CATERPILLAR INC
Form 10-Q
July 31, 2009

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

FORM 10-Q

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

For the quarterly period ended June 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	37-0602744
(State or other jurisdiction of incorporation)	(IRS Employer I.D. No.)
100 NE Adams Street, Peoria, Illinois	61629
(Address of principal executive offices)	(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 [X] 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	X	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 June 30, 2009, 621,293,542 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.

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 June 30,		
		2009		2008
Sales and revenues:				
Sales of Machinery and Engines	$	7,254	$	12,797
Revenues of Financial Products		721		827
Total sales and revenues		7,975		13,624
Operating costs:				
Cost of goods sold		5,752		10,036
Selling, general and administrative expenses		914		1,074
Research and development expenses		351		415
Interest expense of Financial Products		272		279
Other operating (income) expenses		339		295
Total operating costs		7,628		12,099
Operating profit		347		1,525
Interest expense excluding Financial Products		109		70
Other income (expense)		163		83
Consolidated profit before taxes		401		1,538
Provision for income taxes		40		434
Profit of consolidated companies		361		1,104
Equity in profit (loss) of unconsolidated affiliated companies		(1)		10
Profit of consolidated and affiliated companies		360		1,114
Less: Profit (loss) attributable to noncontrolling interests		(11)		8
Profit 1	$	371	$	1,106
Profit per common share	$	0.61	$	1.80
Profit per common share – diluted 2	$	0.60	$	1.74
Weighted-average common shares outstanding (millions)				
- Basic		611.8		614.3
- Diluted 2		619.8		635.5
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.

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

		Six Months Ended June 30,	
		2009	2008
Sales and revenues:			
	Sales of Machinery and Engines	$ 15,764	$ 23,776
	Revenues of Financial Products	1,436	1,644
	Total sales and revenues	17,200	25,420
Operating costs:			
	Cost of goods sold	12,779	18,645
	Selling, general and administrative expenses	1,796	2,033
	Research and development expenses	739	784
	Interest expense of Financial Products	551	563
	Other operating (income) expenses	1,163	577
	Total operating costs	17,028	22,602
Operating profit		172	2,818
	Interest expense excluding Financial Products	210	144
	Other income (expense)	227	205
Consolidated profit before taxes		189	2,879
	Provision (benefit) for income taxes	(40)	854
	Profit of consolidated companies	229	2,025
	Equity in profit (loss) of unconsolidated affiliated companies	—	21
Profit of consolidated and affiliated companies		229	2,046
Less: Profit (loss) attributable to noncontrolling interests		(30)	18
Profit 1		$ 259	$ 2,028

Profit per common share	$	0.43	$	3.29
Profit per common share – diluted 2	$	0.42	$	3.18
Weighted-average common shares outstanding (millions)				
- Basic		607.6		616.0
- Diluted 2		614.0		637.0
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.

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

	June 30, 2009	December 31, 2008
Assets		
Current assets:		
Cash and short-term investments	$ 3,991	$ 2,736
Receivables – trade and other	6,534	9,397
Receivables – finance	8,110	8,731
Deferred and refundable income taxes	1,147	1,223
Prepaid expenses and other current assets	441	765
Inventories	7,160	8,781
Total current assets	27,383	31,633
Property, plant and equipment – net	12,226	12,524
Long-term receivables – trade and other	817	1,479
Long-term receivables – finance	13,488	14,264
Investments in unconsolidated affiliated companies	92	94
Noncurrent deferred and refundable income taxes	3,270	3,311
Intangible assets	485	511
Goodwill	2,264	2,261
Other assets	2,067	1,705
Total assets	$ 62,092	$ 67,782
Liabilities		
Current liabilities:		
Short-term borrowings:		
Machinery and Engines	$ 702	$ 1,632
Financial Products	4,470	5,577
Accounts payable	2,682	4,827
Accrued expenses	3,611	4,121

Accrued wages, salaries and employee benefits	795	1,242
Customer advances	1,546	1,898
Dividends payable	261	253
Other current liabilities	857	1,027
Long-term debt due within one year:		
Machinery and Engines	472	456
Financial Products	4,094	5,036
Total current liabilities	19,490	26,069
Long-term debt due after one year:		
Machinery and Engines	5,677	5,736
Financial Products	17,881	17,098
Liability for postemployment benefits	8,920	9,975
Other liabilities	2,268	2,190
Total liabilities	54,236	61,068
Commitments and contingencies (Notes 10 and 12)		
Redeemable noncontrolling interest	481	524
Stockholders' equity		
Common stock of $1.00 par value:		
Authorized shares: 900,000,000		
Issued shares: (6/30/09 and 12/31/08 – 814,894,624) at paid-in amount	3,347	3,057
Treasury stock (6/30/09 – 193,601,082; 12/31/08 – 213,367,983) at cost	(10,745)	(11,217)
Profit employed in the business	19,579	19,826
Accumulated other comprehensive income (loss)	(4,906)	(5,579)
Noncontrolling interests	100	103
Total stockholders' equity	7,375	6,190
Total liabilities, redeemable noncontrolling interest and stockholders' equity	$ 62,092	$ 67,782

See accompanying notes to Consolidated Financial Statements.

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

Six Months Ended June 30, 2008	Common stock	Treasury stock	Profit employed in the business	Accumulated other comprehensive income (loss) 1	Noncontrolling interests	Total	Comprehensive income (loss)
Balance at December 31, 2007	$2,744	$ (9,451)	$17,398	$ (1,808)	$ 113	$ 8,996	
Adjustment to adopt measurement date provisions of FAS 158, net	—	—	(33)	17	—	(16)	

of tax 2							
Balance at January 1, 2008	2,744	(9,451)	17,365	(1,791)	113	8,980	
Profit of consolidated and affiliated companies	—	—	2,028	—	18	2,046	$ 2,046
Foreign currency translation, net of tax of $3	—	—	—	177	(1)	176	176
Pension and other postretirement benefits							
Amortization of actuarial (gain) loss, net of tax of $41	—	—	—	76	—	76	76
Amortization of transition (asset) obligation, net of tax of $0	—	—	—	1	—	1	1
Derivative financial instruments							
Gains (losses) deferred, net of tax of $0	—	—	—	7	—	7	7
(Gains) losses reclassified to earnings, net of tax of $26	—	—	—	(45)	—	(45)	(45)
Retained interests							
Gains (losses) deferred, net of tax of $2	—	—	—	(5)	—	(5)	(5)
(Gains) losses reclassified to earnings, net of tax of $1	—	—	—	2	—	2	2
Available-for-sale securities							
Gains (losses) deferred, net of tax of $18	—	—	—	(36)	—	(36)	(36)
(Gains) losses reclassified to earnings, net of tax of $0	—	—	—	(1)	—	(1)	(1)
Change in ownership for noncontrolling interests	—	—	—	—	(17)	(17)	—
Dividends declared	—	—	(475)	—	—	(475)	—
Common shares issued from treasury stock for stock-based compensation: 4,123,074	5	111	—	—	—	116	—
Stock-based compensation expense	107	—	—	—	—	107	—
	51	—	—	—	—	51	—

Tax benefits from stock-based compensation							
Shares repurchased: 19,393,026	—	(1,390)	—	—	—	(1,390)	—
Stock repurchase derivative contracts	(10)	—	—	—	—	(10)	—
Balance at June 30, 2008	$2,897	$(10,730)	$18,918	$(1,615)	$ 113	$ 9,583	$ 2,221

(Continued)

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

Six Months Ended June 30, 2009	Common stock	Treasury stock	Profit employed in the business	Accumulated other comprehensive income (loss)	Noncontrolling interests	Total	Comprehensive income (loss)
Balance at December 31, 2008	$3,057	$(11,217)	$19,826	$(5,579)	$ 103	$6,190	
Profit of consolidated and affiliated companies	—	—	259	—	(30)	229	$ 229
Foreign currency translation, net of tax of $16	—	—	—	166	1	167	167
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 $54	—	—	—	95	2	97	97
Current year prior service cost, net of tax of $197 3	—	—	—	236	—	236	236
Amortization of prior service cost, net of tax of $1	—	—	—	2	—	2	2
Amortization of transition (asset) obligation, net of tax of $0	—	—	—	1	—	1	1
Derivative financial instruments							

Gains (losses) deferred, net of tax of $57	—	—	—	92	—	92	92
(Gains) losses reclassified to earnings, net of tax of $12	—	—	—	(15)	—	(15)	(15)
Retained interests							
Gains (losses) deferred, net of tax of $12 4	—	—	—	(22)	—	(22)	(22)
(Gains) losses reclassified to earnings, net of tax of $10	—	—	—	18	—	18	18
Available-for-sale securities							
Gains (losses) deferred, net of tax of $14	—	—	—	26	—	26	26
(Gains) losses reclassified to earnings, net of tax of $10	—	—	—	19	—	19	19
Change in ownership for noncontrolling interests	—	—	—	—	(6)	(6)	—
Dividends declared	—	—	(513)	—	—	(513)	—
Common shares issued from treasury stock for stock-based compensation: 1,286,806	(6)	37	—	—	—	31	—
Common shares issued from treasury stock for benefit plans: 18,480,095 5	224	435	—	—	—	659	—
Stock-based compensation expense	74	—	—	—	—	74	—
Tax benefits from stock-based compensation	(2)	—	—	—	—	(2)	—
Cat Japan share redemption 6	—	—	7	—	30	37	—
Balance at June 30, 2009	$3,347	$(10,745)	$19,579	$(4,906)	$ 100	$7,375	$ 905

1 Pension and other postretirement benefits include net adjustments for Cat Japan, while they were an unconsolidated affiliate, of ($6) million for the six months ended June 30, 2008. The ending balance was ($58) million at June 30, 2008.

2 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 Changes in 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 ($10) million, net of tax of $5 million, for the six months ended June 30, 2009. See

Note 16 for additional information.
5 See Note 9 regarding shares issued for benefit plans.
6 See Note 15 regarding the Cat Japan share redemption.
See accompanying notes to Consolidated Financial Statements.

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

	Six Months Ended June 30, 2009	2008
Cash flow from operating activities:		
Profit of consolidated and affiliated companies	$ 229	$ 2,046
Adjustments for non-cash items:		
Depreciation and amortization	1,072	952
Other	59	184
Changes in assets and liabilities:		
Receivables – trade and other	3,133	(1,137)
Inventories	1,631	(1,009)
Accounts payable and accrued expenses	(2,717)	1,023
Customer advances	(338)	210
Other assets – net	168	(93)
Other liabilities – net	(434)	(271)
Net cash provided by (used for) operating activities	2,803	1,905
Cash flow from investing activities:		
Capital expenditures – excluding equipment leased to others	(443)	(814)
Expenditures for equipment leased to others	(441)	(699)
Proceeds from disposals of property, plant and equipment	454	449
Additions to finance receivables	(3,800)	(7,099)
Collections of finance receivables	5,119	4,748
Proceeds from sales of finance receivables	93	696
Investments and acquisitions (net of cash acquired)	—	(111)
Proceeds from sale of available-for-sale securities	170	173
Investments in available-for-sale securities	(251)	(230)
Other – net	(53)	56
Net cash provided by (used for) investing activities	848	(2,831)
Cash flow from financing activities:		
Dividends paid	(505)	(444)
Common stock issued, including treasury shares reissued	31	116
Payment for stock repurchase derivative contracts	—	(38)
Treasury shares purchased	—	(1,362)
Excess tax benefit from stock-based compensation	2	53
Acquisition of noncontrolling interests	(6)	—

Proceeds from debt issued (original maturities greater than three months):				
– Machinery and Engines		872		110
– Financial Products		8,157		9,048
Payments on debt (original maturities greater than three months):				
– Machinery and Engines		(915)		(133)
– Financial Products		(6,655)		(6,397)
Short-term borrowings – net (original maturities three months or less)		(3,365)		(393)
Net cash provided by (used for) financing activities		(2,384)		560
Effect of exchange rate changes on cash		(12)		26
Increase (decrease) in cash and short-term investments		1,255		(340)
Cash and short-term investments at beginning of period		2,736		1,122
Cash and short-term investments at end of period	$	3,991	$	782

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 18.4 million shares of company stock with a fair value of $659 million to our U.S. benefit plans. See Note 9 for further discussion.

See accompanying notes to Consolidated Financial Statements.

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 six month periods ended June 30, 2009 and 2008, (b) the consolidated financial position at June 30, 2009 and December 31, 2008, (c) the consolidated changes in stockholders' equity for the six month periods ended June 30, 2009 and 2008, and (d) the consolidated statement of cash flow for the six month periods ended June 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 SFAS 160, "Noncontrolling Interests in Consolidated Financial Statements – an amendment of ARB No. 51," and the change in our reportable segments as discussed in Note 13.

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 June 30, 2009 and 2008 was $791 million and $1,208 million, respectively. Total Comprehensive income for the six months ended June 30, 2009 and 2008 was $905 million and $2,221 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 July 31, 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.

2. New Accounting Pronouncements

SFAS 157 – In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 157 (SFAS 157), "Fair Value Measurements." SFAS 157 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, the Statement expands disclosures about fair value measurements. In February 2008, the FASB issued final Staff Positions that (1) deferred the effective date of this Statement for one year for certain nonfinancial assets and nonfinancial liabilities (see below) and (2) removed certain leasing transactions from the scope of the Statement. We applied this new accounting standard to all other fair value measurements effective January 1, 2008. The adoption of SFAS 157 did not have a material impact on our financial statements. See Note 14 for additional information.

FSP 157-2 – In February 2008, the FASB issued FASB Staff Position on Statement 157, "Effective Date of FASB Statement No. 157" (FSP 157-2). FSP 157-2 delayed the effective date of SFAS 157 for nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed on a recurring basis, to fiscal years beginning after November 15, 2008. Our significant nonfinancial assets and liabilities include those initially measured at fair value in a business combination and goodwill tested annually for impairment. We adopted this new accounting standard on January 1, 2009. The adoption of FSP 157-2 did not have a material impact on our financial statements.

FSP 157-3 – In October 2008, the FASB issued FASB Staff Position on Statement 157, "Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active" (FSP 157-3). FSP 157-3 clarifies how SFAS 157 should be applied when valuing securities in markets that are not active by illustrating key considerations in determining fair value. It also reaffirms the notion of fair value as the exit price as of the measurement date. FSP 157-3 was effective upon issuance, which included periods for which financial statements have not yet been issued. We adopted this new accounting standard on July 1, 2008. The adoption of FSP 157-3 did not have a material impact on our financial statements.

SFAS 158 – In September 2006, the FASB issued Statement of Financial Accounting Standards No. 158 (SFAS 158), "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans – an amendment of FASB Statements No. 87, 88, 106 and 132(R)." SFAS 158 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 provisions 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 provisions are 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 postretirement benefit plans and September 30th for our non-U.S. plans. The following summarizes the effect of adopting the year-end measurement date provisions as of January 1, 2008. See Note 9 for additional information.

Adoption of SFAS 158 year-end measurement date	January 1, 2008 Prior to SFAS 158 Adjustment	SFAS 158 Adjustment	January 1, 2008 Post SFAS 158 Adjustment
(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

SFAS 159 – In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159 (SFAS 159), "The Fair Value Option for Financial Assets and Financial Liabilities – including an amendment of SFAS No. 115." SFAS 159 creates a fair value option under which an entity may irrevocably elect fair value as the initial and subsequent measurement attribute for certain financial assets and liabilities on a contract by contract basis, with changes in fair values recognized in earnings as these changes occur. We adopted this new accounting standard on January 1, 2008. We have not elected to measure any financial assets or financial liabilities at fair value which were not previously required to be measured at fair value. Therefore, the adoption of SFAS 159 did not have a material impact on our financial statements.

SFAS 141R and SFAS 160 – In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141 (revised 2007) (SFAS 141R), "Business Combinations," and No. 160 (SFAS 160), "Noncontrolling Interests in Consolidated Financial Statements – an amendment of ARB No. 51." SFAS 141R requires the acquiring entity in a business combination to recognize the assets acquired and liabilities assumed. Further, SFAS 141R also changes the accounting for acquired in-process research and development assets, contingent consideration, partial acquisitions and transaction costs. Under SFAS 160, 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 these new accounting standards on January 1, 2009. As required, SFAS 160 was adopted through retrospective application, and all prior period information has been adjusted accordingly. The adoption of SFAS 141R and SFAS 160 did not have a material impact on our financial statements.

SFAS 161 – In March 2008, the FASB issued Statement of Financial Accounting Standards No. 161 (SFAS 161), “Disclosures about Derivative Instruments and Hedging Activities – an amendment of FASB Statement No. 133.” SFAS 161 expands disclosures for derivative instruments by requiring entities to disclose the fair value of derivative instruments and their gains or losses in tabular format. SFAS 161 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 accounting standard on January 1, 2009. The adoption of SFAS 161 did not have a material impact on our financial statements. See Note 4 for additional information.

SFAS 162 – In May 2008, the FASB issued Statement of Financial Accounting Standards No. 162 (SFAS 162), “The Hierarchy of Generally Accepted Accounting Principles.” SFAS 162 identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with U.S. GAAP. SFAS 162 was effective November 13, 2008 and is superseded by Statement of Financial Accounting Standards No. 168 (SFAS 168), “The FASB Accounting Standards CodificationTM and the Hierarchy of Generally Accepted Accounting Principles—a replacement of FASB Statement No. 162.” See below for additional information on SFAS 168.

SFAS 163 – In May 2008, the FASB issued Statement of Financial Accounting Standards No. 163 (SFAS 163), “Accounting for Financial Guarantee Insurance Contracts – an interpretation of FASB Statement No. 60.” SFAS 163 requires that an insurance enterprise recognize a claim liability prior to an event of default (insured event) when there is evidence that credit deterioration has occurred in an insured financial obligation. It also requires disclosure about (1) the risk-management activities used by an insurance enterprise to evaluate credit deterioration in its insured financial obligations and (2) the insurance enterprise’s surveillance or watch list. We adopted this new accounting standard on January 1, 2009. The adoption of SFAS 163 did not have a material impact on our financial statements.

FSP FAS 140-4 and FIN 46R-8 – In December 2008, the FASB issued FASB Staff Position on Statement 140 and FIN 46R, "Disclosures by Public Entities (Enterprises) about Transfers of Financial Assets and Interests in Variable Interest Entities" (FSP FAS 140-4 and FIN 46R-8). This FSP expands the disclosure requirements in SFAS 140 and FIN 46R by requiring additional information about companies’ involvement with variable interest entities (VIEs) and their continuing involvement with transferred financial assets. This new accounting standard was adopted for our financial statements for the annual period ending December 31, 2008. The adoption of FSP FAS 140-4 and FIN 46R-8 did not have a material impact on our financial statements.

FSP FAS 132R-1 – In December 2008, the FASB issued FASB Staff Position on Statement 132R, "Employers’ Disclosures about Postretirement Benefit Plan Assets" (FSP FAS 132R-1). This FSP expands the disclosure set forth in SFAS 132R 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, the FSP requires an employer to disclose information about the valuation of plan assets similar to that required under SFAS 157. We will adopt this new accounting standard for our financial statements for the annual period ending December 31, 2009. We do not expect the adoption of FSP FAS 132R-1 to have a material impact on our financial statements.

FSP EITF 99-20-1 – In January 2009, the FASB issued FASB Staff Position on EITF Issue No. 99-20, "Amendments to the Impairment Guidance of EITF Issue No. 99-20" (FSP EITF 99-20-1). FSP EITF 99-20-1 aligns the impairment guidance in EITF Issue No. 99-20 with that in Statement of Financial Accounting Standards No. 115 (SFAS 115), “Accounting for Certain Investments in Debt and Equity Securities.” It changes how companies determine whether an other-than-temporary impairment exists for certain beneficial interests by allowing management to exercise more judgment. This new accounting standard was adopted for our financial statements for the annual period ending December 31, 2008. The adoption of FSP EITF 99-20-1 did not have a material impact on our financial statements.

FSP FAS 107-1 and APB 28-1 – In April 2009, the FASB issued FASB Staff Position on FAS 107-1 and APB 28-1, "Interim Disclosures about Fair Value of Financial Instruments" (FSP FAS 107-1 and APB 28-1). This FSP requires that the fair value disclosures required by SFAS 107 “Disclosures about Fair Value of Financial Instruments” be included for interim reporting periods. We adopted this new accounting standard on April 1, 2009. The adoption of FSP FAS 107-1 and APB 28-1 did not have a material impact on our financial statements. See Note 14 for additional information.

FSP FAS 115-2 and FAS 124-2 – In April 2009, the FASB issued FASB Staff Position on FAS 115-2 and FAS 124-2, “Recognition and Presentation of Other-Than-Temporary Impairments” (FSP FAS 115-2 and FAS 124-2). This FSP amends the 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 company meets the criteria for impairment, the impairment charges related to credit losses would be recognized in earnings, while non-credit losses would be reflected in other comprehensive income. Additionally, it requires a more detailed, risk-oriented breakdown of major security types and related information currently required by SFAS 115. We adopted this new accounting standard on April 1, 2009. The adoption of FSP FAS 115-2 and FAS 124-2 did not have a material impact on our financial statements. See Notes 8 and 16 for additional information.

FSP FAS 157-4 – In April 2009, the FASB issued FASB Staff Position on FAS 157-4, “Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly” (FSP FAS 157-4). FSP FAS 157-4 provides guidance on determining when the trading volume and activity for an asset or liability has significantly decreased, which may indicate an inactive market, and on measuring the fair value of an asset or liability in inactive markets. We adopted this new accounting standard on April 1, 2009. The adoption of FSP FAS 157-4 did not have a material impact on our financial statements.

FSP FAS 141R-1 – In April 2009, the FASB issued FASB Staff Position on FAS 141R-1, “Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies” (FSP FAS 141R-1). FSP FAS 141R-1 requires that an acquirer recognize at fair value, at the acquisition date, an asset acquired or a liability assumed in a business combination that arises from a contingency if the acquisition-date fair value of the asset or liability can be determined during the measurement period. We adopted this new accounting standard on January 1, 2009. The adoption of FSP FAS 141R-1 did not have a material impact on our financial statements.

SFAS 165 – In May 2009, the FASB issued Statement of Financial Accounting Standards No. 165 (SFAS 165), "Subsequent Events." SFAS 165 establishes the general 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 accounting standard was adopted for our financial statements for the quarterly period ending June 30, 2009. The adoption of SFAS 165 did not have a material impact on our financial statements. See Note 1A for additional information.

SFAS 166 – In June 2009, the FASB issued Statement of Financial Accounting Standards No. 166 (SFAS 166), "Accounting for Transfers of Financial Assets – an amendment of FASB Statement No. 140." SFAS 166 amends SFAS 140 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 standard required extensive new disclosures regarding an entity's involvement in a transfer of financial assets. Finally, existing QSPEs (prior to the effective date of SFAS 166) 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 accounting standard effective January 1, 2010. We are currently reviewing the impact of SFAS 166 on our financial statements and expect to complete this evaluation in 2009.

SFAS 167 – In June 2009, the FASB issued Statement of Financial Accounting Standards No. 167 (SFAS 167), "Amendments to FASB Interpretation No. 46R." SFAS 167 revises FIN 46R 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 accounting standard effective January 1, 2010. We are currently reviewing the impact of SFAS 167 on our financial statements and expect to complete this evaluation in 2009.

SFAS 168 – In June 2009, the FASB issued SFAS 168, "The FASB Accounting Standards CodificationTM and the Hierarchy of Generally Accepted Accounting Principles—a replacement of FASB Statement No. 162." SFAS 168 establishes the FASB Accounting Standards CodificationTM (Codification) as the source of authoritative U.S. GAAP to be applied by nongovernmental entities. While not intended to change U.S. GAAP, the Codification significantly changes the way in which the accounting literature is organized. We will adopt this new accounting standard for our financial statements for the quarterly period ending September 30, 2009. We do not expect the adoption of SFAS 168 to have a material impact on our financial statements.

3. Stock-Based Compensation

Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment" (SFAS 123R), 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 $41 million and $74 million for the three and six months ended June 30, 2009, respectively; and $70 million and $107 million for the three and six months ended June 30, 2008, respectively.

The following table illustrates the type and fair market value of the stock-based compensation awards granted during the six month periods ended June 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.

The following table provides the assumptions used in determining the fair value of the stock-based awards for the six month periods ended June 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 June 30, 2009, the total remaining unrecognized compensation cost related to nonvested stock-based compensation awards was $153 million, which will be amortized over the weighted-average remaining requisite service periods of approximately 2.0 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 June 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 Statement of Financial Accounting Standards No. 133 (SFAS 133), "Accounting for Derivative Instruments and Hedging Activities."

We adopted SFAS 161 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 currency, 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 June 30, 2009, $87 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 on-going 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 June 30, 2009, $47 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.

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 $1 million were recorded in current earnings for the three and six months ended June 30, 2009. There were no contracts outstanding for the six months ended June 30, 2008.

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

(Millions of dollars)	June 30, 2009	
		Asset (Liability)

		Consolidated Statement of Financial Position Location	Fair Value
Designated derivatives			
Foreign exchange contracts			
	Machinery and Engines	Receivables – trade and other	$ 150
	Machinery and Engines	Long-term receivables – trade and other	182
	Machinery and Engines	Accrued expenses	(24)
Interest rate contracts			
	Financial Products	Receivables – trade and other	14
	Financial Products	Long-term receivables – trade and other	139
	Financial Products	Accrued expenses	(148)
			$ 313
Undesignated derivatives			
Foreign exchange contracts			
	Machinery and Engines	Receivables – trade and other	$ 21
	Machinery and Engines	Long-term receivables – trade and other	60
	Machinery and Engines	Accrued expenses	(5)
	Financial Products	Receivables – trade and other	16
	Financial Products	Accrued expenses	(52)
Interest rate contracts			
	Machinery and Engines	Accrued expenses	(5)
	Financial Products	Receivables – trade and other	3
	Financial Products	Long-term receivables – trade and other	3
	Financial Products	Accrued expenses	(13)
Commodity contracts			
	Machinery and Engines	Receivables – trade and other	1
			$ 29

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

Fair Value Hedges
(Millions of dollars)

	Three Months Ended June 30, 2009		Six Months Ended June 30, 2009	
Classification	Gains (Losses) on Derivatives	Gains (Losses) on Borrowings	Gains (Losses) on Derivatives	Gains (Losses) on Borrowings

Interest rate contracts					
Financial Products	Other income (expense)	$ (160)	$ 155	$ (220)	$ 234
		$ (160)	$ 155	$ (220)	$ 234

Cash Flow Hedges
(Millions of dollars)

	Three Months Ended June 30, 2009				
				Recognized in Earnings	
	Classification	Recognized in AOCI (Effective Portion)	Classification of Gains (Losses)	Reclassified from AOCI (Effective Portion)	Recognized in Earnings (Ineffective Portion)
Foreign exchange contracts					
Machinery and Engines	AOCI	$ 138	Other income (expense)	$ 63	$ 3
Interest rate contracts					
Machinery and Engines	AOCI	—	Other income (expense)	(1)	—
Financial Products	AOCI	(5)	Interest expense of Financial Products	(22)	1 4
		$ 133		$ 40	$ 7

	Six Months Ended June 30, 2009				
				Recognized in Earnings	
	Classification	Recognized in AOCI (Effective Portion)	Classification of Gains (Losses)	Reclassified from AOCI (Effective Portion)	Recognized in Earnings (Ineffective Portion)
Foreign exchange contracts					
Machinery and Engines	AOCI	$ 196	Other income (expense)	$ 71	$ (3)
Interest rate contracts					
Machinery and Engines	AOCI	(29)	Other income (expense)	(2)	—
Financial Products	AOCI	(18)	Interest expense of Financial Products	(42)	1 5