by assumed exercise of stock-based compensation awards using the treasury stock method.

See accompanying notes to Consolidated Financial Statements.

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Caterpillar Inc.
Consolidated Statement of Results of Operations
(Unaudited)
(Dollars in millions except per share data)

		Nine Months Ended September 30,	
		2009	2008
Sales and revenues:			
Sales of Machinery and Engines	\$	22,347	\$ 35,924
Revenues of Financial Products		2,151	2,477
Total sales and revenues		24,498	38,401
Operating costs:			
Cost of goods sold		18,034	28,349
Selling, general and administrative expenses		2,703	3,094
Research and development expenses		1,066	1,221
Interest expense of Financial Products		807	854
Other operating (income) expense		1,439	892
Total operating costs		24,049	34,410
Operating profit		449	3,991
Interest expense excluding Financial Products		301	203
Other income (expense)		293	351
Consolidated profit before taxes		441	4,139
Provision (benefit) for income taxes		(179)	1,249
Profit of consolidated companies		620	2,890
Equity in profit (loss) of unconsolidated affiliated companies		1	32

Profit of consolidated and affiliated companies	621	2,922
Less: Profit (loss) attributable to noncontrolling interests	(42)	26
Profit 1	\$ 663	\$ 2,896
Profit per common share	\$ 1.08	\$ 4.72
Profit per common share – diluted 2	\$ 1.07	\$ 4.57
Weighted-average common shares outstanding (millions)		
- Basic	612.1	613.2
- Diluted 2	620.6	633.2
Cash dividends declared per common share	\$ 0.84	\$ 0.78

- 1 Profit attributable to common stockholders.
2 Diluted by assumed exercise of stock-based compensation awards using the treasury stock method.

See accompanying notes to Consolidated Financial Statements.

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Caterpillar Inc.
Consolidated Statement of Financial Position
(Unaudited)
(Dollars in millions)

	September 30, 2009	December 31, 2008
Assets		
Current assets:		
Cash and short-term investments	\$ 4,188	\$ 2,736
Receivables – trade and other	5,733	9,397
Receivables – finance	7,791	8,731
Deferred and refundable income taxes	1,248	1,223
Prepaid expenses and other current assets	448	765
Inventories	6,815	8,781
Total current assets	26,223	31,633
Property, plant and equipment – net	12,250	12,524
Long-term receivables – trade and other	867	1,479
Long-term receivables – finance	13,240	14,264
Investments in unconsolidated affiliated companies	101	94
Noncurrent deferred and refundable income taxes	3,298	3,311
Intangible assets	474	511
Goodwill	2,272	2,261
Other assets	2,113	1,705
Total assets	\$ 60,838	\$ 67,782

Liabilities

Current liabilities:			
Short-term borrowings:			
	Machinery and Engines	\$ 554	\$ 1,632
	Financial Products	3,969	5,577
	Accounts payable	2,714	4,827
	Accrued expenses	3,360	4,121
	Accrued wages, salaries and employee benefits	761	1,242
	Customer advances	1,283	1,898
	Dividends payable	—	253
	Other current liabilities	792	1,027
Long-term debt due within one year:			
	Machinery and Engines	193	456
	Financial Products	4,331	5,036
	Total current liabilities	17,957	26,069
Long-term debt due after one year:			
	Machinery and Engines	5,709	5,736
	Financial Products	17,360	17,098
	Liability for postemployment benefits	9,039	9,975
	Other liabilities	2,260	2,190
	Total liabilities	52,325	61,068
	Commitments and contingencies (Notes 10 and 12)		
	Redeemable noncontrolling interest	431	524
Stockholders' equity			
Common stock of \$1.00 par value:			
	Authorized shares: 900,000,000		
	Issued shares: (9/30/09 and 12/31/08 – 814,894,624)		
	at paid-in amount	3,392	3,057
	Treasury stock (9/30/09 – 192,167,067; 12/31/08 – 213,367,983) at cost	(10,702)	(11,217)
	Profit employed in the business	20,026	19,826
	Accumulated other comprehensive income (loss)	(4,740)	(5,579)
	Noncontrolling interests	106	103
	Total stockholders' equity	8,082	6,190
	Total liabilities, redeemable noncontrolling interest and stockholders' equity	\$ 60,838	\$ 67,782

See accompanying notes to Consolidated Financial Statements.

Caterpillar Inc.
Consolidated Statement of Changes in Stockholders' Equity
(Unaudited)
(Dollars in millions)

Nine Months Ended September 30, 2008	Common stock	Treasury stock	Profit employed	Accumulated other	Noncontrolling interests	Total	Comprehensive
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			in the business	comprehensive income (loss) 1			income (loss)
Balance at December 31, 2007	\$2,744	\$ (9,451)	\$17,398	\$(1,808)	\$ 113	\$ 8,996	
Adjustment to adopt postretirement benefit measurement date provisions, net of tax 2	—	—	(33)	17	—	(16)	
Balance at January 1, 2008	2,744	(9,451)	17,365	(1,791)	113	8,980	
Profit of consolidated and affiliated companies	—	—	2,896	—	26	2,922	\$ 2,922
Foreign currency translation, net of tax of \$107	—	—	—	(237)	(1)	(238)	(238)
Pension and other postretirement benefits							
Amortization of actuarial (gain) loss, net of tax of \$61	—	—	—	113	—	113	113
Amortization of prior service cost, net of tax of \$0	—	—	—	1	—	1	1
Amortization of transition (asset) obligation, net of tax of \$1	—	—	—	1	—	1	1
Derivative financial instruments							
Gains (losses) deferred, net of tax of \$69	—	—	—	102	—	102	102
(Gains) losses reclassified to earnings, net of tax of \$18	—	—	—	(22)	—	(22)	(22)
Retained interests							
Gains (losses) deferred, net of tax of \$6	—	—	—	(12)	—	(12)	(12)
(Gains) losses reclassified to earnings, net of tax of \$2	—	—	—	4	—	4	4
Available-for-sale securities							
Gains (losses) deferred, net of tax of \$39	—	—	—	(72)	—	(72)	(72)
(Gains) losses reclassified to earnings, net of tax of	—	—	—	1	—	1	1

\$1							
Change in ownership for noncontrolling interests	—	—	—	—	(13)	(13)	—
Dividends declared	—	—	(475)	—	(10)	(485)	—
Common shares issued from treasury stock for stock-based compensation: 4,514,729	8	120	—	—	—	128	—
Stock-based compensation expense	163	—	—	—	—	163	—
Tax benefits from stock-based compensation	54	—	—	—	—	54	—
Shares repurchased: 25,267,026	—	(1,778)	—	—	—	(1,778)	—
Stock repurchase derivative contracts	24	—	—	—	—	24	—
Cat Japan share redemption 6	—	—	(113)	—	—	(113)	—
Balance at September 30, 2008	\$2,993	\$(11,109)	\$19,673	\$(1,912)	\$ 115	\$ 9,760	\$ 2,800

(Continued)

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Caterpillar Inc.
Consolidated Statement of Changes in Stockholders' Equity
(Unaudited)
(Dollars in millions)

Nine Months Ended	Common	Treasury	Profit	Accumulated	Noncontrolling	Total	Comprehensive
September 30, 2009	stock	stock	in the	other	interests		income
Balance at December 31, 2008			business	comprehensive			(loss)
	\$3,057	\$(11,217)	\$19,826	income (loss)	\$ 103	\$6,190	
Profit of consolidated and affiliated companies	—	—	663	—	(42)	621	\$ 621
Foreign currency translation, net of tax of \$52	—	—	—	324	10	334	334
Pension and other postretirement benefits							
Current year actuarial gain (loss), net of tax of \$80 3	—	—	—	55	—	55	55
Amortization of actuarial (gain) loss, net of tax of \$76	—	—	—	140	1	141	141
	—	—	—	235	—	235	235

Current year prior service cost, net of tax of \$197.3								
Amortization of prior service cost, net of tax of \$1	—	—	—	(2)	—	(2)	(2)	
Amortization of transition (asset) obligation, net of tax of \$1	—	—	—	1	—	1	1	
Derivative financial instruments								
Gains (losses) deferred, net of tax of \$19	—	—	—	27	(1)	26	26	
(Gains) losses reclassified to earnings, net of tax of \$22	—	—	—	(33)	—	(33)	(33)	
Retained interests								
Gains (losses) deferred, net of tax of \$10.4	—	—	—	(18)	—	(18)	(18)	
(Gains) losses reclassified to earnings, net of tax of \$11	—	—	—	20	—	20	20	
Available-for-sale securities								
Gains (losses) deferred, net of tax of \$42	—	—	—	78	—	78	78	
(Gains) losses reclassified to earnings, net of tax of \$6	—	—	—	12	—	12	12	
Change in ownership for noncontrolling interests	—	—	—	—	(6)	(6)	—	
Dividends declared	—	—	(513)	—	—	(513)	—	
Common shares issued from treasury stock for stock-based compensation: 2,109,686	(12)	62	—	—	—	50	—	
Common shares issued from treasury stock for benefit plans: 19,091,230.5	235	453	—	—	—	688	—	
Stock-based compensation expense	108	—	—	—	—	108	—	
Tax benefits from stock-based compensation	4	—	—	—	—	4	—	
Cat Japan share redemption ⁶	—	—	50	—	41	91	—	
	\$3,392	\$(10,702)	\$20,026	\$(4,740)	\$106	\$8,082	\$1,470	

Balance at September 30,
2009

- 1 Pension and other postretirement benefits include net adjustments for Cat Japan, while they were an unconsolidated affiliate, of (\$1) million for the nine months ended September 30, 2008. The ending balance was (\$53) million at September 30, 2008.
- 2 Adjustments were made to adopt the measurement date provision of the guidance on employer's accounting for defined benefits pension and other postretirement plans. Adjustments to profit employed in the business and pension and other postretirement benefits were net of tax of (\$17) million and \$9 million, respectively. See Note 2 for additional information.
- 3 Amounts due to plan re-measurements. See Note 9 for additional information.
- 4 Includes noncredit component of other-than-temporary impairment losses on securitized retained interest of (\$8) million, net of tax of \$5 million, for the nine months ended September 30, 2009. See Note 15 for additional information.
- 5 See Note 9 regarding shares issued for benefit plans.
- 6 See Note 16 regarding the Cat Japan share redemption.

See accompanying notes to Consolidated Financial Statements.

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Caterpillar Inc.
Consolidated Statement of Cash Flow
(Unaudited)
(Millions of dollars)

	Nine Months Ended September 30,	
	2009	2008
Cash flow from operating activities:		
Profit of consolidated and affiliated companies	\$ 621	\$ 2,922
Adjustments for non-cash items:		
Depreciation and amortization	1,633	1,453
Other	62	58
Changes in assets and liabilities:		
Receivables – trade and other	3,964	(676)
Inventories	1,985	(1,380)
Accounts payable and accrued expenses	(2,872)	790
Customer advances	(606)	321
Other assets – net	102	154
Other liabilities – net	(371)	(362)
Net cash provided by (used for) operating activities	4,518	3,280
Cash flow from investing activities:		
Capital expenditures – excluding equipment leased to others	(751)	(1,362)
Expenditures for equipment leased to others	(747)	(1,082)
Proceeds from disposals of property, plant and equipment	799	754
Additions to finance receivables	(5,255)	(11,168)
Collections of finance receivables	7,343	7,402
Proceeds from sales of finance receivables	69	710
Investments and acquisitions (net of cash acquired)	(9)	(139)

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Proceeds from available-for-sale securities	232	292
Investments in available-for-sale securities	(312)	(270)
Other – net	(89)	116
Net cash provided by (used for) investing activities	1,280	(4,747)
Cash flow from financing activities:		
Dividends paid	(766)	(700)
Distribution to noncontrolling interests	—	(10)
Common stock issued, including treasury shares reissued	50	128
Payment for stock repurchase derivative contracts	—	(38)
Treasury shares purchased	—	(1,716)
Excess tax benefit from stock-based compensation	8	55
Acquisition of noncontrolling interests	(6)	—
Proceeds from debt issued (original maturities greater than three months):		
– Machinery and Engines	1,036	49
– Financial Products	9,833	13,971
Payments on debt (original maturities greater than three months):		
– Machinery and Engines	(1,396)	(173)
– Financial Products	(9,420)	(10,715)
Short-term borrowings – net (original maturities three months or less)	(3,686)	1,646
Net cash provided by (used for) financing activities	(4,347)	2,497
Effect of exchange rate changes on cash	1	(14)
Increase (decrease) in cash and short-term investments	1,452	1,016
Cash and short-term investments at beginning of period	2,736	1,122
Cash and short-term investments at end of period	\$ 4,188	\$ 2,138

All short-term investments, which consist primarily of highly liquid investments with original maturities of three months or less, are considered to be cash equivalents.

Non-cash activities:

During 2009, we contributed 19.1 million shares of company stock with a fair value of \$688 million to our U.S. benefit plans. See Note 9 for further discussion.

See accompanying notes to Consolidated Financial Statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. A. Basis of Presentation

In the opinion of management, the accompanying financial statements include all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of (a) the consolidated results of operations for the three and nine month periods ended September 30, 2009 and 2008, (b) the consolidated financial position at September 30, 2009 and December 31, 2008, (c) the consolidated changes in stockholders' equity for the nine month periods ended

September 30, 2009 and 2008, and (d) the consolidated statement of cash flow for the nine month periods ended September 30, 2009 and 2008. The financial statements have been prepared in conformity with generally accepted accounting principles in the United States of America (U.S. GAAP) and pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain amounts for prior periods have been reclassified to conform to the current period financial statement presentation.

Interim results are not necessarily indicative of results for a full year. The information included in this Form 10-Q should be read in conjunction with the audited financial statements and notes thereto included in our Company's annual report on Form 10-K for the year ended December 31, 2008, as supplemented by the Company's current report on Form 8-K filed on May 14, 2009 (2008 Form 10-K) to reflect certain retrospective adjustments relating to the adoption of accounting guidance on noncontrolling interests and the change in our reportable segments as discussed in Note 14.

Comprehensive income (loss) is comprised of Profit of consolidated and affiliated companies, as well as adjustments for foreign currency translation, derivative instruments designated as cash flow hedges, available-for-sale securities, pension and other postretirement benefits and retained interests. Total Comprehensive income for the three months ended September 30, 2009 and 2008 was \$565 million and \$579 million, respectively. Total Comprehensive income for the nine months ended September 30, 2009 and 2008 was \$1,470 million and \$2,800 million, respectively.

The December 31, 2008 financial position data included herein is derived from the audited consolidated financial statements included in the 2008 Form 10-K but does not include all disclosures required by U.S. GAAP.

We have performed a review of subsequent events through October 30, 2009, the date the financial statements were issued, and concluded there were no events or transactions occurring during this period that required recognition or disclosure in our financial statements.

B. Nature of Operations

We operate in three principal lines of business:

- (1) Machinery - A principal line of business which includes the design, manufacture, marketing and sales of construction, mining and forestry machinery—track and wheel tractors, track and wheel loaders, pipelayers, motor graders, wheel tractor-scrapers, track and wheel excavators, backhoe loaders, log skidders, log loaders, off-highway trucks, articulated trucks, paving products, skid steer loaders, underground mining equipment, tunnel boring equipment and related parts. Also includes logistics services for other companies and the design, manufacture, remanufacture, maintenance and services of rail-related products.
- (2) Engines - A principal line of business including the design, manufacture, marketing and sales of engines for Caterpillar machinery; electric power

generation systems; on-highway vehicles and locomotives; marine, petroleum, construction, industrial, agricultural and other applications; and related parts. Also includes remanufacturing of Caterpillar engines and a variety of Caterpillar machine and engine components and remanufacturing services for other companies. Reciprocating engines meet power needs ranging from 10 to 21,700 horsepower (8 to over 16 000 kilowatts). Turbines range from 1,600 to 30,000 horsepower (1 200 to 22 000 kilowatts).

- (3) Financial Products - A principal line of business consisting primarily of Caterpillar Financial Services Corporation (Cat Financial), Caterpillar Insurance Holdings, Inc. (Cat Insurance) and their respective subsidiaries. Cat Financial provides a wide range of financing alternatives to customers and dealers for Caterpillar machinery and engines, Solar gas turbines as well as other equipment and marine vessels. Cat Financial also extends loans to customers and dealers. Cat Insurance provides various forms of insurance to customers and dealers to help support the purchase and lease of our equipment.

Our Machinery and Engines operations are highly integrated. Throughout the Notes, Machinery and Engines represents the aggregate total of these principal lines of business.

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2. New Accounting Guidance

Fair value measurements - In September 2006, the Financial Accounting Standards Board (FASB) issued accounting guidance on fair value measurements, which provides a common definition of fair value and a framework for measuring assets and liabilities at fair values when a particular standard prescribes it. In addition, this guidance expands disclosures about fair value measurements. In February 2008, the FASB issued additional guidance that (1) deferred the effective date of the original guidance for one year for certain nonfinancial assets and nonfinancial liabilities and (2) removed certain leasing transactions from the scope of the original guidance. We applied this new guidance to all other fair value measurements effective January 1, 2008. The adoption of this guidance did not have a material impact on our financial statements. See Note 17 for additional information.

Employers' accounting for defined benefit pension and other postretirement plans - In September 2006, the FASB issued accounting guidance on employers' accounting for defined benefits pension and other postretirement plans. This guidance requires recognition of the overfunded or underfunded status of pension and other postretirement benefit plans on the balance sheet. Also, the measurement date - the date at which the benefit obligation and plan assets are measured - is required to be the company's fiscal year-end. We adopted the balance sheet recognition provision at December 31, 2006, and adopted the year-end measurement date effective January 1, 2008 using the "one measurement" approach. Under the one measurement approach, net periodic benefit cost for the period between any early measurement date and the end of the fiscal year that the measurement provision is applied are allocated proportionately between amounts to be recognized as an adjustment of retained earnings and net periodic benefit cost for the fiscal year. Previously, we used a November 30th measurement date for our U.S. pension and other

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postretirement benefit plans and September 30th for our non-U.S. plans. The following summarizes the effect of adopting the year-end measurement date provision as of January 1, 2008. See Note 9 for additional information.

Adoption of postretirement benefit year-end measurement date provision	January 1, 2008 Prior to adoption	Adjustment	January 1, 2008 Post adoption
(Millions of dollars)			
Noncurrent deferred and refundable income taxes	\$ 1,553	\$ 8	\$ 1,561
Liability for postemployment benefits	5,059	24	5,083
Accumulated other comprehensive income	(1,808)	17	(1,791)
Profit employed in the business	17,398	(33)	17,365

Business combinations and noncontrolling interests in consolidated financial statements - In December 2007, the FASB issued accounting guidance on business combinations and noncontrolling interests in consolidated financial statements. The guidance on business combinations requires the acquiring entity in a business combination to recognize the assets acquired and liabilities assumed. Further, it also changes the accounting for acquired in-process research and development assets, contingent consideration, partial acquisitions and transaction costs. Under the guidance on noncontrolling interests, all entities are required to report noncontrolling (minority) interests in subsidiaries as equity in the consolidated financial statements. In addition, transactions between an entity and noncontrolling interests will be treated as equity transactions. We adopted this new guidance on January 1, 2009. As required, the guidance on noncontrolling interests was adopted through retrospective application, and all prior period information has been adjusted accordingly. The adoption of this guidance did not have a material impact on our financial statements.

Disclosures about derivative instruments and hedging activities - In March 2008, the FASB issued accounting guidance on disclosures about derivative instruments and hedging activities. This guidance expands disclosures for derivative instruments by requiring entities to disclose the fair value of derivative instruments and their gains or losses in tabular format. It also requires disclosure of information about credit risk-related contingent features in derivative agreements, counterparty credit risk, and strategies and objectives for using derivative instruments. We adopted this new guidance on January 1, 2009. The adoption of this guidance did not have a material impact on our financial statements. See Note 4 for additional information.

Employers' disclosures about postretirement benefit plan assets - In December 2008, the FASB issued accounting guidance on employers' disclosures about postretirement benefit plan assets. This guidance expands the disclosure set forth in previous guidance by adding required disclosures about (1) how investment allocation decisions are made by management, (2) major categories of plan assets, and (3) significant concentration of risk. Additionally, this guidance requires an employer to disclose information about the valuation of plan assets similar to that required under the accounting guidance on fair value measurements. We will adopt this guidance for our financial statements for the annual period ending December 31, 2009. We do not expect the adoption of this guidance to have a material impact on our financial statements.

Interim disclosures about fair value of financial instruments - In April 2009, the FASB issued accounting guidance that requires that the fair value disclosures previously required on an annual basis be included for interim reporting periods. We adopted this guidance on April 1,

2009. The adoption of this guidance did not have a material impact on our financial statements. See Note 17 for additional information.

Recognition and presentation of other-than-temporary impairments - In April 2009, the FASB issued accounting guidance on the recognition and presentation of other-than-temporary impairments. This new guidance amends the existing impairment guidance relating to certain debt securities and requires a company to assess the likelihood of selling the security prior to recovering its cost basis. When a security meets the criteria for impairment, the impairment charges related to credit losses would be recognized in earnings, while noncredit losses would be reflected in other comprehensive income. Additionally, it requires a more detailed, risk-oriented breakdown of major security types and related information. We adopted this guidance on April 1, 2009. The adoption of this guidance did not have a material impact on our financial statements. See Notes 8 and 15 for additional information.

Subsequent events - In May 2009, the FASB issued accounting guidance on subsequent events that establishes standards of accounting for and disclosure of subsequent events. In addition, it requires disclosure of the date through which an entity has evaluated subsequent events and the basis for that date. This new guidance was adopted for our financial statements for the quarterly period ending June 30, 2009. The adoption of this guidance did not have a material impact on our financial statements. See Note 1A for additional information.

Accounting for transfers of financial assets - In June 2009, the FASB issued accounting guidance on accounting for transfers of financial assets. This guidance amends previous guidance by including: the elimination of the qualifying special-purpose entity (QSPE) concept; a new participating interest definition that must be met for transfers of portions of financial assets to be eligible for sale accounting; clarifications and changes to the derecognition criteria for a transfer to be accounted for as a sale; and a change to the amount of recognized gain or loss on a transfer of financial assets accounted for as a sale when beneficial interests are received by the transferor. Additionally, the guidance requires extensive new disclosures regarding an entity's involvement in a transfer of financial assets. Finally, existing QSPEs (prior to the effective date of this guidance) must be evaluated for consolidation by reporting entities in accordance with the applicable consolidation guidance upon the elimination of this concept. We will adopt this new guidance effective January 1, 2010. We do not expect the adoption of this guidance to have a material impact on our financial statements.

Consolidation of variable interest entities - In June 2009, the FASB issued accounting guidance on the consolidation of variable interest entities (VIEs). This new guidance revises previous guidance by eliminating the exemption for qualifying special purpose entities, by establishing a new approach for determining who should consolidate a variable-interest entity and by changing when it is necessary to reassess who should consolidate a variable-interest entity. We will adopt this new guidance effective January 1, 2010. We do not expect the adoption of this guidance to have a material impact on our financial statements.

3. Stock-Based Compensation

Accounting for stock-based compensation requires that the cost resulting from all stock-based payments be recognized in the financial statements based on the grant date fair value of the award. Stock-based compensation primarily consists of stock-settled stock appreciation rights (SARs), restricted stock units (RSUs) and stock options. We recognized pretax stock-based compensation cost in the amount of \$34 million and \$108 million for the three and nine months ended September 30, 2009, respectively; and \$56 million and \$163 million for the three and nine months ended September 30, 2008, respectively.

The following table illustrates the type and fair value of the stock-based compensation awards granted during the nine month periods ended September 30, 2009 and 2008, respectively:

	2009		2008	
	# Granted	Fair Value Per Award	# Granted	Fair Value Per Award
SARs	6,260,647	\$ 7.10	4,476,095	\$ 22.32
RSUs	2,185,674	20.22	1,511,523	69.17
Stock options	562,580	7.10	410,506	22.32

The stock price on the date of grant was \$22.17 and \$73.20 for 2009 and 2008, respectively.

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The following table provides the assumptions used in determining the fair value of the stock-based awards for the nine month periods ended September 30, 2009 and 2008, respectively:

	Grant Year	
	2009	2008
Weighted-average dividend yield	3.07%	1.89%
Weighted-average volatility	36.02%	27.14%
Range of volatilities	35.75-61.02%	27.13-28.99%
Range of risk-free interest rates	0.17-2.99%	1.60-3.64%
Weighted-average expected lives	8 years	8 years

As of September 30, 2009, the total remaining unrecognized compensation cost related to nonvested stock-based compensation awards was \$117 million, which will be amortized over the weighted-average remaining requisite service periods of approximately 1.7 years.

Our long-standing practices and policies specify all stock-based compensation awards are approved by the Compensation Committee (the Committee) of the Board of Directors on the date of grant. The stock-based award approval process specifies the number of awards granted, the terms of the award and the grant date. The same terms and conditions are consistently applied to all employee grants, including Officers. The Committee approves all individual Officer grants. The number of stock-based compensation awards included in an individual's award is determined based on the methodology approved by the Committee. In 2007, under the terms of the Caterpillar Inc. 2006 Long-Term Incentive Plan (approved by stockholders in September of 2006), the Committee approved the exercise price methodology to be the closing price of the Company stock on the date of grant.

4. Derivative Instruments and Hedging Activities

Our earnings and cash flow are subject to fluctuations due to changes in foreign currency exchange rates, interest rates and commodity prices. In addition, the amount of Caterpillar stock that can be repurchased under our stock repurchase program is impacted by movements in the price of the stock. Our Risk Management Policy (policy) allows for the use of derivative financial instruments to prudently manage foreign currency exchange rate, interest rate, commodity price and Caterpillar stock price exposures. Our policy specifies that derivatives are not to be used for speculative purposes. Derivatives that we use are primarily foreign currency forward and option contracts, interest rate swaps and commodity forward and option contracts. Our derivative activities are subject to the management, direction and control of our senior financial officers. Risk management practices, including the use of financial derivative instruments, are presented to the Audit Committee of the Board of Directors at least annually.

All derivatives are recognized on the Consolidated Statement of Financial Position at their fair value. On the date the derivative contract is entered, we designate the derivative as (1) a hedge of the fair value of a recognized asset or liability ("fair value" hedge), (2) a hedge of a forecasted transaction or the variability of cash flow to be paid ("cash flow" hedge), or (3) an "undesignated" instrument. Changes in the fair value of a derivative that is qualified, designated and highly effective as a fair value hedge, along with the gain or loss on the hedged liability that is attributable to the hedged risk, are recorded in current earnings. Changes in the fair value of a derivative that is qualified, designated and highly effective as a cash flow hedge are recorded in Accumulated other comprehensive income (AOCI) in the Consolidated Statement of Financial Position until they are reclassified to earnings in the same period or periods during which the hedged transaction affects earnings. Changes in the fair value of undesignated derivative instruments and the ineffective portion of designated derivative instruments are reported in current earnings. Cash flow from designated derivative financial instruments are classified within the same category as the item being hedged on the Consolidated Statement of Cash Flow. Cash flow from undesignated derivative financial instruments are included in the investing category on the Consolidated Statement of Cash Flow.

We formally document all relationships between hedging instruments and hedged items, as well as the risk-management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives that are designated as fair value hedges to specific assets and liabilities on the Consolidated Statement of Financial Position and linking cash flow hedges to specific forecasted transactions or variability of cash flow.

We also formally assess, both at the hedge's inception and on an ongoing basis, whether the designated derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flow of hedged items. When a derivative is determined not to be highly effective as a hedge or the underlying hedged transaction is no longer probable, we discontinue hedge accounting prospectively, in accordance with the derecognition criteria for hedge accounting.

We adopted new accounting guidance on disclosures about derivative instruments and hedging activities as of January 1, 2009. See Note 2 for additional information.

Foreign Currency Exchange Rate Risk

Foreign currency exchange rate movements create a degree of risk by affecting the U.S. dollar value of sales made and costs incurred in foreign currencies. Movements in foreign currency rates also affect our competitive position as these changes may affect business practices and/or pricing strategies of non-U.S.-based competitors. Additionally, we have balance sheet positions denominated in foreign currencies, thereby creating exposure to movements in exchange rates.

Our Machinery and Engines operations purchase, manufacture and sell products in many locations around the world. As we have a diversified revenue and cost base, we manage our future foreign currency cash flow exposure on a net basis. We use foreign currency forward and option contracts to manage unmatched foreign currency cash inflow and outflow. Our objective is to minimize the risk of exchange rate movements that would reduce the U.S. dollar value of our foreign currency cash flow. Our policy allows for managing anticipated foreign currency cash flow for up to five years.

We generally designate as cash flow hedges at inception of the contract any Australian dollar, Brazilian real, British pound, Canadian dollar, Chinese yuan, euro, Japanese yen, Mexican peso, Singapore dollar, New Zealand dollar or Swiss franc forward or option contracts that meet the requirements for hedge accounting and the maturity extends beyond the current quarter-end. Designation is performed on a specific exposure basis to support hedge accounting. The remainder of Machinery and Engines foreign currency contracts are undesignated. We also designate as fair value hedges specific euro forward contracts used to hedge firm commitments.

As of September 30, 2009, \$43 million of deferred net gains, net of tax, included in equity (Accumulated other comprehensive income (loss) in the Consolidated Statement of Financial Position), are expected to be reclassified to current earnings (Other income (expense) in the Consolidated Statement of Results of Operations) over the next twelve months when earnings are affected by the hedged transactions. The actual amount recorded in Other income (expense) will vary based on exchange rates at the time the hedged transactions impact earnings.

In managing foreign currency risk for our Financial Products operations, our objective is to minimize earnings volatility resulting from conversion and the remeasurement of net foreign currency balance sheet positions. Our policy allows the use of foreign currency forward and option contracts to offset the risk of currency mismatch between our receivables and debt. All such foreign currency forward and option contracts are undesignated.

Interest Rate Risk

Interest rate movements create a degree of risk by affecting the amount of our interest payments and the value of our fixed-rate debt. Our practice is to use interest rate derivatives to manage our exposure to interest rate changes and, in some cases, lower the cost of borrowed funds.

Machinery and Engines operations generally use fixed rate debt as a source of funding. Our objective is to minimize the cost of borrowed funds. Our policy allows us to enter into fixed-to-floating interest rate swaps and forward rate agreements to meet that objective with the intent to designate as fair value hedges at inception of the contract all fixed-to-floating interest rate swaps. Designation as a hedge of the fair value of our fixed rate debt is performed to support hedge accounting.

Financial Products operations have a match-funding policy that addresses interest rate risk by aligning the interest rate profile (fixed or floating rate) of Cat Financial's debt portfolio with the

interest rate profile of their receivables portfolio within predetermined ranges on an ongoing basis. In connection with that policy, we use interest rate derivative instruments to modify the debt structure to match assets within the receivables portfolio. This match-funding reduces the volatility of margins between interest-bearing assets and interest-bearing liabilities, regardless of which direction interest rates move.

Our policy allows us to use fixed-to-floating, floating-to-fixed, and floating-to-floating interest rate swaps to meet the match-funding objective. We designate fixed-to-floating interest rate swaps as fair value hedges to protect debt against changes in fair value due to changes in the benchmark interest rate. We designate most floating-to-fixed interest rate swaps as cash flow hedges to protect against the variability of cash flows due to changes in the benchmark interest rate.

As of September 30, 2009, \$38 million of deferred net losses, net of tax, included in equity (Accumulated other comprehensive income (loss) in the Consolidated Statement of Financial Position), related to Financial Products floating-to-fixed interest rate swaps, are expected to be reclassified to current earnings (Interest expense of Financial Products in the Consolidated Statement of Results of Operations) over the next twelve months.

We have, at certain times, liquidated fixed-to-floating and floating-to-fixed swaps at both Machinery and Engines and Financial Products. The gains or losses associated with these swaps at the time of liquidation are amortized into earnings over the original term of the underlying hedged item.

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Commodity Price Risk

Commodity price movements create a degree of risk by affecting the price we must pay for certain raw material. Our policy is to use commodity forward and option contracts to manage the commodity risk and reduce the cost of purchased materials.

Our Machinery and Engines operations purchase aluminum, copper and nickel embedded in the components we purchase from suppliers. Our suppliers pass on to us price changes in the commodity portion of the component cost. In addition, we are also subject to price changes on natural gas purchased for operational use.

Our objective is to minimize volatility in the price of these commodities. Our policy allows us to enter into commodity forward and option contracts to lock in the purchase price of a portion of these commodities within a five-year horizon. All such commodity forward and option contracts are undesignated. Gains of \$3 million and \$4 million were recorded in current earnings for the three and nine months ended September 30, 2009, respectively. There were no contracts outstanding during the nine months ended September 30, 2008.

The location and fair value of derivative instruments reported in the Statement of Financial Position are as follows:

(Millions of dollars)

September 30, 2009

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	Consolidated Statement of Financial Position Location	Asset (Liability) Fair Value
Designated derivatives		
Foreign exchange contracts		
Machinery and Engines	Receivables – trade and other	\$ 87
	Long-term receivables – trade	
Machinery and Engines	and other	120
Machinery and Engines	Accrued expenses	(20)
Interest rate contracts		
Financial Products	Receivables – trade and other	13
	Long-term receivables – trade	
Financial Products	and other	173
Financial Products	Accrued expenses	(98)
		\$ 275
Undesignated derivatives		
Foreign exchange contracts		
Machinery and Engines	Receivables – trade and other	\$ 4
	Long-term receivables – trade	
Machinery and Engines	and other	62
Machinery and Engines	Accrued expenses	(3)
Financial Products	Receivables – trade and other	10
Financial Products	Accrued expenses	(41)
Interest rate contracts		
Machinery and Engines	Accrued expenses	(7)
Financial Products	Receivables – trade and other	1
	Long-term receivables – trade	
Financial Products	and other	2
Financial Products	Accrued expenses	(10)
Commodity contracts		
Machinery and Engines	Receivables – trade and other	4
		\$ 22

The effect of derivatives designated as hedging instruments on the Statement of Results of Operations is as follows:

Fair Value Hedges
(Millions of dollars)

Classification	Three Months Ended September 30, 2009		Nine Months Ended September 30, 2009		
	Gains (Losses) on Derivatives	Gains (Losses) on Borrowings	Gains (Losses) on Derivatives	Gains (Losses) on Borrowings	
Interest rate contracts					
Machinery and Engines	Other income (expense)	\$ 1	\$ (1)	\$ 1	\$ (1)
Financial Products	Other income (expense)	74	(74)	(146)	160
		\$ 75	\$ (75)	\$ (145)	\$ 159

Cash Flow Hedges
(Millions of dollars)

	Three Months Ended September 30, 2009			
	Recognized in AOCI (Effective Portion)	Classification of Gains (Losses)	Recognized in Earnings Reclassified from AOCI (Effective Portion)	Recognized in Earnings (Ineffective Portion)
Foreign exchange contracts				
Machinery and Engines	\$ (90)	Other income (expense)	\$ 49	\$ 4
Interest rate contracts				
Financial Products	(13)	Interest expense of Financial Products	(21)	1
	\$ (103)		\$ 28	\$ 5

	Nine Months Ended September 30, 2009			
	Recognized in AOCI (Effective Portion)	Classification of Gains (Losses)	Recognized in Earnings Reclassified from AOCI (Effective Portion)	Recognized in Earnings (Ineffective Portion)
Foreign exchange contracts				
Machinery and Engines	\$ 106	Other income (expense)	\$ 120	\$ 1
Interest rate contracts				
Machinery and Engines	(29)	Other income (expense)	(2)	—
Financial Products	(31)	Interest expense of Financial Products	(63)	1
	\$ 46		\$ 55	\$ 7

1 The ineffective portion recognized in earnings is included in Other income (expense).

The effect of derivatives not designated as hedging instruments on the Statement of Results of Operations is as follows:

(Millions of dollars)	Classification of Gains or (Losses)	Three Months Ended September 30, 2009	Nine Months Ended September 30, 2009
Foreign exchange contracts			

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Machinery and Engines	Other income (expense)	\$	3	\$	28
Financial Products	Other income (expense)		(75)		(141)
Interest rate contracts					
Machinery and Engines	Other income (expense)		(1)		(3)
Financial Products	Other income (expense)		1		2
Commodity contracts					
Machinery and Engines	Other income (expense)		3		4
		\$	(69)	\$	(110)

Stock Repurchase Risk

Payments for stock repurchase derivatives are accounted for as a reduction in stockholders' equity. In February 2007, the Board of Directors authorized a \$7.5 billion stock repurchase program, expiring on December 31, 2011. The amount of Caterpillar stock that can be repurchased under the authorization is impacted by movements in the price of the stock. In August 2007, the Board of Directors authorized the use of derivative contracts to reduce stock repurchase price volatility.

In connection with our stock repurchase program, we entered into capped call transactions ("call") with a major bank for an aggregate 6.0 million shares. Through March 31, 2008, we paid the bank \$94 million for the establishment of the calls (of which \$38 million was paid in the first quarter 2008 for 2.5 million shares), which was accounted for as a reduction to stockholders' equity. A call permits us to reduce share repurchase price volatility by providing a floor and cap on the price at which the shares can be repurchased. The floor, cap and strike prices for the calls were based upon the average purchase price paid by the bank to purchase our common stock to hedge these transactions. Each call matured and was exercisable within one year after the call was established. If we exercised a call, we could elect to settle the transaction with the bank by physical settlement (paying cash and receiving shares), cash settlement (receiving a net amount of cash) or net share settlement (receiving a net amount of shares).

During the nine months ended September 30, 2008, \$219 million of cash was used to repurchase 4.0 million shares pursuant to calls exercised under this program. Premiums previously paid associated with these calls were \$62 million. All outstanding calls under this program expired in 2008.

5. Inventories

Inventories (principally using the "last-in, first-out" (LIFO) method) are comprised of the following:

(Millions of dollars)	September 30, 2009	December 31, 2008
Raw materials	\$ 2,152	\$ 2,678
Work-in-process	865	1,508
Finished goods	3,534	4,316
Supplies	264	279
Total inventories	\$ 6,815	\$ 8,781

Inventory quantities have been further reduced during the three and nine months ended September 30, 2009. This reduction resulted in a liquidation of LIFO inventory layers carried at lower costs prevailing in prior years as compared with current costs. The effect of this reduction of inventory that is not expected to be replaced by the end of 2009 decreased Cost of goods sold in the Consolidated Results of Operations by approximately \$120 million and increased Profit by approximately \$100 million or \$0.16 per share for the three months ended September 30, 2009. For the nine months ended September 30, 2009, LIFO liquidations decreased Cost of goods sold by approximately \$230 million and increased Profit by approximately \$185 million or \$0.30 per share. Additional LIFO liquidations may occur during the fourth quarter of 2009.

6. Investments in Unconsolidated Affiliated Companies

Our investments in affiliated companies accounted for by the equity method have historically consisted primarily of a 50 percent interest in Shin Caterpillar Mitsubishi Ltd. (SCM) located in Japan. On August 1, 2008, SCM redeemed half of Mitsubishi Heavy Industries Ltd.'s (MHI's) shares in SCM. As a result, Caterpillar now owns 67 percent of the renamed entity, Caterpillar Japan Ltd. (Cat Japan) and consolidates its financial statements. See Note 16 for additional information. In February 2008, we sold our 23 percent equity investment in A.S.V. Inc. (ASV) resulting in a \$60 million pretax gain. Accordingly, the September 30, 2009 and December 31, 2008 financial position and equity investment amounts noted below do not include ASV or Cat Japan.

Combined financial information of the unconsolidated affiliated companies accounted for by the equity method (generally on a lag of three months or less) was as follows:

Results of Operations of unconsolidated affiliated companies:

(Millions of dollars)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Sales	\$ 133	\$ 1,285	\$ 400	\$ 3,455
Cost of sales	99	1,063	299	2,863
Gross profit	\$ 34	\$ 222	\$ 101	\$ 592
Profit (loss)	\$ (1)	\$ 16	\$ (9)	\$ 53

Prior to consolidation of Cat Japan, sales from SCM to Caterpillar for the three months ended September 30, 2008 of \$437 million and for the nine months ended September 30, 2008 of \$1,669 million are included in the affiliated company sales. In addition, SCM purchases of Caterpillar products were \$95 million for the three months ended September 30, 2008 and \$353 million for the nine months ended September 30, 2008.

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Financial Position of unconsolidated affiliated companies: (Millions of dollars)	September 30, 2009	December 31, 2008
Assets:		
Current assets	\$ 227	\$ 209

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Property, plant and equipment – net	222	227
Other assets	9	26
	458	462
Liabilities:		
Current liabilities	250	173
Long-term debt due after one year	44	110
Other liabilities	16	35
	310	318
Equity	\$ 148	\$ 144
Caterpillar's investments in unconsolidated affiliated companies: (Millions of dollars)		
Investments in equity method companies	\$ 74	\$ 66
Plus: Investments in cost method companies	27	28
Total investments in unconsolidated affiliated companies	\$ 101	\$ 94

7. Intangible Assets and Goodwill

A. Intangible assets

Intangible assets are comprised of the following:

(Dollars in millions)	Weighted Amortizable Life (Years)	September 30, 2009	December 31, 2008
Customer relationships	18	\$ 403	\$ 397
Intellectual property	10	212	211
Other	11	115	112
Total finite-lived intangible assets – gross	15	730	720
Less: Accumulated amortization		(256)	(209)
Intangible assets – net		\$ 474	\$ 511

Amortization expense for the three and nine months ended September 30, 2009 was \$15 million and \$46 million, respectively. Amortization expense for the three and nine months ended September 30, 2008 was \$12 million and \$44 million, respectively. Amortization expense related to intangible assets is expected to be:

(Millions of dollars)					
2009	2010	2011	2012	2013	Thereafter
\$ 62	\$ 58	\$ 51	\$ 42	\$ 38	\$ 269

B. Goodwill

We test goodwill annually and whenever events or circumstances make it more likely than not that an impairment may have occurred. We perform our annual goodwill impairment test as of October 1 and monitor for interim triggering events on an ongoing basis.

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No goodwill was impaired or disposed of during the nine months ended September 30, 2009 or 2008. The carrying amount of goodwill by reportable segment as of September 30, 2009 and December 31, 2008 was as follows:

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(Millions of dollars)	September 30, 2009	December 31, 2008
Building Construction Products	\$ 26	\$ 26
Cat Japan 1	238	233
Earthmoving	43	43
Electric Power	203	203
Excavation	39	39
Large Power Systems	569	569
Marine & Petroleum Power	60	