CATERPILLAR INC
Form 10-Q
May 03, 2010

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 March 31, 2010

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 [X] 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 March 31, 2010, 627,745,394 shares of common stock of the registrant were outstanding.

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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 March 31,			
		2010		2009
Sales and revenues:				
Sales of Machinery and Engines	$	7,551	$	8,510
Revenues of Financial Products		687		715
Total sales and revenues		8,238		9,225
Operating costs:				
Cost of goods sold		5,894		7,027
Selling, general and administrative expenses		932		882
Research and development expenses		402		388
Interest expense of Financial Products		233		279
Other operating (income) expenses		269		824
Total operating costs		7,730		9,400
Operating profit (loss)		508		(175)
Interest expense excluding Financial Products		102		101
Other income (expense)		63		64
Consolidated profit (loss) before taxes		469		(212)
Provision (benefit) for income taxes		231		(80)
Profit (loss) of consolidated companies		238		(132)
Equity in profit (loss) of unconsolidated affiliated companies		(2)		1
Profit (loss) of consolidated and affiliated companies		236		(131)
Less: Profit (loss) attributable to noncontrolling interests		3		(19)
Profit (loss) 1	$	233	$	(112)
Profit (loss) per common share	$	0.37	$	(0.19)
Profit (loss) per common share – diluted 2	$	0.36	$	(0.19)
Weighted-average common shares outstanding (millions)				
- Basic		626.4		602.1
- Diluted 2		643.5		602.1
Cash dividends declared per common share	$	—	$	—

1 Profit (loss) 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)

	March 31, 2010	December 31, 2009
Assets		
Current assets:		
Cash and short-term investments	$ 3,538	$ 4,867
Receivables – trade and other	6,068	5,611
Receivables – finance	8,123	8,301
Deferred and refundable income taxes	1,153	1,216
Prepaid expenses and other current assets	540	434
Inventories	6,990	6,360
Total current assets	26,412	26,789
Property, plant and equipment – net	12,057	12,386
Long-term receivables – trade and other	722	971
Long-term receivables – finance	12,157	12,279
Investments in unconsolidated affiliated companies	133	105
Noncurrent deferred and refundable income taxes	2,558	2,714
Intangible assets	488	465
Goodwill	2,284	2,269
Other assets	2,025	2,060
Total assets	$ 58,836	$ 60,038
Liabilities		
Current liabilities:		
Short-term borrowings:		
Machinery and Engines	$ 584	$ 433
Financial Products	2,996	3,650
Accounts payable	3,431	2,993
Accrued expenses	3,216	3,351
Accrued wages, salaries and employee benefits	900	797
Customer advances	1,367	1,217
Dividends payable	—	262
Other current liabilities	881	888
Long-term debt due within one year:		
Machinery and Engines	248	302
Financial Products	4,794	5,399
Total current liabilities	18,417	19,292
Long-term debt due after one year:		
Machinery and Engines	5,135	5,652
Financial Products	16,413	16,195
Liability for postemployment benefits	7,281	7,420

Other liabilities	2,116	2,179
Total liabilities	49,362	50,738
Commitments and contingencies (Notes 10 and 12)		
Redeemable noncontrolling interest	452	477
Stockholders' equity		
Common stock of $1.00 par value:		
Authorized shares: 900,000,000		
Issued shares: (3/31/10 and 12/31/09 – 814,894,624) at paid-in amount	3,482	3,439
Treasury stock (3/31/10 – 187,149,230 shares; 12/31/09 – 190,171,905 shares) at cost	(10,595)	(10,646)
Profit employed in the business	19,941	19,711
Accumulated other comprehensive income (loss)	(3,886)	(3,764)
Noncontrolling interests	80	83
Total stockholders' equity	9,022	8,823
Total liabilities, redeemable noncontrolling interest and stockholders' equity	$ 58,836	$ 60,038

See accompanying notes to Consolidated Financial Statements.

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

	Common stock	Treasury stock	Profit employed in the business	Accumulated other comprehensive income (loss)	Noncontrolling interests	Total	Comprehensive income (loss)
Three Months Ended March 31, 2009							
Balance at December 31, 2008	$3,057	$(11,217)	$19,826	$(5,579)	$ 103	$6,190	
Profit (loss) of consolidated and affiliated companies	—	—	(112)	—	(19)	(131)	$ (131)
Foreign currency translation, net of tax of $38	—	—	—	(120)	(3)	(123)	(123)
Pension and other postretirement benefits							
Current year actuarial gain (loss), net of tax of $831	—	—	—	50	—	50	50
Amortization of actuarial (gain) loss, net of tax of $30	—	—	—	50	2	52	52
Current year prior service cost, net of tax of $1971	—	—	—	236	—	236	236
	—	—	—	6	—	6	6

Amortization of prior service cost, net of tax of $3							
Derivative financial instruments and other							
Gains (losses) deferred, net of tax of $7	—	—	—	9	—	9	9
(Gains) losses reclassified to earnings, net of tax of $5	—	—	—	8	(1)	7	7
Retained interests							
Gains (losses) deferred, net of tax of $5	—	—	—	(9)	—	(9)	(9)
(Gains) losses reclassified to earnings, net of tax of $7	—	—	—	14	—	14	14
Available-for-sale securities							
Gains (losses) deferred, net of tax of $4	—	—	—	(8)	—	(8)	(8)
(Gains) losses reclassified to earnings, net of tax of $6	—	—	—	11	—	11	11
Common shares issued from treasury stock for stock-based compensation: 183,040	(3)	3	—	—	—	—	—
Stock-based compensation expense	32	—	—	—	—	32	—
Cat Japan share redemption[2]	—	—	(20)	—	20	—	—
Balance at March 31, 2009	$3,086	$(11,214)	$19,694	$(5,332)	$ 102	$6,336	$ 114
Three Months Ended March 31, 2010							
Balance at December 31, 2009	$3,439	$(10,646)	$19,711	$(3,764)	$ 83	$8,823	
Adjustment to adopt consolidation of variable interest entities[3]	—	—	(6)	3	—	(3)	
Balance at January 1, 2010	$ 3,439	$(10,646)	$19,705	$(3,761)	$ 83	$8,820	
Profit (loss) of consolidated and affiliated companies	—	—	233	—	3	236	$ 236
Foreign currency translation, net of tax of $64	—	—	—	(165)	(5)	(170)	(170)
Pension and other postretirement benefits							

Amortization of actuarial (gain) loss, net of tax of $46	—	—	—	77	4	81	81
Amortization of prior service cost, net of tax of $4	—	—	—	(2)	—	(2)	(2)
Derivative financial instruments and other							
Gains (losses) deferred, net of tax of $40	—	—	—	(65)	—	(65)	(65)
(Gains) losses reclassified to earnings, net of tax of $9	—	—	—	16	—	16	16
Available-for-sale securities							
Gains (losses) deferred, net of tax of $9	—	—	—	14	—	14	14
Change in ownership from noncontrolling interests	(17)	—	—	—	(11)	(28)	—
Common shares issued from treasury stock for stock-based compensation: 2,489,804	(14)	40	—	—	—	26	—
Common shares issued from treasury stock for benefit plans: 532,871	18	11	—	—	—	29	—
Stock-based compensation expense	42	—	—	—	—	42	—
Excess tax benefits from stock-based compensation	14	—	—	—	—	14	—
Cat Japan share redemption2	—	—	3	—	6	9	—
Balance at March 31, 2010	$3,482	$(10,595)	$19,941	$(3,886)	$ 80	$9,022	$ 110

1 Changes in amounts due to plan re-measurements. See Note 9 for additional information.
2 See Note 16 regarding the Cat Japan share redemption.
3 See Note 15 for additional information.

See accompanying notes to Consolidated Financial Statements.

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

Three Months Ended

	March 31, 2010	2009
Cash flow from operating activities:		
Profit (loss) of consolidated and affiliated companies	$ 236	$ (131)
Adjustments for non-cash items:		
Depreciation and amortization	554	534
Other	94	106
Changes in assets and liabilities:		
Receivables – trade and other	(373)	1,622
Inventories	(644)	764
Accounts payable	533	(1,406)
Accrued expenses	(65)	(321)
Customer advances	140	(179)
Other assets – net	109	48
Other liabilities – net	(33)	(142)
Net cash provided by (used for) operating activities	551	895
Cash flow from investing activities:		
Capital expenditures – excluding equipment leased to others	(204)	(224)
Expenditures for equipment leased to others	(169)	(221)
Proceeds from disposals of property, plant and equipment	353	208
Additions to finance receivables	(1,757)	(1,789)
Collections of finance receivables	1,956	2,450
Proceeds from sales of finance receivables	2	27
Investments and acquisitions (net of cash acquired)	(103)	—
Proceeds from sale of available-for-sale securities	45	87
Investments in available-for-sale securities	(46)	(58)
Other – net	33	23
Net cash provided by (used for) investing activities	110	503
Cash flow from financing activities:		
Dividends paid	(262)	(253)
Common stock issued, including treasury shares reissued	26	—
Excess tax benefit from stock-based compensation	13	—
Acquisitions of noncontrolling interests	(26)	—
Proceeds from debt issued (original maturities greater than three months):		
– Machinery and Engines	54	121
– Financial Products	1,264	4,697
Payments on debt (original maturities greater than three months):		
– Machinery and Engines	(607)	(205)
– Financial Products	(2,729)	(3,116)
Short-term borrowings – net (original maturities three months or less)	331	(1,779)
Net cash provided by (used for) financing activities	(1,936)	(535)
Effect of exchange rate changes on cash	(54)	(33)
Increase (decrease) in cash and short-term investments	(1,329)	830
Cash and short-term investments at beginning of period	4,867	2,736
Cash and short-term investments at end of period	$ 3,538	$ 3,566

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.

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 month periods ended March 31, 2010 and 2009, (b) the consolidated financial position at March 31, 2010 and December 31, 2009, (c) the consolidated changes in stockholders' equity for the three month periods ended March 31, 2010 and 2009, and (d) the consolidated cash flow for the three month periods ended March 31, 2010 and 2009. 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, 2009 (2009 Form 10-K).

The December 31, 2009 financial position data included herein is derived from the audited consolidated financial statements included in the 2009 Form 10-K but does not include all disclosures required by U.S. GAAP.

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, 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 21,800 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.

C. Accumulated Other Comprehensive Income (Loss)

Comprehensive income (loss) and its components are presented in Consolidated Statement of Changes in Stockholders' Equity. Accumulated other comprehensive income (loss), net of tax, consisted of the following:

(Millions of dollars)	March 31, 2010	March 31, 2009
Foreign currency translation	$ 438	$ 141
Pension and other postretirement benefits	(4,364)	(5,507)
Derivative financial instruments	11	112
Retained interests	—	(2)
Available-for-sale securities	29	(76)
Total accumulated other comprehensive income (loss)	$ (3,886)	$ (5,332)

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 financial assets and liabilities effective January 1, 2008 and nonfinancial assets and liabilities effective January 1, 2009. The adoption of this guidance did not have a material impact on our financial statements. See Note 17 for additional information.

In January 2010, the FASB issued new accounting guidance that requires the gross presentation of activity within the Level 3 fair value measurement roll forward and details of transfers in and out of Level 1 and 2 fair value measurements. It also clarifies existing disclosure requirements regarding the level of disaggregation of fair value measurements and disclosures on inputs. We adopted this new accounting guidance for the quarterly period ended March 31, 2010. The adoption of this guidance did not have a material impact on our financial statements. See Note 17 for additional information.

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 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 are 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. The adoption of this guidance did not have a material impact on our financial statements. See Note 19 for further details.

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 adopted this guidance for our financial statements for the annual period ending December 31, 2009. The adoption of this guidance did not have a material impact on our financial statements.

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 Note 8 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.

In February 2010, the FASB issued new accounting guidance that amends the May 2009 subsequent events guidance described above to (1) eliminate the requirement for an SEC filer to disclose the date through which it has evaluated subsequent events, (2) clarify the period through which conduit bond obligors must evaluate subsequent events, and (3) refine the scope of the disclosure requirements for reissued financial statements. We adopted this new accounting guidance for our financial statements for the quarterly period ended March 31, 2010. The adoption of this guidance did not have a material impact on our financial statements.

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 and includes: 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 adopted this new guidance on January 1, 2010. The adoption of this guidance did not have a material impact on our financial statements. See Note 15 for additional information.

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 QSPEs, by establishing a new approach for determining who should consolidate a VIE and by changing when it is necessary to reassess who should consolidate a VIE. We adopted this new guidance on January 1, 2010. The adoption of this guidance resulted in the consolidation of QSPEs related to Cat Financial's asset-backed securitization program that were previously not recorded on our consolidated financial statements. The adoption of this guidance did not have a material impact on our financial statements. See Note 15 for additional information.

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 of $42 million and $32 million in the first quarter of 2010 and 2009, respectively.

The following table illustrates the type and fair value of the stock-based compensation awards granted during the first quarter of 2010 and 2009, respectively:

	2010		2009	
	# Granted	Fair Value Per Award	# Granted	Fair Value Per Award
SARs	7,125,210	$ 22.31	6,260,647	$ 7.10
RSUs	1,711,771	53.35	2,185,674	20.22
Stock options	431,271	22.31	562,580	7.10

The stock price on the date of grant was $57.85 and $22.17 for 2010 and 2009, respectively.

The following table provides the assumptions used in determining the fair value of the stock-based awards for the three month periods ended March 31, 2010 and 2009, respectively:

	Grant Year	
	2010	2009
Weighted-average dividend yield	2.32%	3.07%
Weighted-average volatility	36.4%	36.0%
Range of volatilities	35.2-51.8%	35.8-61.0%
Range of risk-free interest rates	0.32-3.61%	0.17-2.99%
Weighted-average expected lives	7 years	8 years

As of March 31, 2010, the total remaining unrecognized compensation cost related to nonvested stock-based compensation awards was $312 million, which will be amortized over the weighted-average remaining requisite service periods of approximately 2.6 years.

4. Derivative Financial Instruments and Risk Management

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, commodity forward and option contracts, and stock repurchase 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 asset or 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 (loss) (AOCI) on 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.

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 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, including any hedges designed to protect our competitive exposure. Periodically we also designate as fair value hedges specific euro forward contracts used to hedge firm commitments.

As of March 31, 2010, $1 million of deferred net losses, 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 matched 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 March 31, 2010, $27 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. The actual amount recorded in Interest expense of Financial Products will vary based on interest rates at the time the hedged transactions impact earnings.

We have, at certain times, liquidated fixed-to-floating and floating-to-fixed interest rate 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, lead 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 and diesel fuel 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.

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

(Millions of dollars)			
		Asset (Liability) Fair Value	
	Statement of Financial Position Location	March 31, 2010	December 31, 2009
Designated derivatives			
Foreign exchange contracts			
		$ 40	$ 27

Machinery and Engines	Receivables – trade and other		
Machinery and Engines	Long-term receivables – trade and other	45	125
Machinery and Engines	Accrued expenses	(42)	(22)
Machinery and Engines	Other liabilities	(4)	(3)
Interest rate contracts			
Machinery and Engines	Receivables – trade and other	1	1
Machinery and Engines	Accrued expenses	(1)	(1)
Financial Products	Receivables – trade and other	13	18
Financial Products	Long-term receivables – trade and other	162	127
Financial Products	Accrued expenses	(67)	(100)
		$ 147	$ 172
Undesignated derivatives			
Foreign exchange contracts			
Machinery and Engines	Receivables – trade and other	$ 5	$ —
Machinery and Engines	Long-term receivables – trade and other	74	66
Machinery and Engines	Accrued expenses	(3)	—
Machinery and Engines	Other liabilities	(9)	(3)
Financial Products	Receivables – trade and other	7	20
Financial Products	Accrued expenses	(6)	(18)
Interest rate contracts			
Machinery and Engines	Accrued expenses	—	(7)
Financial Products	Receivables – trade and other	—	1
Financial Products	Long-term receivables – trade and other	1	1
Financial Products	Accrued expenses	(5)	(6)
Commodity contracts			
Machinery and Engines	Receivables – trade and other	13	10
		$ 77	$ 64

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

Fair Value Hedges

(Millions of dollars)

	Classification	Three Months Ended March 31, 2010 Gains (Losses) on Derivatives	Gains (Losses) on Borrowings
Interest rate contracts			
Machinery and Engines	Other income (expense)	$ 1	$ (1)
Financial Products	Other income (expense)	53	(51)
		$ 54	$ (52)

	Classification	Three Months Ended March 31, 2009 Gains (Losses) on Derivatives	Gains (Losses) on Borrowings
Interest rate contracts			
Financial Products	Other income (expense)	$ (60)	$ 79
		$ (60)	$ 79

Cash Flow Hedges
(Millions of dollars)

		Three Months Ended March 31, 2010			
			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	$ (99)	Other income (expense)	$ (8)	$ 1
Interest rate contracts					
Financial Products	AOCI	(6)	Interest expense of Financial Products	(17)	1 1
		$ (105)		$ (25)	$ 2

		Three Months Ended March 31, 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					
	AOCI	$ 58		$ 8	$ (6)

Machinery and Engines			Other income (expense)		
Interest rate contracts					
Machinery and Engines	AOCI	(29)	Other income (expense)	(1)	—
Financial Products	AOCI	(13)	Interest expense of Financial Products	(20)	1 1
		$ 16		$ (13)	$ (5)

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

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

(Millions of dollars)

	Classification of Gains (Losses)	Three Months Ended March 31, 2010
Foreign exchange contracts		
Machinery and Engines	Other income (expense)	$ 11
Financial Products	Other income (expense)	23
Interest rate contracts		
Machinery and Engines	Other income (expense)	(2)
Financial Products	Other income (expense)	1
Commodity contracts		
Machinery and Engines	Other income (expense)	4
		$ 37

	Classification of Gains (Losses)	Three Months Ended March 31, 2009
Foreign exchange contracts		
Machinery and Engines	Other income (expense)	$ 21
Financial Products	Other income (expense)	15
Interest rate contracts		
Machinery and Engines	Other income (expense)	(2)
Financial Products	Other income (expense)	(3)
		$ 31

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. There were no stock repurchase derivatives outstanding for the three months ended March 31, 2010 or 2009.

5. Inventories

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

(Millions of dollars)	March 31, 2010	December 31, 2009
Raw materials	$ 2,116	$ 1,979
Work-in-process	795	656
Finished goods	3,840	3,465
Supplies	239	260
Total inventories	$ 6,990	$ 6,360

6. Investments in Unconsolidated Affiliated Companies

Combined financial information of the unconsolidated affiliated companies accounted for by the equity method (generally on a lag of 3 months or less) was as follows:

Results of Operations of unconsolidated affiliated companies: (Millions of dollars)	Three Months Ended March 31, 2010	2009
Sales	$ 162	$ 123
Cost of sales	120	91
Gross profit	$ 42	$ 32
Profit (loss)	$ (2)	$ 2

Financial Position of unconsolidated affiliated companies: (Millions of dollars)	March 31, 2010	December 31, 2009
Assets:		
Current assets	$ 320	$ 223
Property, plant and equipment – net	198	219
Other assets	8	5
	526	447
Liabilities:		
Current liabilities	205	250
Long-term debt due after one year	92	41
Other liabilities	26	17
	323	308
Equity	$ 203	$ 139

Caterpillar's investments in unconsolidated affiliated companies: (Millions of dollars)		
Investments in equity method companies	$ 98	$ 70
Plus: Investments in cost method companies	35	35
Total investments in unconsolidated affiliated companies	$ 133	$ 105

7. Intangible Assets and Goodwill

A. Intangible assets

Intangible assets are comprised of the following:

	March 31, 2010			
(Millions of dollars)	Weighted Amortizable Life (Years)	Gross Carrying Amount	Accumulated Amortization	Net
Customer relationships	17	$ 417	$ (82)	$ 335
Intellectual property	9	228	(147)	81
Other	11	129	(57)	72
Total intangible assets	14	$ 774	$ (286)	$ 488

	December 31, 2009			
(Millions of dollars)	Weighted Amortizable Life (Years)	Gross Carrying Amount	Accumulated Amortization	Net
Customer relationships	18	$ 396	$ (75)	$ 321
Intellectual property	10	211	(143)	68
Other	11	130	(54)	76
Total intangible assets	15	$ 737	$ (272)	$ 465

During the first quarter of 2010, we acquired finite-lived intangible assets of $28 million due to the purchase of GE Transportation's Inspection Products business. During the first quarter of 2010, we also acquired finite-lived intangible assets of $12 million due to the purchase of JCS Co. Ltd. See Note 19 for details on these business combinations.

Amortization expense for the three months ended March 31, 2010 and March 31, 2009 was $15 million and $18 million, respectively. Amortization expense related to intangible assets is expected to be:

(Millions of dollars)					
2010	2011	2012	2013	2014	Thereafter
$ 63	$ 57	$ 50	$ 45	$ 42	$ 246

B. Goodwill

During the first quarter of 2010, we acquired net assets with related goodwill of $14 million as part of the purchase of GE Transportation's Inspection Products business. During the first quarter of 2010, we also acquired net assets with related goodwill of $8 million as part of the purchase of

JCS Co. Ltd. See Note 19 for details on the acquisition of these assets.

We test goodwill for impairment 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. Goodwill is reviewed for impairment utilizing a two-step process. The first step requires us to compare the fair value of each reporting unit, which we primarily determine using an income approach based on the present value of discounted cash flows, to the respective carrying value, which includes goodwill. If the fair value of the reporting unit exceeds its carrying value, the goodwill is not considered impaired. If the carrying value is greater than the fair value, there is an indication that an impairment may exist and the second step is required. In step two, the implied fair value of goodwill is calculated as the excess of the fair value of a reporting unit over the fair values assigned to its assets and liabilities. If the implied fair value of goodwill is less than the carrying value of the reporting unit's goodwill, the difference is recognized as an impairment loss.

No goodwill was impaired or disposed of during the first quarter of 2010 or 2009. The change in goodwill during the first quarter of 2009 was due to foreign currency translation in the Cat Japan segment.

The changes in the carrying amount of the goodwill by reportable segment for the first quarter of 2010 were as follows:

(Millions of dollars)	Balance at December 31, 2009	Business combinations	Other adjustments1