CATERPILLAR INC
Form 10-Q
August 01, 2008

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, 2008

OR

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

For the transition period from ________________ to ________________

Commission File Number: 1-768

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

Delaware (State or other jurisdiction of incorporation)	37-0602744 (IRS Employer I.D. No.)
100 NE Adams Street, Peoria, Illinois (Address of principal executive offices)	61629 (Zip Code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [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 June 30, 2008, 608,716,182 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,	
	2008	2007
Sales and revenues:		

Sales of Machinery and Engines	$ 12,797	$ 10,613
Revenues of Financial Products	827	743
Total sales and revenues	13,624	11,356
Operating costs:		
Cost of goods sold	10,036	8,300
Selling, general and administrative expenses	1,074	968
Research and development expenses	415	350
Interest expense of Financial Products	279	279
Other operating expenses	295	246
Total operating costs	12,099	10,143
Operating profit	1,525	1,213
Interest expense excluding Financial Products	70	80
Other income (expense)	75	70
Consolidated profit before taxes	1,530	1,203
Provision for income taxes	434	385
Profit of consolidated companies	1,096	818
Equity in profit (loss) of unconsolidated affiliated companies	10	5
Profit	$ 1,106	$ 823
Profit per common share	$ 1.80	$ 1.28
Profit per common share – diluted 1	$ 1.74	$ 1.24
Weighted average common shares outstanding (millions)		
- Basic	614.3	640.5
- Diluted 1	635.5	662.8
Cash dividends declared per common share	$ .78	$ .66

1 Diluted by assumed exercise of stock-based compensation awards using the treasury stock method.

See accompanying notes to Consolidated Financial Statements.

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

	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Sales and revenues:		
Sales of Machinery and Engines	$ 23,776	$ 19,934
Revenues of Financial Products	1,644	1,438
Total sales and revenues	25,420	21,372
Operating costs:		
Cost of goods sold	18,645	15,436
Selling, general and administrative expenses	2,033	1,858
Research and development expenses	784	690
Interest expense of Financial Products	563	550
Other operating expenses	577	485
Total operating costs	22,602	19,019
Operating profit	2,818	2,353
Interest expense excluding Financial Products	144	159
Other income (expense)	187	181
Consolidated profit before taxes	2,861	2,375
Provision for income taxes	854	760
Profit of consolidated companies	2,007	1,615
Equity in profit (loss) of unconsolidated affiliated companies	21	24
Profit	$ 2,028	$ 1,639
Profit per common share	$ 3.29	$ 2.55
Profit per common share – diluted [1]	$ 3.18	$ 2.47
Weighted average common shares outstanding (millions)		
- Basic	616.0	642.4
- Diluted [1]	637.0	664.3
Cash dividends declared per common share	$ .78	$ .66

1 Diluted by assumed exercise of stock-based compensation awards using the treasury stock method.

See accompanying notes to Consolidated Financial Statements.

Consolidated Statement of Financial Position
(Unaudited)
(Dollars in millions)

	June 30, 2008	December 31, 2007
Assets		
Current assets:		
Cash and short-term investments	$ 782	$ 1,122
Receivables – trade and other	9,297	8,249
Receivables – finance	8,025	7,503
Deferred and refundable income taxes	866	816
Prepaid expenses and other current assets	585	583
Inventories	8,303	7,204
Total current assets	27,858	25,477
Property, plant and equipment – net	10,394	9,997
Long-term receivables – trade and other	705	685
Long-term receivables – finance	14,795	13,462
Investments in unconsolidated affiliated companies	641	598
Noncurrent deferred and refundable income taxes	1,523	1,553
Intangible assets	492	475
Goodwill	1,994	1,963
Other assets	2,051	1,922
Total assets	$ 60,453	$ 56,132
Liabilities		
Current liabilities:		
Short-term borrowings:		
Machinery and Engines	$ 130	$ 187
Financial Products	6,199	5,281
Accounts payable	5,357	4,723
Accrued expenses	3,633	3,178
Accrued wages, salaries and employee benefits	938	1,126
Customer advances	1,814	1,442
Dividends payable	256	225
Other current liabilities	1,043	951
Long-term debt due within one year:		
Machinery and Engines	172	180
Financial Products	6,852	4,952
Total current liabilities	26,394	22,245
Long-term debt due after one year:		
Machinery and Engines	3,637	3,639
Financial Products	14,006	14,190
Liability for postemployment benefits	4,836	5,059
Other liabilities	2,110	2,116
Total liabilities	50,983	47,249
Commitments and contingencies (Notes 10 and 12)		
Stockholders' equity		
Common stock of $1.00 par value:		
Authorized shares: 900,000,000	2,897	2,744

Issued shares: (6/30/08 and 12/31/07 – 814,894,624) at paid-in amount		
Treasury stock (6/30/08 – 206,178,442; 12/31/07 – 190,908,490) at cost	(10,730)	(9,451)
Profit employed in the business	18,918	17,398
Accumulated other comprehensive income (loss)	(1,615)	(1,808)
Total stockholders' equity	9,470	8,883
Total liabilities and stockholders' equity	$ 60,453	$ 56,132

See accompanying notes to Consolidated Financial Statements.

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

				Accumulated other comprehensive income (loss)				
Six Months Ended June 30, 2007	Common stock	Treasury stock	Profit employed in the business	Foreign currency translation	Pension & other post-retirement benefits 1	Derivative financial instruments and other	Available-for-sale securities	Total
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	—	—	1,639	—	—	—	—	1,639
Foreign currency translation	—	—	—	106	—	—	—	106
Pension and other postretirement benefits								
Amortization of actuarial (gain) loss, net of tax of $61	—	—	—	—	112	—	—	112
Amortization of prior service cost, net of tax of $5	—	—	—	—	9	—	—	9
Amortization of transition asset/obligation, net of tax of $0	—	—	—	—	1	—	—	1
Derivative financial instruments and other	—	—	—	—	—	31	—	31

Gains (losses) deferred, net of tax of $17								
(Gains) losses reclassified to earnings, net of tax of $19	—	—	—	—	—	(35)	—	(35)
Available-for-sale securities								
Gains (losses) deferred, net of tax of $4	—	—	—	—	—	—	6	6
(Gains) losses reclassified to earnings, net of tax of $1	—	—	—	—	—	—	(4)	(4)
Comprehensive income (loss)								1,865
Dividends declared	—	—	(422)	—	—	—	—	(422)
Common shares issued from treasury stock for stock-based compensation: 8,047,005	8	215	—	—	—	—	—	223
Stock-based compensation expense	82	—	—	—	—	—	—	82
Tax benefits from stock-based compensation	100	—	—	—	—	—	—	100
Shares repurchased: 14,700,000	—	(1,017)	—	—	—	—	—	(1,017)
Balance at June 30, 2007	$2,655	$ (8,154)	$15,951	$ 577	$(3,254)	$ 44	$ 12	$ 7,831
Six Months Ended June 30, 2008								
Balance at December 31, 2007	$2,744	$ (9,451)	$17,398	$ 749	$(2,594)	$ 19	$ 18	$ 8,883
Adjustment to adopt measurement date provisions 2 of FAS 158, net of tax	—	—	(33)	—	17	—	—	(16)
Balance at January 1, 2008	2,744	(9,451)	17,365	749	(2,577)	19	18	8,867
Profit	—	—	2,028	—	—	—	—	2,028
Foreign currency translation, net of tax of $3	—	—	—	185	(8)	—	—	177

Pension and other postretirement benefits								
Amortization of actuarial (gain) loss, of FAS 158, net of tax of $41	—	—	—	—	76	—	—	76
Amortization of transition asset/obligation, net of tax of $0	—	—	—	—	1	—	—	1
Derivative financial instruments and other								
Gains (losses) deferred, net of tax of $2	—	—	—	—	—	2	—	2
(Gains) losses reclassified to earnings, net of tax of $25	—	—	—	—	—	(43)	—	(43)
Available-for-sale securities								
Gains (losses) deferred, net of tax of $18	—	—	—	—	—	—	(36)	(36)
(Gains) losses reclassified to earnings, net of tax of $0	—	—	—	—	—	—	(1)	(1)
Comprehensive income (loss)								2,204
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
Tax benefits from stock-based compensation	51	—	—	—	—	—	—	51
Shares repurchased: [3] 19,393,026	—	(1,390)	—	—	—	—	—	(1,390)
Stock repurchase derivative contracts	(10)	—	—	—	—	—	—	(10)
Balance at June 30, 2008	$ 2,897	$ (10,730)	$ 18,918	$ 934	$ (2,508)	$ (22)	$ (19)	$ 9,470

1 Pension and other postretirement benefits include net adjustments for unconsolidated companies of $6 million and $0 million for the six months ended June 30, 2008 and 2007, respectively. The ending balances were $58 million and $43 million at June 30, 2008 and 2007, respectively.

2 Adjustments to profit employed in the business and pension and other postemployment benefits were net of tax of ($17) million and $9 million, respectively.
3 Amount consists of $1,362 million of cash-settled purchases and $28 million of derivative contracts.

See accompanying notes to Consolidated Financial Statements.

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Caterpillar Inc.
Condensed Consolidated Statement of Cash Flow
(Unaudited)
(Dollars in millions)

	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Cash flow from operating activities:		
Profit	$ 2,028	$ 1,639
Adjustments for non-cash items:		
Depreciation and amortization	952	849
Other	202	71
Changes in assets and liabilities:		
Receivables – trade and other	(1,137)	927
Inventories	(1,009)	(691)
Accounts payable and accrued expenses	1,023	14
Customer advances	210	352
Other assets – net	(93)	(300)
Other liabilities – net	(271)	375
Net cash provided by (used for) operating activities	1,905	3,236
Cash flow from investing activities:		
Capital expenditures – excluding equipment leased to others	(814)	(582)
Expenditures for equipment leased to others	(699)	(621)
Proceeds from disposals of property, plant and equipment	449	208
Additions to finance receivables	(7,099)	(6,356)
Collections of finance receivables	4,748	5,233
Proceeds from sales of finance receivables	696	84
Investments and acquisitions (net of cash acquired)	(111)	(174)
Proceeds from sales of available-for-sale securities	173	119
Investments in available-for-sale securities	(230)	(217)
Other – net	56	285
Net cash provided by (used for) investing activities	(2,831)	(2,021)
Cash flow from financing activities:		
Dividends paid	(444)	(386)
Common stock issued, including treasury shares reissued	116	223
Payment for stock repurchase derivative contracts	(38)	—
Treasury shares purchased	(1,362)	(1,017)
Excess tax benefit from stock-based compensation	53	97

Proceeds from debt issued (original maturities greater than three months)		
– Machinery and Engines	110	43
– Financial Products	9,048	5,216
Payments on debt (original maturities greater than three months)		
– Machinery and Engines	(133)	(49)
– Financial Products	(6,397)	(5,404)
Short-term borrowings – net (original maturities three months or less)	(393)	86
Net cash provided by (used for) financing activities	560	(1,191)
Effect of exchange rate changes on cash	26	8
Increase (decrease) in cash and short-term investments	(340)	32
Cash and short-term investments at beginning of period	1,122	530
Cash and short-term investments at end of period	$ 782	$ 562

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.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. A. Basis of Presentation

In the opinion of management, the accompanying financial statements include all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of (a) the consolidated results of operations for the three and six month periods ended June 30, 2008 and 2007, (b) the consolidated financial position at June 30, 2008 and December 31, 2007, (c) the consolidated changes in stockholders' equity for the six month periods ended June 30, 2008 and 2007, and (d) the consolidated statement of cash flow for the six month periods ended June 30, 2008 and 2007. 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, 2007 (2007 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 June 30, 2008 and 2007 was $1,201 million and $989 million, respectively. Total Comprehensive income for the six months ended June 30, 2008 and 2007 was $2,204 million and $1,865 million, respectively.

The December 31, 2007 financial position data included herein is derived from the audited consolidated financial statements included in the 2007 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 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 5 to 21,500 horsepower (4 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), 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

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.

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. 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 delays 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 that could be impacted by this deferral include assets and liabilities initially measured at fair value in a business combination and goodwill tested annually for impairment. The adoption of FSP 157-2 is not expected to have a significant 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 (loss)	(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. The adoption of SFAS 159 did not have a material impact on our financial statements.

SFAS 141R & 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. SFAS 141R and SFAS 160 will become effective for fiscal years beginning after December 15, 2008. We will adopt these new accounting standards on January 1, 2009. We are currently reviewing the impact of SFAS 141R and SFAS 160 on our financial statements and expect to complete this evaluation in 2008.

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. SFAS 161 will become effective for fiscal years beginning after November 15, 2008. We will adopt this new accounting standard on January 1, 2009. We do not expect the adoption to have a material impact on our financial statements.

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 will become effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, "The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles." This statement is not expected to result in a change in our current practice.

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 recognizes 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. SFAS 163 will become effective for fiscal years beginning after December 15, 2008. We will adopt this new accounting standard on January 1, 2009. We do not expect the adoption 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. Our 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 $70 million and $107 million for the three and six months ended June 30, 2008, respectively; and $55 million and $82 million for the three and six months ended June 30, 2007, 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, 2008 and 2007, respectively:

	2008		2007	
	# Granted	Fair Value Per Award	# Granted	Fair Value Per Award
SARs	4,476,095	$ 22.32	4,195,188	$ 20.73
Stock options	410,506	22.32	231,615	20.73
RSUs	1,511,523	69.17	1,282,020	59.94

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, 2008 and 2007, respectively:

	Grant Year	
	2008	2007
Weighted-average dividend yield	1.89%	1.68%
Weighted-average volatility	27.14%	26.04%
Range of volatilities	27.13-28.99%	26.03-26.62%
Range of risk-free interest rates	1.60-3.64%	4.40-5.16%

Weighted-average expected lives	8 years	8 years

As of June 30, 2008, the total remaining unrecognized compensation cost related to nonvested stock-based compensation awards was $224 million, which will be amortized over the weighted-average remaining requisite service periods of approximately 2.2 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 not 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.

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 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. Designation is performed on a specific exposure basis to support hedge accounting. The remainder of Machinery and Engines foreign currency contracts is undesignated. We designate as fair value hedges specific euro forward contracts used to hedge firm commitments.

As of June 30, 2008, no deferred net gains or losses 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 12 months. The actual amount recorded in “Other income (expense)” will vary based on the 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.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
(Millions of dollars)	2008	2007	2008	2007
Machinery and Engines	$ (8)	$ 4	$ (1)	$ 8
Financial Products	(19)	(4)	(106)	(10)
	$ (27)	$ —	$ (107)	$ (2)

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

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 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.

Since 2006, we entered into $400 million (notional amount) of interest rate swaps designated as fair value hedges of our fixed rate long-term debt. During the first quarter 2008, our Machinery and Engines operations liquidated all of these fixed-to-floating interest rate swaps. The gain ($19 million remaining at June 30, 2008) 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 fixed-to-floating, floating-to-fixed 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 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.

Financial Products liquidated fixed-to-floating interest rate swaps during 2006, 2005 and 2004, which resulted in deferred net gains. These gains ($4 million remaining at June 30, 2008) are being amortized to earnings ratably over the remaining life of the hedged debt.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
(Millions of dollars)	2008	2007	2008	2007
Fixed-to-floating interest rate swaps				
Machinery and Engines:				
Gain (loss) on designated interest rate derivatives	$ —	$ (5)	$ 18	$ (5)
Gain (loss) on hedged debt	—	4	(9)	3
Gain (loss) on liquidated swaps – included in interest expense	1	1	2	2
Financial Products:				
Gain (loss) on designated interest rate derivatives	(194)	(43)	(68)	(31)
Gain (loss) on hedged debt	192	43	66	31
Gain (loss) on liquidated swaps – included in interest expense	1	1	1	1
	$ —	$ 1	$ 10	$ 1

As of June 30, 2008, $9 million of deferred net losses 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 12 months.

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 four-year horizon. All such commodity forward and option contracts are undesignated. There were no net gains or losses on undesignated contracts for the three and six months ended June 30, 2007, and no contracts were outstanding during 2008.

Stock Repurchases Risk

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 the movements in the price of the stock. In August 2007, the Board of Directors authorized the use of derivative contracts to reduce stock repurchase volatility.

In connection with our stock repurchase program, we entered into capped call transactions (“call”) with a major bank for an aggregate of 6.0 million shares. During 2008, we paid the bank premiums of $38 million for the establishment of calls for 2.5 million shares, which was accounted for as a reduction to stockholders’ equity. A call permits us to reduce share repurchase price volatility by providing a floor and cap on the price at which the shares can be repurchased. The floor, cap and strike prices for the calls were based upon the average purchase price paid by the bank to purchase our common stock to hedge these transactions. Each call will mature and be exercisable within one year after the call was established. If we exercise a call, we can elect to settle the transaction with the bank by physical settlement (paying cash and receiving shares), cash settle (receiving a net amount of cash) or net share settlement (receiving a net amount of shares). We will continue to use open market purchases in conjunction with capped call transactions to repurchase our stock.

During the six months ended June 30, 2008, $100 million of cash was used to repurchase 1.8 million shares pursuant to calls exercised under this program. Premiums previously paid associated with these exercised calls were $28 million. The following table summarizes the call contracts outstanding as of June 30, 2008:

Stock repurchase derivative contracts outstanding at June 30, 2008

				per share	
Contract Date	Number of Shares	Expiration Date	Net Premiums Paid (Millions)	Lower Strike Price	Upper Strike Price
October 2007	1,000,000	October 2008	$ 17	$ 58.00	$ 88.00

November 2007	700,000	September 2008	11	58.00	88.00
November 2007	800,000	August 2008	12	53.60	80.40
January 2008	700,000	September 2008	10		