CATERPILLAR INC
Form 10-Q/A
May 03, 2007

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

FORM 10-Q/A
(Amendment No. 1*)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2007
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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer [X]   Accelerated filer [   ]   Non-accelerated filer [   ]

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, 2007, 640,395,899 shares of common stock of the Registrant were outstanding.

This Form 10-Q/A is identical to the Form 10-Q filed with the SEC on 5/3/07 (SEC Accession No. 0000018230-07-000304) and is being filed for the sole purpose of correcting a typographical error whereby Exhibit 31.2 did not contain the typed signature of the signing officer.

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, 2007	Three Months Ended March 31, 2006
Sales and revenues:		
Sales of Machinery and Engines	$ 9,321	$ 8,743
Revenues of Financial Products	695	649
Total sales and revenues	10,016	9,392
Operating costs:		
Cost of goods sold	7,136	6,552
Selling, general and administrative expenses	890	821
Research and development expenses	340	307
Interest expense of Financial Products	271	232
Other operating expenses	239	262
Total operating costs	8,876	8,174
Operating profit	1,140	1,218
Interest expense excluding Financial Products	79	68
Other income (expense)	111	43
Consolidated profit before taxes	1,172	1,193
Provision for income taxes	375	370
Profit of consolidated companies	797	823
Equity in profit (loss) of unconsolidated affiliated companies	19	17
Profit	$ 816	$ 840
Profit per common share	$ 1.27	$ 1.25
Profit per common share - diluted [1]	$ 1.23	$ 1.20

Weighted-average common shares outstanding (millions)				
- Basic		643.9		672.0
- Diluted [1]		665.2		699.1
Cash dividends declared per common share	$	—	$	—

[1] 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, 2007	December 31, 2006
Assets		
Current assets:		
Cash and short-term investments	$ 607	$ 530
Receivables - trade and other	8,016	8,607
Receivables - finance	6,700	6,804
Deferred and refundable income taxes	847	733
Prepaid expenses and other current assets	657	638
Inventories	7,131	6,351
Total current assets	23,958	23,663
Property, plant and equipment - net	8,892	8,851
Long-term receivables - trade and other	705	860
Long-term receivables - finance	11,799	11,531
Investments in unconsolidated affiliated companies	554	562
Noncurrent deferred and refundable income taxes	2,121	1,949
Intangible assets	460	387
Goodwill	1,940	1,904
Other assets	1,819	1,742
Total assets	$ 52,248	$ 51,449
Liabilities		
Current liabilities:		
Short-term borrowings:		
Machinery and Engines	$ 649	$ 165
Financial Products	5,592	4,990
Accounts payable	4,044	4,085

Accrued expenses	2,883	2,923
Accrued wages, salaries and employee benefits	704	938
Customer advances	1,081	921
Dividends payable	—	194
Other current liabilities	899	1,145
Long-term debt due within one year:		
Machinery and Engines	442	418
Financial Products	3,656	4,043
Total current liabilities	19,950	19,822
Long-term debt due after one year:		
Machinery and Engines	3,679	3,694
Financial Products	13,338	13,986
Liability for postemployment benefits	5,873	5,879
Other liabilities	1,916	1,209
Total liabilities	44,756	44,590
Commitments and contingencies (Notes 10 and 12)		
Stockholders' equity		
Common stock of $1.00 par value:		
Authorized shares: 900,000,000		
Issued shares: (3/31/07 and 12/31/06 - 814,894,624) at paid-in amount	2,518	2,465
Treasury stock (3/31/07 - 174,498,725; 12/31/06 - 169,086,448) at cost	(7,789)	(7,352)
Profit employed in the business	15,550	14,593
Accumulated other comprehensive income	(2,787)	(2,847)
Total stockholders' equity	7,492	6,859
Total liabilities and stockholders' equity	$ 52,248	$ 51,449

See accompanying notes to Consolidated Financial Statements.

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

				Accumulated other comprehensive income				
	Common stock	Treasury stock	Profit employed in the	Foreign currency translation	Pension & other post-	Derivative financial instruments	Available-for-sale securities	Total

			business		retirement benefits[1]			
Three Months ended March 31, 2006								
Balance at December 31, 2005	$1,859	$(4,637)	$11,808	$302	$ (934)	$ 18	$ 16	$8,432
Profit	—	—	840	—	—	—	—	840
Foreign currency translation	—	—	—	14	—	—	—	14
Minimum pension liability adjustment, net of tax of $0	—	—	—	—	1	—	—	1
Derivative financial instruments								
Gains (losses) deferred, net of tax of $7	—	—	—	—	—	19	—	19
(Gains) losses reclassified to earnings, net of tax of $6	—	—	—	—	—	8	—	8
Available-for-sale securities								
Gains (losses) deferred, net of tax of $2	—	—	—	—	—	—	3	3
(Gains) losses reclassified to earnings, net of tax of $2	—	—	—	—	—	—	(3)	(3)
Comprehensive Income								882
Common shares issued from treasury stock for stock-based compensation: 9,212,797	68	182	—	—	—	—	—	250
Stock-based compensation expense	34	—	—	—	—	—	—	34
Tax benefits from stock-based compensation	102	—	—	—	—	—	—	102
Shares repurchased: 10,450,000	—	(738)	—	—	—	—	—	(738)
Balance at March 31, 2006	**$2,063**	**$(5,193)**	**$12,648**	**$316**	**$ (933)**	**$ 45**	**$ 16**	**$8,962**
Three Months ended March 31, 2007								
Balance at December 31, 2006	$2,465	$(7,352)	$14,593	$471	$(3,376)	$ 48	$ 10	$6,859
Adjustment to adopt FIN 48	—	—	141	—	—	—	—	141
Balance at January 1, 2007	2,465	(7,352)	14,734	471	(3,376)	48	10	7,000
Profit	—	—	816	—	—	—	—	816
Foreign currency translation	—	—	—	16	—	—	—	16

Amortization of pension and other postretirement benefits losses, net of tax of $33	—	—	—	—	62	—	—	62
Derivative financial instruments								
Gains (losses) deferred, net of tax of $1	—	—	—	—	—	2	—	2
(Gains) losses reclassified to earnings, net of tax of $12	—	—	—	—	—	(22)	—	(22)
Available-for-sale securities								
Gains (losses) deferred, net of tax of $2	—	—	—	—	—	—	4	4
(Gains) losses reclassified to earnings, net of tax of $1	—	—	—	—	—	—	(2)	(2)
Comprehensive Income								876
Common shares issued from treasury stock for stock-based compensation: 2,645,723	(1)	74	—	—	—	—	—	73
Stock-based compensation expense	27	—	—	—	—	—	—	27
Tax benefits from stock-based compensation	27	—	—	—	—	—	—	27
Shares repurchased: 8,058,000	—	(511)	—	—	—	—	—	(511)
Balance at March 31, 2007	**$2,518**	**$(7,789)**	**$15,550**	**$487**	**$(3,314)**	**$28**	**$12**	**$7,492**

[1] Pension and other postretirement benefits includes the aggregate adjustment for unconsolidated companies of $0 million and $1 million for the three months ended March 31, 2007 and 2006, respectively. The ending balances were $43 million and $36 million at March 31, 2007 and 2006, respectively.

See accompanying notes to Consolidated Financial Statements.

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

	Three Months Ended March 31,	
	2007	**2006**
Cash flow from operating activities:		

Profit	$ 816	$ 840
Adjustments for non-cash items:		
Depreciation and amortization	412	400
Other	1	10
Changes in assets and liabilities:		
Receivables - trade and other	739	(463)
Inventories	(734)	(618)
Accounts payable and accrued expenses	(141)	216
Other assets - net	(71)	(4)
Other liabilities - net	327	126
Net cash provided by (used for) operating activities	1,349	507
Cash flow from investing activities:		
Capital expenditures - excluding equipment leased to others	(252)	(233)
Expenditures for equipment leased to others	(252)	(252)
Proceeds from disposals of property, plant and equipment	106	208
Additions to finance receivables	(2,553)	(2,346)
Collections of finance receivables	2,359	2,220
Proceeds from sales of finance receivables	40	17
Investments and acquisitions (net of cash acquired)	(153)	(4)
Proceeds from sale of available-for-sale securities	62	76
Investments in available-for-sale securities	(124)	(118)
Other - net	140	117
Net cash provided by (used for) investing activities	(627)	(315)
Cash flow from financing activities:		
Dividends paid	(193)	(168)
Common stock issued, including treasury shares reissued	73	253
Treasury shares purchased	(511)	(738)
Excess tax benefit from stock-based compensation	26	101
Proceeds from debt issued (original maturities greater than three months):		
- Machinery and Engines	26	29
- Financial Products	1,849	2,055
Payments on debt (original maturities greater than three months):		
- Machinery and Engines	(28)	(7)
- Financial Products	(3,000)	(2,823)
Short-term borrowings - net (original maturities three months or less)	1,107	806
Net cash provided by (used for) financing activities	(651)	(492)
Effect of exchange rate changes on cash	6	(2)
Increase (decrease) in cash and short-term investments	77	(302)

Cash and short-term investments at beginning of period		530		1,108
Cash and short-term investments at end of period	$	607	$	806

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, 2007 and 2006, (b) the consolidated financial position at March 31, 2007 and December 31, 2006, (c) the consolidated changes in stockholders' equity for the three month periods ended March 31, 2007 and 2006, and (d) the consolidated statement of cash flow for the three month periods ended March 31, 2007 and 2006. The financial statements have been prepared in conformity with generally accepted accounting principles (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 Management's Discussion and Analysis and the audited financial statements and notes thereto included in our Company's annual report on Form 10-K for the year ended December 31, 2006 (2006 Form 10-K).

Comprehensive income is comprised of profit, as well as adjustments for foreign currency translation, derivative instruments designated as cash flow hedges, available-for-sale securities and pension and other postretirement benefits. Total comprehensive income for the three months ended March 31, 2007 and 2006 was $876 million and $882 million, respectively.

The December 31, 2006 financial position data included herein is derived from the audited consolidated financial statements included in the 2006 Form 10-K.

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 and related parts. Also includes logistics services for other companies and the design, manufacture, remanufacture, maintenance and service 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 5 to 21,500 horsepower (4 to over 16 000 kilowatts). Turbines range from 1,600 to 20,500 horsepower (1 200 to 15 000 kilowatts).

(3) **Financial Products** - A principal line of business consisting primarily of Caterpillar Financial Services Corporation (Cat Financial), Caterpillar Insurance Holdings, Inc. (Cat Insurance), Caterpillar Power Ventures Corporation (Cat Power Ventures) 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. Cat Power Ventures is an investor in independent power projects using Caterpillar power generation equipment and services.

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 155 - In February 2006, the FASB issued Statement of Financial Accounting Standards No. 155 (SFAS 155), "Accounting for Certain Hybrid Financial Instruments - an amendment of FASB Statements No. 133 and 140." SFAS 155 allows financial instruments that have embedded derivatives to be accounted for as a whole, eliminating the need to separate the derivative from its host, if the holder elects to account for the whole instrument on a fair value basis. This new accounting standard was effective January 1, 2007. The adoption of SFAS 155 did not have a material impact on our financial statements.

SFAS 156 - In March 2006, the FASB issued Statement of Financial Accounting Standards No. 156 (SFAS 156), "Accounting for Servicing of Financial Assets - an amendment of FASB Statement No. 140." SFAS 156 requires that all separately recognized servicing rights be initially measured at fair value, if practicable. In addition, this Statement permits an entity to choose between two measurement methods (amortization method or fair value measurement method) for each class of separately recognized servicing assets and liabilities. This new accounting standard was effective January 1, 2007. The adoption of SFAS 156 did not have a material impact on our financial statements.

FIN 48 - In July 2006, the FASB issued FIN 48 "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109" to create a single model to address accounting for uncertainty in tax positions. FIN 48 clarifies that a tax position must be more likely than not of being sustained before being recognized in the financial statements. As required, we adopted the provisions of FIN 48 as of January 1, 2007. The following table summarizes the effect of the initial adoption of FIN 48. (See Note 14 for additional information.)

Initial adoption of FIN 48

	January 1, 2007 Prior to FIN 48 Adjustment	FIN 48 Adjustment	January 1, 2007 Post FIN 48 Adjustment
(Millions of dollars)			
Deferred and refundable income taxes	$ 733	$ 82	$ 815
Noncurrent deferred and refundable income taxes	1,949	211	2,160
Other current liabilities	1,145	(530)	615
Other liabilities	1,209	682	1,891
Profit employed in the business	14,593	141	14,734

SFAS 157 - In September 2006, the 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. As required by SFAS 157, we will adopt this new accounting standard effective January 1, 2008. We are currently reviewing the impact of SFAS 157 on our financial statements. We expect to complete this evaluation in 2007.

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. Under SFAS 158, gains and losses, prior service costs and credits and any remaining transition amounts under SFAS 87 and SFAS 106 that have not yet been recognized through net periodic benefit cost are recognized in accumulated other comprehensive income, net of tax effects, until they are amortized as a component of net periodic cost. 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. As required by SFAS 158, we adopted the balance sheet recognition provisions at December 31, 2006, and will adopt the year-end measurement date in 2008 using the prospective method.

SFAS 159 - In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159 (SFAS 159), "The Fair Value Option for Financial Assets & Financial Liabilities - Including an Amendment of SFAS No. 115." SFAS 159 will create 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. SFAS 159 will become effective for fiscal years beginning after November 15, 2007. We are currently reviewing the impact of SFAS 159 on our financial statements and expect to complete this evaluation in 2007. We will adopt this new accounting standard on January 1, 2008.

3. Stock-Based Compensation

We adopted Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment (SFAS 123R), effective January 1, 2006. 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 options, stock-settled stock appreciation rights (SARs) and restricted stock units (RSUs). We recognized pretax stock-based compensation cost in the amount of $27 million and $34 million in the first quarter of 2007 and 2006, respectively.

The following table illustrates the type and fair market value of the stock-based compensation awards granted during the first quarter of 2007 and 2006, respectively:

	2007		**2006**	
	# Granted	**Fair Value Per Award**	**# Granted**	**Fair Value Per Award**
SARs	4,193,401	$ 20.73	9,388,534	$ 23.44
Stock options	231,615	20.73	331,806	23.44
RSUs	1,282,020	59.94	—	—

As of March 31, 2007, the total remaining unrecognized compensation cost related to nonvested stock-based compensation awards was $240 million, which will be amortized over the weighted-average remaining requisite service periods of approximately 2.5 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. Prior to 2007, the terms of the 1996 Stock Option and Long-Term Incentive Plan (which expired in April of 2006) provided for the exercise price methodology to be the average of the high and low price of our stock on the date of grant. In 2007, under the terms of the Caterpillar Inc. 2006 Long-Term Incentive Plan (approved by stockholders in June of 2006), the Compensation Committee approved the exercise price methodology to be the closing price of the Company stock on the date of grant.

In November 2005, the FASB issued FASB Staff Position No. FAS 123R-3 "Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards." In the third quarter of 2006, we elected to adopt the alternative transition method provided in the FASB Staff Position for calculating the tax effects of stock-based compensation. The alternative transition method includes simplified methods to determine the beginning balance of the additional paid-in capital (APIC) pool related to the tax effects of stock-based compensation, and to determine the subsequent impact on the APIC pool and the Statement of Cash Flow of the tax effects of stock-based awards that were fully vested and outstanding upon the adoption of SFAS 123R. In accordance with SFAS 154 "Accounting Changes and Error Corrections," this change in accounting principle has been applied retrospectively to the 2006 Consolidated Statement of Cash Flow. The impact on the Consolidated Statement of Cash Flow was a decrease in operating cash flow and an offsetting increase in financing cash flow of $20 million for the three months ended March 31, 2006.

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. Our Risk Management Policy (policy) allows for the use of derivative financial instruments to prudently manage foreign currency exchange rate, interest rate and commodity price exposure. 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.

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 four years.

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

As of March 31, 2007, $10 million of deferred net gains (net of tax) included in equity ("Accumulated other comprehensive income" 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 12 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 re-measurement 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.

Gains (losses) included in current earnings [Other income (expense)] on undesignated contracts:

(Millions of dollars)	**Three Months Ended March 31, 2007**	**2006**
Machinery and Engines:		
On undesignated contracts	$ 4	$ 11
Financial Products:		
On undesignated contracts	(6)	5
	$ (2)	$ 16

Gains and losses on the Financial Products contracts above are substantially offset by balance sheet translation gains and losses.

<u>Interest Rate Risk</u>
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 swap agreements 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. During 2001, our Machinery and Engines operations liquidated all fixed-to-floating interest rate swaps. The gain ($7 million at March 31, 2007) is being amortized to earnings ratably over the remaining life of the hedged debt.

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 floating-to-fixed, fixed-to-floating and floating-to-floating interest rate swaps to meet the match funding objective. To support hedge accounting, we designate fixed-to-floating interest rate swaps as fair value hedges of the fair value of our fixed rate debt at the inception of the swap contract. Financial Products' practice is to designate most floating-to-fixed interest rate swaps as cash flow hedges of the variability of future cash flows at the inception of the swap contract. Designation as a hedge of the variability of cash flow is performed to support hedge accounting. Financial Products liquidated fixed-to-floating interest rate swaps during 2006, 2005 and 2004, which resulted in deferred net gains. These gains ($7 million at March 31, 2007) are being amortized to earnings ratably over the remaining life of the hedged debt.

Gains (losses) included in current earnings [Other income (expense)]:

(Millions of dollars)	Three Months Ended March 31, 2007	2006
Fixed-to-floating interest rate swaps		
Machinery and Engines:		
Gain (loss) on designated interest rate derivatives	$ —	$ —
Gain (loss) on hedged debt	(1)	—
Gain (loss) on liquidated swaps - included in interest expense	1	1
Financial Products:		
Gain (loss) on designated interest rate derivatives	12	(50)
Gain (loss) on hedged debt	(12)	50

Gain (loss) on liquidated swaps - included in interest expense	—	2
	$ —	$ 3

As of March 31, 2007, $11 million, net of tax, of deferred net gains included in equity ("Accumulated other comprehensive income"), 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 12 months.

Commodity Price Risk

Commodity price movements create a degree of risk by affecting the price we must pay for certain raw materials. 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 subjected 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 four-year horizon. All such commodity forward and option contracts are undesignated. There were no gains or losses on undesignated contracts for the three months ended March 31, 2007 or 2006.

5. Inventories

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

(Millions of dollars)	**March 31, 2007**	**December 31, 2006**
Raw materials	$ 2,477	$ 2,182
Work-in-process	1,098	977
Finished goods	3,288	2,915
Supplies	268	277
Total inventories	$ 7,131	$ 6,351

6. Investments in Unconsolidated Affiliated Companies

Our investments in affiliated companies accounted for by the equity method consist primarily of a 50% interest in Shin Caterpillar Mitsubishi Ltd. (SCM) located in Japan. Combined financial information of the unconsolidated affiliated companies accounted for by the equity method (generally on a three month lag, e.g., SCM results reflect the periods ending December 31) was as follows:

Results of Operations of unconsolidated affiliated companies:

(Millions of dollars)	Three Months Ended March 31, 2007		Three Months Ended March 31, 2006	
Sales	$	1,022	$	1,025
Cost of sales		823		815
Gross profit	$	199	$	210
Profit (loss)	$	50	$	39
Caterpillar's profit (loss)	$	19	$	17

Sales from SCM to Caterpillar for the three months ended March 31, 2007 and March 31, 2006 of approximately $379 million and $417 million, respectively, are included in the affiliated company sales. In addition, SCM purchased $65 million and $71 million of products from Caterpillar during the three months ended March 31, 2007 and March 31, 2006, respectively.

Financial Position of unconsolidated affiliated companies:

(**Millions of dollars**)		**March 31, 2007**		**December 31, 2006**
Assets:				
Current assets	$	1,717	$	1,807
Property, plant and equipment - net		1,043		1,119
Other assets		156		176
		2,916		3,102
Liabilities:				
Current liabilities		1,251		1,394
Long-term debt due after one year		265		309
Other liabilities		148		145

	1,664	1,848
Ownership	$ 1,252	$ 1,254

Caterpillar's investments in unconsolidated affiliated companies:

(Millions of dollars)		
Investments in equity method companies	$ 529	$ 542
Plus: Investments in cost method companies	25	20
Total investments in unconsolidated affiliated companies	$ 554	$ 562

On February 15, 2007, we signed a nonbinding memorandum of understanding with Mitsubishi Heavy Industries Ltd. (MHI) and SCM to conclude a plan that would result in a new ownership structure for SCM. The companies are in discussions with the intention of reaching definitive agreements that would result in Caterpillar owning a majority stake in SCM. When complete, SCM will proceed with the execution of a share redemption for a portion of SCM's shares held by MHI. In conjunction with the plan, we agreed to discuss with MHI the creation of a new comprehensive joint venture agreement as well as certain definitive agreements for implementation of the plan. These definitive agreements would be subject to applicable regulatory approvals.

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7. Intangible Assets and Goodwill

A. Intangible assets

Intangible assets are comprised of the following:

(Dollars in millions)	Weighted Amortizable Life (Years)	March 31, 2007	December 31, 2006
Customer relationships	20	$ 324	$ 242
Intellectual property	11	197	211
Other	13	75	73
Total finite-lived intangible assets - gross	16	596	526
Less: Accumulated amortization		136	139

Intangible assets - net	$ 460	$ 387

Amortization expense for the three months ended March 31, 2007 and March 31, 2006 was $11 million and $6 million, respectively. Amortization expense related to intangible assets is expected to be:

(Millions of dollars)					
2007	**2008**	**2009**	**2010**	**2011**	**Thereafter**
$ 41	$ 40	$ 40	$ 39	$ 37	$ 274

During the first quarter 2007, we acquired finite-lived intangible assets of $82 million due to the purchase of Franklin Power Products. (See Note 15 for acquisition details.)

B. Goodwill

On an annual basis, we test goodwill for impairment in accordance with Statement of Financial Accounting Standards No. 142 "Goodwill and Other Intangible Assets." Goodwill is tested for impairment between annual tests whenever events or circumstances make it more likely than not that an impairment may have occurred.

No goodwill was impaired or disposed of during the first quarter of 2007. During the first quarter of 2006, we determined that the business outlook for the parts and accessories distribution business of MG Rover Ltd., acquired in 2004, required a specific impairment evaluation. The declining outlook of this business resulted from the MG Rover's cessation of vehicle production and warranties resulting from bankruptcy in 2005. Although the MG Rover parts business continues to provide parts to the existing population of vehicles, the unit's sales will continue to decline in the future as production of new vehicles has ceased. In determining if there was impairment, we first compared the fair value of the reporting unit (calculated by discounting projected cash flows) to the carrying value. Because the carrying value exceeded the fair value, we allocated the fair value to the assets and liabilities of the unit and determined the fair value of the implied goodwill was zero. Accordingly, a goodwill impairment charge of $18 million was included in "Other Operating Expenses" in the Consolidated Statement of Results of Operations and reported in the "All Other" category during the first quarter of 2006.

During the first quarter of 2007, we acquired assets with related goodwill of $36 million as part purchase of Franklin Power Products (See Note 15 for details on the acquisition of these assets.)

The changes in carrying amount of the goodwill by reportable segment for the quarter ended March 31, 2007 were as follows:

(Millions of dollars)	Heavy Construction & Mining	Electric Power	Large Power Products	All Other[1]	Consolidated Total
Balance at December 31, 2006	$ 20	$ 203	$ 628	$ 1,053	$ 1,904
Acquisitions	—	—	—	36	36
Balance at March 31, 2007	$ 20	$ 203	$ 628	$ 1,089	$ 1,940

[1] All Other includes operating segments included in "All Other" category (See Note 13).

8. Available-For-Sale Securities

Financial Products, primarily Cat Insurance, has investments in certain debt and equity securities that have been classified as available-for-sale in accordance with Statement of Financial Accounting Standards No. 115 (SFAS 115) and recorded at fair value based upon quoted market prices. These fair values are included in "Other assets" in the Consolidated Statement of Financial Position. Unrealized gains and losses arising from the revaluation of available-for-sale securities are included, net of applicable deferred income taxes, in equity ("Accumulated other comprehensive income" in the Consolidated Statement of Financial Position). Realized gains and losses on sales of investments are generally determined using the FIFO ("first-in, first-out") method for debt instruments and the specific identification method for equity securities. Realized gains and losses are included in "Other income (expense)" in the Consolidated Statement of Results of Operations.

	March 31, 2007			December 31, 2006		
(Millions of dollars)	Cost Basis	Unrealized Pretax Net Gains (Losses)	Fair Value	Cost Basis	Unrealized Pretax Net Gains (Losses)	Fair Value
Government debt	$ 350	$ (3)	$ 347	$ 355	$ (5)	$ 350
Corporate bonds	608	(4)	604	541	(6)	535
Equity securities	157	25	182	154	26	180
Total	$ 1,115	$ 18	$ 1,133	$ 1,050	$ 15	$ 1,065

Investments in an unrealized loss position that are not other-than-temporarily impaired:

	March 31, 2007					
	Less than 12 months[1]		12 months or more[1]		Total	
(Millions of dollars)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Government debt	$ 77	$ —	$ 181	$ 3	$ 258	$ 3
Corporate bonds	144	1	135	4	279	5
Equity securities	13	1	22	—	35	1
Total	$ 234	$ 2	$ 338	$ 7	$ 572	$ 9

[1] Indicates length of time that individual securities have been in a continuous unrealized loss position.

Investments in an unrealized loss position that are not other-than-temporarily impaired:

	December 31, 2006					
	Less than 12 months[1]		12 months or more[1]		Total	
(Millions of dollars)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Government debt	$ 116	$ —	$ 199	$ 4	$ 315	$ 4
Corporate bonds	198	1	233	5	431	6
Equity securities	22	1	1	—	23	1
Total	$ 336	$ 2	$ 433	$ 9	$ 769	$ 11

[1] Indicates length of time that individual securities have been in a continuous unrealized loss position.

The fair value of the available-for-sale debt securities at March 31, 2007, by contractual maturity, is shown on the following page. Expected maturities will differ from contractual maturities because borrowers may have the right to prepay and creditors may have the right to call obligations.

(Millions of dollars)	Fair Value

Due in one year or less	$	102
Due after one year through five years	$	247
Due after five years through ten years	$	130
Due after ten years	$	472

Proceeds from sales of investments in debt and equity securities during the three months ended March 31, 2007 and March 31, 2006 was $62 million and $76 million, respectively. Gross gains of $3 million and $5 million were included in current earnings for the three months ended March 31, 2007 and 2006, respectively.

9. Postretirement Benefits

A. Pension and postretirement benefit costs

(Millions of dollars)	U.S. Pension Benefits		Non-U.S. Pension Benefits		Other Postretirement Benefits	
	March 31, 2007	March 31, 2006	March 31, 2007	March 31, 2006	March 31, 2007	March 31, 2006
For the three months ended:						
Components of net periodic benefit cost:						
Service cost	$ 46	$ 40	$ 18	$ 16	$ 22	$ 24
Interest cost	149	143	32	27	74	76
Expected return on plan assets	(210)	(199)	(41)	(35)	(32)	(29)
Amortization of:						
Net asset existing at adoption of SFAS 87/106	—	—	—	—	—	1
Prior service cost[1]	14	15	1	1	(9)	(8)
Net actuarial loss (gain)	54	58	13	14	20	28
Total cost included in operating profit	$ 53	$ 57	$ 23	$ 23	$ 75	$ 92
Weighted-average assumptions used to determine net cost:						
Discount rate	5.5%	5.6%	4.8%	4.6%	5.5%	5.6%
Expected return on plan assets	9.0%	9.0%	7.7%	7.5%	9.0%	9.0%
Rate of compensation increase	4.0%	4.0%	4.0%	3.7%	4.0%	4.0%

[1] Prior service costs for both pension and other postretirement benefits are generally amortized using the straight-line method over the average remaining service period to the full retirement eligibility date of employees expected to receive benefits from the plan amendment. For other postretirement benefit plans in which all or almost all of the plan's participants are fully eligible for benefits under the plan, prior service costs are amortized using the straight-line method over the remaining life expectancy of those participants.

We made $24 million of contributions to certain non-U.S. pension plans during the three months ended March 31, 2007 and we currently anticipate additional contributions of approximately $10 million during the remainder of the year. Although we have no ERISA (Employee Retirement Income Security Act) funding requirements in 2007, we will continue to evaluate additional contributions to both pension and other postretirement benefit plans.

B. Defined contribution benefit costs

Total company costs related to U.S. and non-U.S. defined contribution plans were as follows:

	Three Months Ended March 31,	
(Millions of dollars)	**2007**	**2006**
U.S. Plans	$ 54	$ 58
Non-U.S. Plans	8	6