

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



**FORM 10-Q**

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

For the quarterly period ended June 30, 2005

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 1-768

**CATERPILLAR INC.**

(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of incorporation)

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

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

61629  
(Zip Code)

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

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

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Act).  
Yes ☒ No ☐

At June 30, 2005, 676,777,490 shares of common stock of the Registrant were outstanding. The shares outstanding reflect a 2-for-1 stock split effective July 13, 2005.

## 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,	
	2005	2004
<b>Sales and revenues:</b>		
Sales of Machinery and Engines .....	\$ 8,784	\$ 7,100
Revenues of Financial Products .....	576	483
Total sales and revenues .....	9,360	7,583
<b>Operating costs:</b>		
Cost of goods sold .....	6,890	5,563
Selling, general and administrative expenses .....	789	744
Research and development expenses .....	268	214
Interest expense of Financial Products .....	184	121
Other operating expenses .....	208	171
Total operating costs .....	8,339	6,813
<b>Operating profit</b> .....	1,021	770
Interest expense excluding Financial Products .....	65	59
Other income (expense) .....	90	50
<b>Consolidated profit before taxes</b> .....	1,046	761
Provision for income taxes .....	315	209
Profit of consolidated companies .....	731	552
Equity in profit (loss) of unconsolidated affiliated companies .....	29	14
<b>Profit</b> .....	\$ 760	\$ 566
<b>Profit per common share</b> .....	\$ 1.12	\$ .83
<b>Profit per common share – diluted</b> <sup>1</sup> .....	\$ 1.08	\$ .80
<b>Weighted average common shares outstanding (millions)</b>		
- Basic .....	678.3	684.8
- Diluted <sup>1</sup> .....	705.1	709.5
<b>Cash dividends declared per common share</b> .....	\$ .46	\$ .39

<sup>1</sup> Diluted by assumed exercise of stock options, using the treasury stock method.

See accompanying notes to Consolidated Financial Statements.

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

	<b>Six Months Ended June 30,</b>	
	<b>2005</b>	<b>2004</b>
<b>Sales and revenues:</b>		
Sales of Machinery and Engines .....	\$ 16,573	\$ 13,102
Revenues of Financial Products .....	1,126	961
Total sales and revenues .....	17,699	14,063
<b>Operating costs:</b>		
Cost of goods sold .....	13,105	10,264
Selling, general and administrative expenses .....	1,533	1,417
Research and development expenses .....	509	445
Interest expense of Financial Products .....	354	240
Other operating expenses .....	421	359
Total operating costs .....	15,922	12,725
<b>Operating profit</b> .....	1,777	1,338
Interest expense excluding Financial Products .....	130	116
Other income (expense) .....	198	111
<b>Consolidated profit before taxes</b> .....	1,845	1,333
Provision for income taxes .....	547	367
Profit of consolidated companies .....	1,298	966
Equity in profit (loss) of unconsolidated affiliated companies .....	43	20
<b>Profit</b> .....	\$ 1,341	\$ 986
<b>Profit per common share</b> .....	\$ 1.97	\$ 1.44
<b>Profit per common share – diluted <sup>1</sup></b> .....	\$ 1.89	\$ 1.39
<b>Weighted average common shares outstanding (millions)</b>		
- Basic .....	680.9	685.2
- Diluted <sup>1</sup> .....	707.9	710.4
<b>Cash dividends declared per common share</b> .....	\$ .46	\$ .39

<sup>1</sup> Diluted by assumed exercise of stock options, using the treasury stock method.

See accompanying notes to Consolidated Financial Statements.

**Caterpillar Inc.**  
**Consolidated Statement of Changes in Stockholders' Equity**  
**For the Six Months Ended**  
**(Unaudited)**  
**(Dollars in millions)**

	June 30, 2005		June 30, 2004
<b>Common stock:</b>			
Balance at beginning of period .....	\$ 1,231		\$ 1,059
Common shares issued from treasury stock .....	135		59
Impact of 2-for-1 stock split .....	338		-
Balance at end of period .....	<u>1,704</u>		<u>1,118</u>
<b>Treasury stock:</b>			
Balance at beginning of period .....	(3,277)		(2,914)
Shares issued: 2005 - 9,376,792; 2004 - 4,360,260 .....	151		59
Shares repurchased: 2005 - 18,473,200; 2004 - 6,420,000 .....	(839)		(250)
Balance at end of period .....	<u>(3,965)</u>		<u>(3,105)</u>
<b>Profit employed in the business:</b>			
Balance at beginning of period .....	9,937		8,450
Profit .....	1,341	\$ 1,341	986
Dividends declared .....	(308)		(268)
Impact of 2-for-1 stock split .....	(338)		-
Balance at end of period .....	<u>10,632</u>		<u>9,168</u>
<b>Accumulated other comprehensive income:</b>			
Foreign currency translation adjustment:			
Balance at beginning of period .....	489		348
Aggregate adjustment for period .....	(132)	(132)	(21)
Balance at end of period .....	<u>357</u>		<u>327</u>
Minimum pension liability adjustment - consolidated companies:			
Balance at beginning of period			
(net of tax of: 2005-\$485; 2004-\$460) .....	(993)		(934)
Aggregate adjustment for period (net of tax of: 2005-\$24) .....	(45)	(45)	-
Balance at end of period			
(net of tax of: 2005-\$509; 2004-\$460) .....	<u>(1,038)</u>		<u>(934)</u>
Minimum pension liability adjustment - unconsolidated companies:			
Balance at beginning of period .....	(48)		(48)
Aggregate adjustment for period .....	(1)	(1)	(3)
Balance at end of period .....	<u>(49)</u>		<u>(51)</u>
Derivative financial instruments:			
Balance at beginning of period			
(net of tax of: 2005-\$58; 2004-\$54) .....	110		104
Gains/(losses) deferred during period			
(net of tax of: 2005-\$5; 2004-\$7) .....	(10)	(10)	12
(Gains)/losses reclassified to earnings during period			
(net of tax of: 2005-\$31; 2004-\$11) .....	(57)	(57)	(15)
Balance at end of period			
(net of tax of: 2005-\$22; 2004-\$50) .....	<u>43</u>		<u>101</u>
Available-for-sale securities:			
Balance at beginning of period			
(net of tax of: 2005-\$10; 2004-\$7) .....	18		13
Gains/(losses) deferred during period			
(net of tax of: 2005-\$2; 2004-\$3) .....	4	4	(5)
(Gains)/losses reclassified to earnings during period			
(net of tax of 2005-\$1; 2004-\$0) .....	(1)	(1)	-
Balance at end of period			
(net of tax of: 2005-\$11; 2004-\$4) .....	<u>21</u>		<u>8</u>
<b>Total accumulated other comprehensive income</b>	<u>(666)</u>		<u>(549)</u>
Comprehensive income .....		<u>\$ 1,099</u>	<u>\$ 954</u>
<b>Stockholders' equity at end of period .....</b>	<u><u>\$ 7,705</u></u>		<u><u>\$ 6,632</u></u>

See accompanying notes to Consolidated Financial Statements.

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

	<b>June 30, 2005</b>	<b>December 31, 2004</b>
<b>Assets</b>		
Current assets:		
Cash and short-term investments .....	\$ 749	\$ 445
Receivables - trade and other .....	7,577	7,463
Receivables – finance .....	5,489	5,182
Deferred and refundable income taxes .....	552	398
Prepaid expenses .....	1,278	1,369
Inventories .....	5,349	4,675
Total current assets .....	20,994	19,532
Property, plant and equipment – net .....	7,593	7,682
Long-term receivables - trade and other .....	845	764
Long-term receivables – finance .....	9,932	9,903
Investments in unconsolidated affiliated companies .....	555	517
Deferred income taxes .....	700	674
Intangible assets .....	468	315
Goodwill .....	1,451	1,450
Other assets .....	2,285	2,258
<b>Total assets</b> .....	<b>\$ 44,823</b>	<b>\$ 43,095</b>
<b>Liabilities</b>		
Current liabilities:		
Short-term borrowings:		
Machinery and Engines .....	612	93
Financial Products .....	4,567	4,064
Accounts payable .....	3,495	3,580
Accrued expenses .....	2,332	2,261
Accrued wages, salaries and employee benefits .....	1,551	1,730
Customer advances .....	536	447
Dividends payable .....	169	141
Deferred and current income taxes payable .....	493	259
Long-term debt due within one year:		
Machinery and Engines .....	232	6
Financial Products .....	3,209	3,525
Total current liabilities .....	17,196	16,106
Long-term debt due after one year:		
Machinery and Engines .....	3,438	3,663
Financial Products .....	12,419	12,174
Liability for postemployment benefits .....	3,271	2,986
Deferred income taxes and other liabilities .....	794	699
<b>Total liabilities</b> .....	<b>37,118</b>	<b>35,628</b>
<b>Stockholders' equity</b>		
Common stock of \$1.00 par:		
Authorized shares: 900,000,000		
Issued shares: (6/30/05 and 12/31/04 – 814,894,624) at paid in amount .....	1,704	1,231
Treasury stock (6/30/05 – 138,117,134; 12/31/04 – 129,020,726) at cost .....	(3,965)	(3,277)
Profit employed in the business .....	10,632	9,937
Accumulated other comprehensive income .....	(666)	(424)
<b>Total stockholders' equity</b> .....	<b>7,705</b>	<b>7,467</b>
<b>Total liabilities and stockholders' equity</b> .....	<b>\$ 44,823</b>	<b>\$ 43,095</b>

See accompanying notes to Consolidated Financial Statements.

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

	Six Months Ended June 30,	
	2005	2004
<b>Cash flow from operating activities:</b>		
Profit .....	\$ 1,341	\$ 986
Adjustments for non-cash items:		
Depreciation and amortization .....	744	703
Other .....	(113)	(58)
Changes in assets and liabilities:		
Receivables - trade and other (see non-cash item below) .....	(742)	(5,508)
Inventories .....	(674)	(921)
Accounts payable and accrued expenses .....	236	476
Other – net .....	204	(275)
Net cash provided by (used for) operating activities .....	996	(4,597)
<b>Cash flow from investing activities:</b>		
Capital expenditures - excluding equipment leased to others .....	(402)	(293)
Expenditures for equipment leased to others .....	(608)	(535)
Proceeds from disposals of property, plant and equipment .....	304	281
Additions to finance receivables .....	(5,159)	(4,221)
Collections of finance receivables .....	3,444	2,939
Proceeds from the sale of finance receivables .....	859	645
Collections of retained interests in securitized trade receivables .....	-	4,476
Investments and acquisitions (net of cash acquired) .....	(8)	(5)
Other – net .....	51	(10)
Net cash provided by (used for) investing activities .....	(1,519)	3,277
<b>Cash flow from financing activities:</b>		
Dividends paid .....	(280)	(254)
Common stock issued, including treasury shares reissued .....	278	107
Treasury shares purchased .....	(839)	(250)
Proceeds from long-term debt issued .....	3,719	3,322
Payments on long-term debt .....	(2,390)	(1,571)
Short-term borrowings – net .....	325	45
Net cash provided by financing activities .....	813	1,399
Effect of exchange rate changes on cash .....	14	46
<b>Increase in cash and short-term investments .....</b>	<b>304</b>	<b>125</b>
Cash and short-term investments at beginning of period .....	445	342
Cash and short-term investments at end of period .....	\$ 749	\$ 467

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

**Non-cash operating and investing activities:**

Trade receivables of \$0 and \$5,090 million were exchanged for retained interests in securitized trade receivables during the six months ended June 30, 2005 and 2004, respectively.

**See accompanying notes to Consolidated Financial Statements.**

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## (Unaudited)

### 1. A. Financial Statement Presentation

In the opinion of management, 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, 2005 and 2004, (b) the changes in stockholders' equity for the six-month periods ended June 30, 2005 and 2004, (c) the consolidated financial position at June 30, 2005 and December 31, 2004, and (d) the consolidated statement of cash flow for the six month periods ended June 30, 2005 and 2004, have been made. Certain amounts for prior periods have been reclassified to conform to the current period financial statement presentation.

In the fourth quarter of 2004, we changed how we classify cash flows related to trade receivables securitized through Cat Financial and wholesale inventory receivables financed by Cat Financial. Amounts reported in the Consolidated Statement of Cash Flow for the six months ended June 30, 2004 have been reclassified to conform to this presentation. These reclassifications had no impact on the Increase in Cash and Short-term Investments on the Consolidated Statement of Cash Flow.

Consolidated cash flow for the six months ended June 30, 2004 has been reclassified as follows:

(Millions of dollars)	Six Months Ended June 30, 2004		
	Previous Classification <sup>1</sup>	Change	As Reclassified
<b>Consolidated Statement of Cash Flow</b>			
Receivables – trade and other .....	\$ (340)	\$ (5,168)	\$ (5,508)
<b>Net cash provided by (used for) operating activities .....</b>	<b>571</b>	<b>(5,168)</b>	<b>(4,597)</b>
Additions to finance receivables.....	(10,802)	6,581	(4,221)
Collections of finance receivables.....	8,292	(5,353)	2,939
Proceeds from sale of finance receivables .....	1,181	(536)	645
Collections of retained interests in securitized trade receivables.....	-	4,476	4,476
<b>Net cash provided by (used for) investing activities .....</b>	<b>(1,891)</b>	<b>5,168</b>	<b>3,277</b>

<sup>1</sup> Certain amounts do not agree to prior period reported amounts due to unrelated reclassifications.

Other postretirement benefit costs for the three and six month periods ended June 30, 2004 reflect the adoption of FASB Staff Position 106-2, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003" in the third quarter of 2004, retroactive to December 31, 2003. The impact of the anticipated federal subsidy for prescription drugs was a decrease of \$14 million and \$22 million for the three and six months ended June 30, 2004 in other postretirement benefit expense. We adjusted our second quarter results in the third quarter of 2004 for this amount, resulting in profit after tax of \$566 million (\$0.80 per share) and \$986 million (\$1.39 per share) as compared to the previously reported profit after tax of \$552 million (\$0.78 per share) and \$964 million (\$1.36 per share) for the three and six months ended June 30, 2004, respectively.

The December 31, 2004 financial position data included herein is derived from the audited consolidated financial statements included in the Company's annual report on Form 10-K for the year ended December 31, 2004.

### 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-scrappers, track and wheel excavators, backhoe loaders, log skidders, log loaders, off-highway trucks, articulated trucks, paving products, telescopic handlers, skid steer loaders and related parts. Also includes logistics services for other companies.

- (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. Reciprocating engines meet power needs ranging from 5 to over 22,000 horsepower (4 to over 16 200 kilowatts). Turbines range from 1,200 to 20,500 horsepower (900 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 active 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.

### C. Stock-Based Compensation

We currently use the intrinsic value method of accounting for stock-based employee compensation in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees." Therefore, no compensation expense is recognized in association with our options. In 2004, we switched from using the Black-Scholes option-pricing model to the binomial option-pricing model in order to calculate the fair value of our options. We believe this model more accurately reflects the value of the options than the Black-Scholes option-pricing model. Grants made prior to 2004 continue to be valued using the Black-Scholes model.

Pro forma net profit and profit per share for the three and six month periods ending June 30, 2005 and 2004 were:

	Three Months Ended June 30,	
	2005	2004
<b>(Dollars in millions except per share data)</b>		
Profit, as reported .....	\$ 760	\$ 566
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects .....	11	28
Pro forma profit .....	<u>\$ 749</u>	<u>\$ 538</u>
Profit per share of common stock:		
As reported:		
Basic .....	\$ 1.12	\$ 0.83
Diluted .....	\$ 1.08	\$ 0.80
Pro forma:		
Basic .....	\$ 1.10	\$ 0.79
Diluted .....	\$ 1.06	\$ 0.76

	Six Months Ended June 30,	
	2005	2004
<b>(Dollars in millions except per share data)</b>		
Profit, as reported .....	\$ 1,341	\$ 986
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects .....	123	46
Pro forma profit .....	<u>\$ 1,218</u>	<u>\$ 940</u>
Profit per share of common stock:		
As reported:		
Basic .....	\$ 1.97	\$ 1.44
Diluted .....	\$ 1.89	\$ 1.39
Pro forma:		
Basic .....	\$ 1.79	\$ 1.37
Diluted .....	\$ 1.72	\$ 1.32

Pro forma profit for the six months ended June 30, 2005 reflects immediate vesting of the 2005 stock option grant. (See Note 4 for further discussion.)



2. The results for the three and six month periods ended June 30, 2005 are not necessarily indicative of the results for the entire year 2005.

### 3. Stock Split and Common Stock Dividend

*Stock Split* - On June 8, 2005, Caterpillar's board of directors approved a 2-for-1 stock split in the form of a 100 percent stock dividend. The stock split shares were distributed on July 13, 2005 to stockholders of record at the close of business on June 22, 2005. The capital accounts, share data, and earnings per share data in these Consolidated Financial Statements reflect the stock split, applied retroactively, to all periods presented.

*Common Stock Dividend* - On June 8, 2005, Caterpillar's board of directors approved an increase in the quarterly dividend rate from 20.5 cents to 25 cents per share post-split. The dividend increase was the largest increase in our 80-year history (on a split-adjusted basis). The cash dividend of 25 cents per share on a post-split basis is payable on August 19, 2005, to stockholders of record on July 22, 2005.

### 4. New Accounting Pronouncements

In November 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 151 (SFAS 151), "Inventory Costs an amendment of ARB No. 43, Chapter 4." SFAS 151 discusses the general principles applicable to the pricing of inventory. Paragraph 5 of ARB 43, Chapter 4 provides guidance on allocating certain costs to inventory. This Statement amends ARB 43, Chapter 4, to clarify that abnormal amounts of idle facility expense, freight, handling costs, and wasted materials (spoilage) should be recognized as current-period charges. In addition, this Statement requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of production facilities. As required by SFAS 151, we will adopt this new accounting standard on January 1, 2006. The adoption of SFAS 151 is not expected to have a material impact on our financial statements.

In December 2004, the FASB issued FASB Staff Position No. 109-1, "Application of FASB Statement No. 109, Accounting for Income Taxes, to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004", (FSP 109-1). FSP 109-1 provides accounting guidance for companies that will be eligible for a tax deduction resulting from "qualified production activities income" as defined in the American Jobs Creation Act of 2004 (the Act). FSP 109-1 requires this deduction be treated as a special deduction in accordance with SFAS 109, which does not require a revaluation of our U.S. deferred tax assets. We applied the guidance in FSP 109-1 upon recognition of this tax deduction beginning January 1, 2005. The application of FSP 109-1 did not have a material impact on our financial statements.

In December 2004, the FASB issued FASB Staff Position No. 109-2, "Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004", (FSP 109-2). FSP 109-2 provides accounting guidance for the one-time tax deduction of 85% of non-U.S. earnings that are repatriated in excess of a base amount as defined in the Act. SFAS 109 requires a company to reflect in the period of enactment the effect of a new tax law. Due to the lack of clarification on certain provisions within the Act, FSP 109-2 allowed companies time beyond the financial reporting period of enactment to evaluate the effect of the Act. In the second quarter of 2005, we completed our evaluation and recognized a provision for income taxes of \$49 million under the provisions of the Act. We expect to repatriate earnings of approximately \$1.4 billion in 2005, which includes \$500 million subject to the preferential treatment allowed by the Act.

We have provided U.S. tax on earnings of non-U.S. subsidiaries that were not considered indefinitely reinvested prior to our evaluation of the Act. In connection with our current repatriation plan, we now intend to indefinitely reinvest earnings of a few selected non-U.S. subsidiaries and have reversed the associated deferred tax liability of \$38 million. The net impact of these items is an \$11 million increase to our second quarter provision for income taxes.

In December 2004, the FASB issued Statement of Financial Accounting Standards No. 153 (SFAS 153), "Exchanges of Non-monetary Assets – an amendment of APB Opinion No. 29." SFAS 153 addresses the measurement of exchanges of non-monetary assets. It eliminates the exception from fair value measurement for non-monetary exchanges of similar productive assets in paragraph 21(b) of APB Opinion No. 29 "Accounting for Non-monetary Transactions" and replaces it with an exception for exchanges that do not have commercial substance. A non-monetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. As required by SFAS 153, we will adopt this new accounting standard effective July 1, 2005. The adoption of SFAS 153 is not expected to have a material impact on our financial statements.

In December 2004, the FASB issued Statement of Financial Accounting Standards No. 123R (revised 2004) "Share-Based Payment," (SFAS 123R). SFAS 123R requires that the cost resulting from all share-based payment transactions be recognized in the financial statements. SFAS 123R also establishes fair value as the measurement method in accounting for share-based payments with employees. The FASB required the provisions of SFAS 123R be adopted for interim or annual periods beginning after June 15, 2005. In April 2005, the SEC adopted a new rule amending the compliance dates for SFAS 123R. In accordance with this rule, we will adopt this new accounting standard effective January 1, 2006. We will transition to the new guidance using the modified prospective method. In anticipation of delaying vesting until three years after the grant date for future grants, the 2004 employee stock option grant (issued in June) fully vested on December 31, 2004. In order to better align our employee stock option program with the overall market, the number of options granted in 2005 (issued in February) was significantly reduced from the previous year. In response to this decrease, we elected to immediately vest the 2005 option grant. Based on the same assumptions used to value our 2005 stock option grant (including number of options granted and exercise price of options), we expect the application of the expensing provisions of SFAS 123R will result in a pretax expense of approximately \$100 million in 2006. As a result of the vesting decisions discussed above, a full complement of expense related to stock options will not be recognized in our results of operations until 2009. We estimate our pretax expense associated with our stock option grants will range from approximately \$110 million in 2007 to approximately \$160 million in 2009.

In June 2005, the FASB issued Statement of Financial Accounting Standards No. 154 (SFAS 154), "Accounting Changes and Error Corrections." SFAS 154 changes the requirements for the accounting for and reporting of a change in accounting principle. This Statement requires retrospective applications to prior periods' financial statements of a voluntary change in accounting principle unless it is impracticable. In addition, this Statement requires that a change in depreciation, amortization, or depletion for long-lived, non-financial assets be accounted for as a change in accounting estimate effected by a change in accounting principle. This new accounting standard is effective January 1, 2006. The adoption of SFAS 154 is not expected to have a material impact on our financial statements.

## **5. 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, Chinese yuan, New Zealand dollar or Swiss franc forward or option contracts that exceed 90 days in duration. Designation is performed on a specific exposure basis to support hedge accounting. The remainder of Machinery and Engines foreign currency contracts are undesignated. We also designate as fair value hedges specific euro forward contracts used to hedge firm commitments.

As of June 30, 2005, \$33 million of deferred net gains 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)") over the next 12 months when earnings are negatively affected by the hedged transactions. As of June 30, 2004, this projected reclassification was a gain of \$62 million. These amounts were based on June 30, 2005 and June 30, 2004 exchange rates, respectively. The actual amount recorded in other income/expense will vary based on exchange rates at the time the hedged transactions impact earnings. There were no circumstances where hedge treatment was discontinued during the three or six month periods ended June 30, 2005 or 2004.

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 contracts to offset the risk of currency mismatch between our receivables and debt. All such foreign currency forward contracts are undesignated.

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

(Millions of dollars)	Three Months Ended June 30,	
	2005	2004
Machinery and Engines:		
On undesignated contracts.....	\$ 6	\$ (1)
Financial Products:		
On undesignated contracts.....	\$ 22	\$ 1

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

(Millions of dollars)	Six Months Ended June 30,	
	2005	2004
Machinery and Engines:		
On undesignated contracts.....	\$ 16	\$ (3)
Financial Products:		
On undesignated contracts.....	\$ 34	\$ 17

Gains on the Financial Products contracts above are substantially offset by balance sheet translation 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 and forward rate agreements to manage our exposure to interest rate changes and 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. Deferred gains on liquidated fixed-to-floating interest rate swaps, which were previously designated as fair value hedges, are being amortized to earnings ratably over the remaining life of the hedged debt. We designate as cash flow hedges at inception of the contract all forward rate agreements. Designation as a hedge of the anticipated issuance of debt is performed to support hedge accounting. Machinery and Engines forward rate agreements are 100% effective.

Financial Products operations have a match funding policy that addresses interest rate risk by aligning the interest rate profile (fixed or floating rate) of their debt portfolio with the interest rate profile of their receivables portfolio within pre-determined ranges on an ongoing basis. In connection with that policy, we use interest rate derivative instruments to modify the debt structure to match assets within the receivables portfolio. This match funding reduces the volatility of margins between interest-bearing assets and interest-bearing liabilities, regardless of which direction interest rates move. This is accomplished by changing the characteristics of existing debt instruments or entering into new agreements in combination with the issuance of new debt.

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 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 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 2005, 2004, and 2002. As a result, the gain (\$11 million as of June 30, 2005) is being amortized to earnings ratably over the remaining life of the hedged debt.

In the second quarter of 2005, Cat Financial liquidated forward starting floating-to-fixed interest rate swaps due to the issuance of the hedged debt. Forward starting interest rate swaps provide a hedge of the anticipated issuance of debt. The \$9 million loss on the swaps will be amortized to earnings ratably over the remaining life of the hedged debt.

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

(Millions of dollars)	Three Months Ended June 30,	
	2005	2004
Fixed-to-floating interest rate swaps		
Machinery and Engines:		
Gain/(loss) on liquidated swaps .....	\$ 1	\$ 1
Financial Products:		
Gain/(loss) on designated interest rate derivatives .....	50	(73)
Gain/(loss) on hedged debt.....	(50)	73
Gain/(loss) on liquidated swaps – included in interest expense.....	1	1
	<u>\$ 2</u>	<u>\$ 2</u>

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

(Millions of dollars)	Six Months Ended June 30,	
	2005	2004
Fixed-to-floating interest rate swaps		
Machinery and Engines:		
Gain/(loss) on liquidated swaps .....	\$ 2	\$ 2
Financial Products:		
Gain/(loss) on designated interest rate derivatives .....	3	(39)
Gain/(loss) on hedged debt.....	(3)	39
Gain/(loss) on liquidated swaps – included in interest expense.....	2	1
	<u>\$ 4</u>	<u>\$ 3</u>

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As of June 30, 2005, \$3 million of deferred net gains included in equity ("Accumulated other comprehensive income" 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") over the next 12 months. As of June 30, 2004, this projected reclassification was a net loss of \$8 million. There were no circumstances where hedge treatment was discontinued during the three or six months ended June 30, 2005 or 2004.

### 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. Losses on the undesignated contracts of \$1 million and gains of \$2 million were recorded in current earnings ("Other income (expense)") for the three and six months ended June 30, 2005. Losses on the undesignated contracts of \$2 million and gains of \$5 million were recorded in current earnings ("Other income (expense)") for the three and six months ended June 30, 2004.

## **6. Inventories**

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

(Millions of dollars)	June 30, 2005	December 31, 2004
Raw materials .....	\$ 1,698	\$ 1,592
Work-in-process .....	831	664
Finished goods .....	2,597	2,209
Supplies .....	223	210
Total inventories .....	<u>\$ 5,349</u>	<u>\$ 4,675</u>

## **7. 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 March 31) was as follows:

(Millions of dollars)	Results of Operations Three Months Ended June 30,		Results of Operations Six Months Ended June 30,	
	2005	2004	2005	2004
Sales .....	\$ 1,057	\$ 899	\$ 2,023	\$ 1,713
Cost of sales .....	810	698	1,567	1,327
Gross profit .....	<u>\$ 247</u>	<u>\$ 201</u>	<u>\$ 456</u>	<u>\$ 386</u>
Profit (loss) .....	<u>\$ 58</u>	<u>\$ 29</u>	<u>\$ 92</u>	<u>\$ 50</u>
Caterpillar's profit (loss) .....	<u>\$ 29</u>	<u>\$ 14</u>	<u>\$ 43</u>	<u>\$ 20</u>

(Millions of dollars)	Financial Position	
	June 30, 2005	December 31, 2004
Assets:		
Current assets .....	\$ 1,676	\$ 1,540
Property, plant and equipment – net .....	1,139	1,097
Other assets .....	221	145
	<u>3,036</u>	<u>2,782</u>
Liabilities:		
Current liabilities .....	1,350	1,345
Long-term debt due after one year .....	351	276
Other liabilities .....	213	214
	<u>1,914</u>	<u>1,835</u>
Ownership .....	<u>\$ 1,122</u>	<u>\$ 947</u>
Caterpillar's investments in unconsolidated affiliated companies		
Investments in equity method companies .....	\$ 525	\$ 487
Plus: Investments in cost method companies .....	30	30
Total investments in unconsolidated affiliated companies .....	<u>\$ 555</u>	<u>\$ 517</u>

## 8. Intangible Assets and Goodwill

### A. Intangible assets

Intangible assets are comprised of the following:

(Millions of dollars)	June 30, 2005	December 31, 2004
Intellectual property .....	\$ 212	\$ 213
Pension-related .....	283	120
Other .....	73	73
Total intangible assets – gross .....	<u>568</u>	<u>406</u>
Less: Accumulated amortization of finite lived intangible assets .....	<u>(100)</u>	<u>(91)</u>
Intangible assets – net .....	<u>\$ 468</u>	<u>\$ 315</u>

Amortization expense for the three and six months ended June 30, 2005 was \$6 million and \$11 million, respectively. Amortization expense for the three and six months ended June 30, 2004 was \$7 million and \$11 million, respectively. Amortization expense related to intangible assets is expected to be:

(Millions of dollars)					
2005	2006	2007	2008	2009	Thereafter
<u>\$ 23</u>	<u>\$ 22</u>	<u>\$ 19</u>	<u>\$ 17</u>	<u>\$ 16</u>	<u>\$ 97</u>

### B. Goodwill

During the three and six months ended June 30, 2005 and 2004, no goodwill was acquired, impaired or disposed. On an annual basis, we test goodwill for impairment in accordance with Statement of Financial Accounting Standards No. 142 "Goodwill and Other Intangible Assets."

## 9. Available-For-Sale Securities

Caterpillar Insurance and Caterpillar Investment Management Ltd. have investments in certain debt and equity securities that are 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 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.

June 30, 2005			
(Millions of dollars)	Cost Basis	Unrealized Pretax Net	Fair Value
		Gains (Losses)	
Government debt.....	\$ 277	\$ (2)	\$ 275
Corporate bonds.....	390	(1)	389
Equity securities.....	176	31	207
Total.....	<u>\$ 843</u>	<u>\$ 28</u>	<u>\$ 871</u>

December 31, 2004			
(Millions of dollars)	Cost Basis	Unrealized Pretax Net	Fair Value
		Gains (Losses)	
Government debt.....	\$ 239	\$ (1)	\$ 238
Corporate bonds.....	342	-	342
Equity securities.....	203	21	224
Total.....	<u>\$ 784</u>	<u>\$ 20</u>	<u>\$ 804</u>

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

June 30, 2005						
(Millions of dollars)	Less than 12 months <sup>(1)</sup>		More than 12 months <sup>(1)</sup>		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Government debt.....	\$ 143	\$ 1	\$ 67	\$ 1	\$ 210	\$ 2
Corporate bonds.....	156	1	86	2	242	3
Equity securities.....	30	2	12	-	42	2
Total.....	<u>\$ 329</u>	<u>\$ 4</u>	<u>\$ 165</u>	<u>\$ 3</u>	<u>\$ 494</u>	<u>\$ 7</u>

<sup>(1)</sup> 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 June 30, 2005, by contractual maturity, is shown below. 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.....	\$ 49
Due after one year through five years.....	\$ 280
Due after five years through ten years.....	\$ 69
Due after ten years.....	\$ 267

Proceeds from sales of investments in debt and equity securities during the three and six months ended June 30, 2005 were \$131 million and \$182 million, respectively. Proceeds from sales of investments in debt and equity securities during the three and six months ended June 30, 2004 were \$57 million and \$135 million, respectively. Gross gains of \$3 million and \$5 million, and gross losses of \$1 million and \$2 million, were included in current earnings for the three and six months ended June 30, 2005, respectively. Gross gains of \$1 million and \$3 million, and gross losses of \$1 million and \$3 million, were included in current earnings for the three and six months ended June 30, 2004, respectively.

## 10. Postretirement Benefits

### A. Pension and postretirement benefit costs

In January 2005, amendments were made to both U.S. pension and other postretirement benefit plans due to the company and the United Auto Workers reaching a new six-year labor agreement that will expire on March 1, 2011. These plans were re-measured as of January 1, 2005 to account for the benefit changes. The result was an \$8 million and \$15 million increase in pension cost, and an \$18 million and \$35 million increase in other postretirement benefit cost for the three and six months ended June 30, 2005, respectively. In addition, the Additional Minimum Pension Liability increased \$233 million as a result of the re-measurement. The liability was offset by an increase in pension-related intangible assets of \$164 million and a decrease in other comprehensive income (pre-tax) of \$69 million.

In April 2005, amendments were made to our U.S. salaried and management other postretirement benefit plan. The plan was re-measured, resulting in a reduction of second quarter postretirement benefit cost of \$6 million.

2004 other postretirement benefit cost reflects the adoption of FASB Staff Position No. 106-2, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003" in the third quarter of 2004, retroactive to December 31, 2003. The impact of the anticipated federal subsidy for prescription drugs was a decrease in other postretirement benefit cost of \$14 million and \$22 million, for the three and six months ended June 30, 2004, respectively.

(Millions of Dollars)	U.S. Pension Benefits		Non-U.S. Pension Benefits		Other Postretirement Benefits	
	June 30,		June 30,		June 30,	
	2005	2004	2005	2004	2005	2004
<b>For the three months ended:</b>						
<b>Components of net periodic benefit cost:</b>						
Service cost .....	\$ 37	\$ 36	\$ 16	\$ 12	\$ 22	\$ 16
Interest cost .....	137	137	27	22	75	67
Expected return on plan assets .....	(178)	(174)	(26)	(24)	(21)	(18)
Amortization of:						
Net asset existing at adoption of SFAS 87/106.....	-	-	-	1	1	-
Prior service cost <sup>1</sup> .....	14	11	2	2	(9)	(12)
Net actuarial loss (gain) .....	49	35	12	9	24	12
Total cost (benefit) included in results of operations.....	\$ 59	\$ 45	\$ 31	\$ 22	\$ 92	\$ 65
<b>Weighted-average assumptions used to determine net cost:</b>						
Discount rate <sup>2</sup> .....	5.8/5.9%	6.2%	5.2%	5.1%	5.7-5.9%	6.2%
Expected return on plan assets .....	9.0%	9.0%	7.2%	7.4%	9.0%	9.0%
Rate of compensation increase .....	4.0%	4.0%	3.5%	3.2%	4.0%	4.0%

<sup>1</sup> 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 employees.

<sup>2</sup> For U.S. plans impacted by the January 2005 plan amendments, a 5.8% discount rate was utilized for valuing the plan re-measurement. For the April 2005 amendment, a 5.7% discount rate was utilized for valuing the plan re-measurement.



(Millions of Dollars)	U.S. Pension Benefits		Non-U.S. Pension Benefits		Other Postretirement Benefits	
	June 30,		June 30,		June 30,	
	2005	2004	2005	2004	2005	2004
<b>For the six months ended:</b>						
<b>Components of net periodic benefit cost:</b>						
Service cost.....	\$ 75	\$ 72	\$ 30	\$ 24	\$ 44	\$ 33
Interest cost.....	277	274	55	44	150	134
Expected return on plan assets .....	(356)	(341)	(52)	(48)	(43)	(36)
Amortization of:						
Net asset existing at adoption of SFAS 87/106 .....	-	-	-	2	1	-
Prior service cost <sup>1</sup> .....	30	22	3	4	(12)	(24)
Net actuarial loss (gain) .....	99	70	25	18	41	25
Total cost (benefit) included in results of operations .....	<u>\$ 125</u>	<u>\$ 97</u>	<u>\$ 61</u>	<u>\$ 44</u>	<u>\$ 181</u>	<u>\$ 132</u>

**Weighted-average assumptions used to determine net cost:**

Discount rate <sup>2</sup> .....	5.8/5.9%	6.2%	5.2%	5.1%	5.7-5.9%	6.2%
Expected return on plan assets.....	9.0%	9.0%	7.2%	7.4%	9.0%	9.0%
Rate of compensation increase.....	4.0%	4.0%	3.5%	3.2%	4.0%	4.0%

<sup>1</sup> 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 employees.

<sup>2</sup> For U.S. plans impacted by the January 2005 plan amendments, a 5.8% discount rate was utilized for valuing the plan re-measurement. For the April 2005 amendment, a 5.7% discount rate was utilized for valuing the plan re-measurement.

We have no ERISA funding requirements in 2005 and do not expect to make any significant contributions to our U.S. pension plans this year. We made contributions to non-U.S. pension plans during the three and six months ended June 30, 2005 of \$30 million and \$80 million, respectively, and anticipate additional contributions of approximately \$180 million during the year. We also expect to make a \$200 million cash contribution to our other postretirement benefit plans during 2005 in addition to our funding of ongoing cash benefit payments of approximately \$360 million.

**B. Defined contribution benefit costs**

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

(Millions of dollars)	Three Months Ended June 30,	
	2005	2004
U.S. Plans .....	\$ 28	\$ 23
Non-U.S. Plans.....	9	3
	<u>\$ 37</u>	<u>\$ 26</u>

(Millions of dollars)	Six Months Ended June 30,	
	2005	2004
U.S. Plans.....	\$ 61	\$ 53
Non-U.S. Plans.....	13	6
	<u>\$ 74</u>	<u>\$ 59</u>

## 11. Guarantees and Product Warranty

We have guaranteed to repurchase loans of certain Caterpillar dealers from third party lenders in the event of default. These guarantees arose in conjunction with Cat Financial's relationship with third party dealers who sell Caterpillar equipment. These guarantees generally have one year terms and are secured primarily by dealer assets.

Cat Financial has provided a limited indemnity to a third party bank for \$42 million resulting from the assignment of certain leases to that bank. The indemnity is for the remote chance that the insurers of these leases would become insolvent. The indemnity expires December 15, 2012 and is unsecured.

No loss has been experienced or is anticipated under any of these guarantees. At June 30, 2005 and December 31, 2004 the book value of these guarantees was \$9 million and \$10 million, respectively. The maximum potential amount of future payments (undiscounted and without reduction for any amount that may possibly be recovered under recourse or collateralized provisions) we could be required to make under the guarantees are as follows:

<b>(Millions of dollars)</b>	<b>June 30, 2005</b>	<b>December 31, 2004</b>
Guarantees with Caterpillar dealers .....	\$ 395	\$ 364
Guarantees – other .....	77	62
Total guarantees .....	<u>\$ 472</u>	<u>\$ 426</u>

Our product warranty liability is determined by applying historical claim rate experience to the current field population and dealer inventory. Historical claim rates are developed using a rolling average of actual warranty payments. Our product warranty liability also includes deferred revenue related to extended warranty contracts, which is recognized in income when the related costs are incurred. The amount of this deferred revenue was \$115 million and \$132 million at June 30, 2005 and December 31, 2004, respectively.

<b>(Millions of dollars)</b>	<b>2005</b>
Warranty liability, January 1 .....	\$ 914
Reduction in liability (payments) .....	(380)
Increase in liability (new warranties) .....	413
Warranty liability, June 30 .....	<u>\$ 947</u>

<b>(Millions of dollars)</b>	<b>2004</b>
Warranty liability, January 1 .....	\$ 695
Reduction in liability (payments) .....	(586)
Increase in liability (new warranties) .....	772
Additional liability from acquisition .....	33
Warranty liability, December 31 .....	<u>\$ 914</u>

## 12. Computations of Profit Per Share

		Three Months Ended June 30,	
(Dollars in millions except per share data)		2005	2004
I.	Profit for the period (A): .....	\$ 760	\$ 566
II.	Determination of shares (millions):		
	Weighted average number of common shares outstanding (B) .....	678.3	684.8
	Shares issuable on exercise of stock options, net of shares assumed to be purchased out of proceeds at average market price .....	26.8	24.7
	Average common shares outstanding for fully diluted computation (C) .....	705.1	709.5
III.	Profit per share of common stock:		
	Assuming no dilution (A/B) .....	\$ 1.12	\$ 0.83
	Assuming full dilution (A/C) .....	\$ 1.08	\$ 0.80

		Six Months Ended June 30,	
(Dollars in millions except per share data)		2005	2004
I.	Profit for the period (A): .....	\$ 1,341	\$ 986
II.	Determination of shares (millions):		
	Weighted average number of common shares outstanding (B) .....	680.9	685.2
	Shares issuable on exercise of stock options, net of shares assumed to be purchased out of proceeds at average market price .....	27.0	25.2
	Average common shares outstanding for fully diluted computation (C) .....	707.9	710.4
III.	Profit per share of common stock:		
	Assuming no dilution (A/B) .....	\$ 1.97	\$ 1.44
	Assuming full dilution (A/C) .....	\$ 1.89	\$ 1.39

## 13. Environmental and Legal Matters

The company is regulated by federal, state, and international environmental laws governing our use of substances and control of emissions in all our operations. Compliance with these existing laws has not had a material impact on our capital expenditures or earnings.

We are cleaning up hazardous waste at a number of locations, often with other companies, pursuant to federal and state laws. When it is likely we will pay clean-up costs at a site and those costs can be estimated, the costs are charged against our earnings. In formulating that estimate, we do not consider amounts expected to be recovered from insurance companies and others.

The amount recorded for environmental clean up is not material and is included in "Accrued expenses" in the Consolidated Statement of Financial Position. If a range of liability estimates is available on a particular site, we accrue at the lower end of that range. We cannot estimate costs on sites in the very early stages of clean up. Currently, we have several sites in the very early stages of clean up, and there is no more than a remote chance that a material amount for clean up will be required.

We have disclosed certain individual legal proceedings in this filing. Additionally, we are involved in other unresolved legal actions that arise in the normal course of business, the most prevalent involve disputes related to product design, manufacture and performance liability (including claimed asbestos and welding fumes exposure), contracts, employment issues, and intellectual property rights. Although it is not possible to predict with certainty the outcome of these unresolved legal actions or the range of probable loss, we believe that these unresolved legal actions will not individually or in the aggregate have a material impact on our consolidated financial position, liquidity or results of operations.

On January 16, 2002, Caterpillar commenced an action in the Circuit Court of the Tenth Judicial Circuit of Illinois in Peoria, Illinois, against Navistar International Transportation Corporation and International Truck and Engine Corporation (collectively Navistar). The lawsuit arises out of a long-term purchase contract between Caterpillar and Navistar effective May 31, 1988, as amended from time to time (the Purchase Agreement). The pending complaint alleges that Navistar breached its contractual obligations by: (i) paying Caterpillar \$8.08 less per fuel injector than the agreed upon price for new unit injectors delivered by Caterpillar; (ii) refusing to pay contractually agreed upon surcharges owed as a result of Navistar ordering less than planned volumes of replacement unit injectors; and (iii) refusing to pay contractually agreed upon interest stemming from Navistar's late payments. As of June 30, 2005, the net past due receivable from Navistar regarding the foregoing and included in "Long-term receivables – trade and other" in the Consolidated Statement of Financial Position totaled \$139 million. The pending complaint also has claims alleging that Newstream Enterprises and Navistar, collectively and individually, failed to pay the applicable price to Caterpillar for shipments of unit injectors to Newstream. In January 2005, Caterpillar and Franklin Power Products, Inc. resolved claims similar to those currently pending against Newstream, and Franklin has been dismissed from the lawsuit. As of June 30, 2005, the net past due receivables for the foregoing, included in "Long-term receivables – trade and other" in the Consolidated Statement of Financial Position totaled \$12 million. The pending complaint further alleges that Sturman Industries, Inc. and Sturman Engine Systems, Inc. colluded with Navistar to utilize technology that Sturman Industries, Inc. misappropriated from Caterpillar to help Navistar develop its G2 fuel system, and tortiously interfered with the Purchase Agreement and Caterpillar's prospective economic relationship with Navistar. The pending complaint further alleges that the two parties' collusion led Navistar to select Sturman Engine Systems, Inc., and another company, instead of Caterpillar, to develop and manufacture the G2 fuel system.

On May 7, 2002 International Truck and Engine Corporation (International) commenced an action against Caterpillar in the Circuit Court of DuPage County, Illinois regarding a long-term agreement term sheet ("term sheet") (the "first lawsuit"). In its sixth amended complaint in the first lawsuit, International alleged that the term sheet constitutes a legally binding contract for the sale of heavy-duty engines at specified prices through the end of 2006, alleged that Caterpillar breached the term sheet by, among other things, raising certain prices effective October 1, 2002, and also alleged that Caterpillar breached an obligation to negotiate a comprehensive long-term agreement referenced in the term sheet. International sought declaratory and injunctive relief as well as damages in an amount to be determined at trial. Caterpillar denied International's claims and filed a counterclaim seeking a declaration that the term sheet had been effectively terminated. Caterpillar also asserted that pursuant to a subsequent agreement International released Caterpillar from certain of its claims. On September 24, 2003 the Appellate Court of Illinois, ruling on an interlocutory appeal, issued an order consistent with Caterpillar's position that, even if the court subsequently determines that the term sheet is a binding contract, it is indefinite in duration and was therefore terminable at will by Caterpillar upon reasonable notice. On April 12, 2005 International commenced a second, related action against Caterpillar in the Circuit Court of DuPage County, Illinois (the "second lawsuit"). The second lawsuit contains allegations that are similar to the allegations contained in the first lawsuit. International also alleges in the second lawsuit that Caterpillar materially breached the subsequent agreement. On June 15, 2005 International voluntarily dismissed its complaint in the first lawsuit. Caterpillar's counterclaims remain at issue in the first lawsuit. No trial dates are currently scheduled for either of the cases pending in the Circuit Court of DuPage County. Neither of these cases are related to the breach of contract action brought by Caterpillar against Navistar which is currently pending in the Circuit Court of Peoria County, Illinois.

In a letter dated November 15, 2004, the EPA proposed a civil penalty of \$641,392 to Caterpillar for the alleged failure to comply with certain requirements of the Federal Clean Air Act. The EPA alleges that Caterpillar constructed a facility in Emporia, Kansas, and failed to comply with Section 112(g)(2)(B) of the Clean Air Act. Caterpillar sold the Emporia facility in December 2002. We are seeking a settlement of this matter with all concerned parties and we believe the outcome will not have a material impact on our consolidated financial position, liquidity, or results of operations.

During the second quarter of 2005, the Internal Revenue Service (IRS) completed its field examination of our 1995 through 1999 U.S. tax returns. In connection with this examination, we received notices of certain adjustments proposed by the IRS, primarily related to foreign sales corporation (FSC) commissions, foreign tax credit calculations, and R&D credits. We disagree with these proposed adjustments and intend to vigorously dispute this matter through applicable IRS and judicial procedures, as appropriate. Although the final resolution of the proposed adjustments is uncertain, in the opinion of our management the ultimate disposition of these matters will not have a material adverse effect on our consolidated financial position, liquidity, or results of operations.

#### 14. Segment Information

Caterpillar is organized based on a decentralized structure that has established accountabilities to continually improve business focus and increase our ability to react quickly to changes in both the global business cycle and competitors' actions. Our current structure uses a product, geographic matrix organization comprised of multiple profit center and service center divisions.

Caterpillar is a highly integrated company. The majority of our profit centers are product focused. They are primarily responsible for the design, manufacture and ongoing support of their products. However, some of these product-focused profit centers also have marketing responsibilities. We also have geographically-based profit centers that are focused primarily on marketing. However, most of these profit centers also have some manufacturing responsibilities. One of our profit centers provides various financial services to our customers and dealers. The service center divisions perform corporate functions and provide centralized services.

We have developed an internal measurement system to evaluate performance and to drive continuous improvement. This measurement system, which is not based on generally accepted accounting principles (GAAP), is intended to motivate desired behavior of employees and drive performance. It is not intended to measure a division's contribution to enterprise results. The sales and cost information used for internal purposes varies significantly from our consolidated, externally reported information resulting in substantial reconciling items. Each division has specific performance targets and is evaluated and compensated based on achieving those targets. Performance targets differ from division to division; therefore, meaningful comparisons cannot be made among the profit or service center divisions. It is the comparison of actual results to budgeted results that makes our internal reporting valuable to management. Consequently, we feel that the financial information required by Statement of Financial Accounting Standards No. 131 (SFAS 131), "Disclosures about Segments of an Enterprise and Related Information" has limited value to our external readers.

In the first quarter of 2005, we made several organizational changes that impacted our segment reporting. No individual segment was materially impacted as a result of the changes and prior period amounts have been restated to conform to the current period presentation.

Due to Caterpillar's high level of integration and our concern that segment disclosures based on SFAS 131 requirements have limited value to external readers, we are continuing to disclose financial results for our three principal lines of business (Machinery, Engines and Financial Products) in our Management's Discussion and Analysis beginning on page 27.

Business Segments Three Months Ended June 30, (Millions of dollars)										
2005	Machinery and Engines								Financing & Insurance Services	Consolidated Total
	Asia/ Pacific Marketing	Construction & Mining Products	EAME Marketing	Latin America Marketing	Power Products	North America Marketing	All Other	Total		
External sales and revenues.....	\$ 648	\$ 114	\$ 1,205	\$ 598	\$ 2,591	\$ 2,985	\$ 605	\$ 8,746	\$ 712	\$ 9,458
Inter-segment sales & revenues .	37	4,027	1,126	421	1,953	116	952	8,632	7	8,639
Total sales and revenues.....	\$ 685	\$ 4,141	\$ 2,331	\$ 1,019	\$ 4,544	\$ 3,101	\$ 1,557	\$ 17,378	\$ 719	\$ 18,097
Depreciation and amortization ....	\$ 3	\$ 46	\$ 16	\$ 12	\$ 74	\$ 1	\$ 30	\$ 182	\$ 161	\$ 343
Imputed interest expense.....	\$ 4	\$ 20	\$ 9	\$ 6	\$ 28	\$ 2	\$ 30	\$ 99	\$ 192	\$ 291
Accountable profit (loss).....	\$ 38	\$ 471	\$ 128	\$ 67	\$ 251	\$ 93	\$ 247	\$ 1,295	\$ 149	\$ 1,444
Accountable assets at June 30, 2005 .....	\$ 531	\$ 2,697	\$ 1,158	\$ 876	\$ 3,739	\$ 416	\$ 4,056	\$ 13,473	\$ 24,965	\$ 38,438
Capital Expenditures .....	\$ 2	\$ 62	\$ 28	\$ 9	\$ 62	\$ -	\$ 25	\$ 188	\$ 330	\$ 518

2004	Machinery and Engines								Financing & Insurance Services	Consolidated Total
	Asia/ Pacific Marketing	Construction & Mining Products	EAME Marketing	Latin America Marketing	Power Products	North America Marketing	All Other	Total		
External sales and revenues.....	\$ 565	\$ 64	\$ 1,025	\$ 398	\$ 2,129	\$ 2,396	\$ 478	\$ 7,055	\$ 667	\$ 7,722
Inter-segment sales & revenues .	22	3,148	923	313	1,677	91	748	6,922	-	6,922
Total sales and revenues.....	\$ 587	\$ 3,212	\$ 1,948	\$ 711	\$ 3,806	\$ 2,487	\$ 1,226	\$ 13,977	\$ 667	\$ 14,644
Depreciation and amortization ....	\$ 3	\$ 45	\$ 15	\$ 11	\$ 77	\$ -	\$ 25	\$ 176	\$ 147	\$ 323
Imputed interest expense.....	\$ 5	\$ 16	\$ 7	\$ 5	\$ 28	\$ 1	\$ 24	\$ 86	\$ 124	\$ 210
Accountable profit (loss).....	\$ 42	\$ 339	\$ 96	\$ 51	\$ 82	\$ 145	\$ 165	\$ 920	\$ 113	\$ 1,033
Accountable assets at December 31, 2004 .....	\$ 525	\$ 2,572	\$ 1,097	\$ 775	\$ 3,900	\$ 28	\$ 3,896	\$ 12,793	\$ 24,450	\$ 37,243
Capital Expenditures .....	\$ 1	\$ 36	\$ 14	\$ 6	\$ 44	\$ 1	\$ 21	\$ 123	\$ 302	\$ 425

Business Segments Six Months Ended June 30, (Millions of dollars)										
2005	Machinery and Engines								Financing & Insurance Services	Consolidated Total
	Asia/ Pacific Marketing	Construction & Mining Products	EAME Marketing	Latin America Marketing	Power Products	North America Marketing	All Other	Total		
External sales and revenues.....	\$ 1,246	\$ 207	\$ 2,318	\$ 1,085	\$ 4,822	\$ 5,567	\$ 1,205	\$ 16,450	\$ 1,392	\$ 17,842
Inter-segment sales & revenues .	73	7,684	2,169	788	4,069	218	1,833	16,834	27	16,861
Total sales and revenues.....	\$ 1,319	\$ 7,891	\$ 4,487	\$ 1,873	\$ 8,891	\$ 5,785	\$ 3,038	\$ 33,284	\$ 1,419	\$ 34,703
Depreciation and amortization ....	\$ 7	\$ 91	\$ 33	\$ 24	\$ 148	\$ 1	\$ 43	\$ 347	\$ 320	\$ 667
Imputed interest expense.....	\$ 8	\$ 40	\$ 17	\$ 12	\$ 57	\$ 3	\$ 59	\$ 196	\$ 368	\$ 564
Accountable profit (loss).....	\$ 72	\$ 854	\$ 244	\$ 115	\$ 385	\$ 129	\$ 459	\$ 2,258	\$ 278	\$ 2,536
Accountable assets at June 30, 2005 .....	\$ 531	\$ 2,697	\$ 1,159	\$ 876	\$ 3,739	\$ 416	\$ 4,055	\$ 13,473	\$ 24,965	\$ 38,438
Capital Expenditures .....	\$ 3	\$ 105	\$ 41	\$ 14	\$ 120	\$ 1	\$ 42	\$ 326	\$ 569	\$ 895

2004	Machinery and Engines								Financing & Insurance Services	Consolidated Total
	Asia/ Pacific Marketing	Construction & Mining Products	EAME Marketing	Latin America Marketing	Power Products	North America Marketing	All Other	Total		
External sales and revenues.....	\$ 1,098	\$ 128	\$ 1,855	\$ 744	\$ 3,856	\$ 4,433	\$ 905	\$ 13,019	\$ 1,214	\$ 14,233
Inter-segment sales & revenues .	49	5,976	1,789	588	3,096	177	1,395	13,070	1	13,071
Total sales and revenues.....	\$ 1,147	\$ 6,104	\$ 3,644	\$ 1,332	\$ 6,952	\$ 4,610	\$ 2,300	\$ 26,089	\$ 1,215	\$ 27,304
Depreciation and amortization ....	\$ 6	\$ 89	\$ 30	\$ 22	\$ 150	\$ 1	\$ 49	\$ 347	\$ 296	\$ 643
Imputed interest expense.....	\$ 9	\$ 32	\$ 14	\$ 9	\$ 56	\$ 1	\$ 46	\$ 167	\$ 248	\$ 415
Accountable profit (loss).....	\$ 89	\$ 637	\$ 187	\$ 98	\$ 97	\$ 231	\$ 316	\$ 1,655	\$ 220	\$ 1,875
Accountable assets at December 31, 2004 .....	\$ 525	\$ 2,572	\$ 1,097	\$ 775	\$ 3,900	\$ 28	\$ 3,896	\$ 12,793	\$ 24,450	\$ 37,243
Capital Expenditures .....	\$ 2	\$ 58	\$ 20	\$ 11	\$ 76	\$ 1	\$ 37	\$ 205	\$ 553	\$ 758

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**Reconciliation of Sales and Revenues:**

(Millions of dollars)	<u>Machinery and Engines</u>	<u>Financing &amp; Insurance Services</u>	<u>Consolidating Adjustments</u>	<u>Consolidated Total</u>
<b>Three Months Ended June 30, 2005:</b>				
Total external sales and revenues from business segments.....	\$ 8,746	\$ 712	\$ -	\$ 9,458
Other .....	38	(56)	(80) <sup>1</sup>	(98)
Total sales and revenues .....	<u>\$ 8,784</u>	<u>\$ 656</u>	<u>\$ (80)</u>	<u>\$ 9,360</u>
<b>Three Months Ended June 30, 2004:</b>				
Total external sales and revenues from business segments.....	\$ 7,055	\$ 667	\$ -	\$ 7,722
Other .....	45	(34)	(150) <sup>1</sup>	(139)
Total sales and revenues .....	<u>\$ 7,100</u>	<u>\$ 633</u>	<u>\$ (150)</u>	<u>\$ 7,583</u>

<sup>1</sup> Elimination of Financial Products revenues from Machinery and Engines.

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**Reconciliation of Sales and Revenues:**

(Millions of dollars)	<u>Machinery and Engines</u>	<u>Financing &amp; Insurance Services</u>	<u>Consolidating Adjustments</u>	<u>Consolidated Total</u>
<b>Six Months Ended June 30, 2005:</b>				
Total external sales and revenues from business segments.....	\$ 16,450	\$ 1,392	\$ -	\$ 17,842
Other .....	123	(124)	(142) <sup>1</sup>	(143)
Total sales and revenues .....	<u>\$ 16,573</u>	<u>\$ 1,268</u>	<u>\$ (142)</u>	<u>\$ 17,699</u>
<b>Six Months Ended June 30, 2004:</b>				
Total external sales and revenues from business segments.....	\$ 13,019	\$ 1,214	\$ -	\$ 14,233
Other .....	83	(64)	(189) <sup>1</sup>	(170)
Total sales and revenues .....	<u>\$ 13,102</u>	<u>\$ 1,150</u>	<u>\$ (189)</u>	<u>\$ 14,063</u>

<sup>1</sup> Elimination of Financial Products revenues from Machinery and Engines.

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**Reconciliation of Profit Before Taxes:**
**(Millions of dollars)**
**Three Months Ended June 30, 2005:**

	<b>Machinery and Engines</b>	<b>Financing &amp; Insurance Services</b>	<b>Consolidated Total</b>
Total accountable profit from business segments .....	\$ 1,295	\$ 149	\$ 1,444
Corporate costs .....	(218)	-	(218)
Timing .....	(41)	-	(41)
Methodology differences:			
Inventory/cost of sales .....	(8)	-	(8)
Postretirement benefit expense .....	(98)	-	(98)
Financing costs .....	(5)	-	(5)
Equity in profit of unconsolidated affiliated companies .....	(26)	(3)	(29)
Currency .....	4	-	4
Other methodology differences .....	(13)	5	(8)
Other .....	5	-	5
Total profit before taxes .....	<u>\$ 895</u>	<u>\$ 151</u>	<u>\$ 1,046</u>

**Three Months Ended June 30, 2004:**

Total accountable profit from business segments .....	\$ 920	\$ 113	\$ 1,033
Corporate costs .....	(132)	-	(132)
Timing .....	(34)	-	(34)
Methodology differences:			
Inventory/cost of sales .....	(25)	-	(25)
Postretirement benefit expense .....	(72)	-	(72)
Financing costs .....	9	-	9
Equity in profit of unconsolidated affiliated companies .....	(13)	(1)	(14)
Currency .....	(2)	-	(2)
Other methodology differences .....	(22)	7	(15)
Other .....	13	-	13
Total profit before taxes .....	<u>\$ 642</u>	<u>\$ 119</u>	<u>\$ 761</u>

**Reconciliation of Profit Before Taxes:**
**(Millions of dollars)**
**Six Months Ended June 30, 2005:**

	<b>Machinery and Engines</b>	<b>Financing &amp; Insurance Services</b>	<b>Consolidated Total</b>
Total accountable profit from business segments .....	\$ 2,258	\$ 278	\$ 2,536
Corporate costs .....	(387)	-	(387)
Timing .....	(67)	-	(67)
Methodology differences:			
Inventory/cost of sales .....	(25)	-	(25)
Postretirement benefit expense .....	(196)	-	(196)
Financing costs .....	2	-	2
Equity in profit of unconsolidated affiliated companies .....	(38)	(5)	(43)
Currency .....	12	-	12
Other methodology differences .....	(10)	10	-
Other .....	13	-	13
Total profit before taxes .....	<u>\$ 1,562</u>	<u>\$ 283</u>	<u>\$ 1,845</u>

**Six Months Ended June 30, 2004:**

Total accountable profit from business segments .....	\$ 1,655	\$ 220	\$ 1,875
Corporate costs .....	(262)	-	(262)
Timing .....	(89)	-	(89)
Methodology differences:			
Inventory/cost of sales .....	(54)	-	(54)
Postretirement benefit expense .....	(147)	-	(147)
Financing costs .....	26	-	26
Equity in profit of unconsolidated affiliated companies .....	(18)	(2)	(20)
Currency .....	10	-	10
Other methodology differences .....	(38)	15	(23)
Other .....	17	-	17
Total profit before taxes .....	<u>\$ 1,100</u>	<u>\$ 233</u>	<u>\$ 1,333</u>



**Reconciliation of Assets:**

(Millions of dollars)	Machinery and Engines	Financing & Insurance Services	Consolidating Adjustments	Consolidated Total
<b>June 30, 2005:</b>				
Total accountable assets from business segments .....	\$ 13,473	\$ 24,965	\$ -	\$ 38,438
Items not included in segment assets:				
Cash and short-term investments .....	464	285	-	749
Intercompany receivables .....	482	46	(528)	-
Trade and other receivables .....	517	-	-	517
Investment in unconsolidated affiliated companies ..	396	-	-	396
Investment in Financial Products .....	3,088	-	(3,088)	-
Deferred income taxes and prepaids .....	2,607	97	(344)	2,360
Intangible assets and other assets .....	2,275	-	-	2,275
Service center assets .....	990	-	-	990
Liabilities included in segment assets .....	1,393	14	-	1,407
Inventory methodology differences .....	(2,316)	-	-	(2,316)
Other .....	90	(83)	-	7
Total assets .....	<u>\$ 23,459</u>	<u>\$ 25,324</u>	<u>\$ (3,960)</u>	<u>\$ 44,823</u>
<b>December 31, 2004:</b>				
Total accountable assets from business segments .....	\$ 12,793	\$ 24,450	\$ -	\$ 37,243
Items not included in segment assets:				
Cash and short-term investments .....	270	175	-	445
Intercompany receivables .....	443	18	(461)	-
Trade and other receivables .....	547	-	-	547
Investment in unconsolidated affiliated companies ..	367	-	(1)	366
Investment in Financial Products .....	3,012	-	(3,012)	-
Deferred income taxes and prepaids .....	2,477	92	(317)	2,252
Intangible assets and other assets .....	2,158	-	-	2,158
Service center assets .....	1,001	-	-	1,001
Liabilities included in segment assets .....	1,346	-	-	1,346
Inventory methodology differences .....	(2,235)	-	-	(2,235)
Other .....	90	(123)	5	(28)
Total assets .....	<u>\$ 22,269</u>	<u>\$ 24,612</u>	<u>\$ (3,786)</u>	<u>\$ 43,095</u>

**15. Asset Securitizations****A. Finance Receivables**

During the second quarter of 2005, Cat Financial securitized retail installment sale contracts and finance leases into a public asset-backed securitization facility. These finance receivables, which are being held in a securitization trust, are secured by new and used equipment. Cat Financial retained servicing responsibilities and subordinated interests related to this securitization. Subordinated interests include subordinated certificates with an initial fair value of \$8 million, an interest in future cash flows (excess) with an initial fair value of \$1 million, and a reserve account with an initial fair value of \$12 million. Cat Financial's retained interests are generally subordinate to the investors' interests. Net proceeds received were \$850 million, which includes both cash proceeds and retained interests. A net gain of \$12 million was recognized on this transaction. Significant assumptions used to estimate the fair value of the retained interests and subordinated certificates include a 10.8% discount rate, a weighted-average prepayment rate of 14.0%, and expected credit losses of 1.0%. Cat Financial receives annual servicing fees of 1.0% of the unpaid note value.

In the second quarter of 2004, a public securitization also occurred. Subordinated interests included subordinated certificates with an initial fair value of \$8 million, an interest in future cash flows (excess) with an initial fair value of \$2 million, and a reserve account with an initial fair value of \$10 million. Net proceeds received were \$659 million, which includes both cash proceeds and retained interests. A net gain of \$13 million was recognized on this transaction. Significant assumptions used to estimate the fair value of the retained interests and subordinated certificates in this transaction include a 10.7% discount rate, a weighted-average prepayment rate of 14.0%, and expected credit losses of 1.0%. Cat Financial receives annual servicing fees of 1.0% of the unpaid note value.

Cat Financial determines the fair value based on discounted cash flow models that incorporate assumptions including credit losses, prepayment rates, and discount rates. These assumptions are based on their historical experience, market trends, and anticipated performance relative to the particular assets securitized.

## **B. Trade Receivables**

Our Machinery and Engines operations generate trade receivables from the sale of inventory to dealers and customers. Certain of these receivables are sold to Cat Financial. Cat Financial holds the receivables and periodically securitizes a portion of the dealer receivables using a revolving securitization structure. The trust issues a collateralized trust obligation (CTO) certificate to third party purchasers for their portion of these receivables. The trust also issues a transferor certificate (certificated retained interests) to Cat Financial for the portion not represented by the CTO.

Through August of 2004, the trust was a qualifying special purpose entity (QSPE) and thus, in accordance with Statement of Financial Accounting Standard 140 (SFAS 140) "Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities," was not consolidated. The outstanding principal balance of the CTO (\$240 million) was not included in our Consolidated Statement of Financial Position during these periods. The certificated retained interests were included in "Retained Interests in Securitized Trade Receivables" in the Consolidated Statement of Financial Position.

From September of 2004 through May of 2005, our certificated retained interests in the trust exceeded 90% of the fair value of trust assets. Thus, during this period, the trust did not qualify as a QSPE as defined by SFAS 140. We therefore consolidated the trust in accordance with FIN 46R, "Consolidation of Variable Interest Entities" (revised) as it represents a variable interest entity for which Cat Financial is the primary beneficiary.

In June 2005, the trust was terminated and the \$240 million of receivables held by the trust (in the form of a CTO) were transferred back to Cat Financial, who then transferred an undivided interest in the receivables to third-party purchasers. In accordance with SFAS 140 the latter transfer was accounted for as a sale.

## **16. Stockholders' Rights Plan**

On June 17, 2005, Caterpillar Inc. executed a Fourth Amended and Restated version of its Stockholders' Rights Plan with Mellon Investor Services LLC. The modified agreement calls for the final termination date of the Stockholders' Rights Plan to be moved up from December 11, 2006 to June 30, 2005, terminating the Stockholders' Rights Plan approximately 17 months earlier than the original agreement and subsequent amendments had specified.

## **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

### **A. Overview**

Bolstered by continued global strength in the markets and industries we serve, we reported record second-quarter sales and revenues of \$9.360 billion and record profit of \$760 million, or \$1.08 per share. First half of the year results were also records, with company sales and revenues of \$17.699 billion and profit of \$1.341 billion, or \$1.89 per share.

Our global markets continue to exhibit the fundamental strengths needed for further growth, and Team Caterpillar remains well positioned to leverage this unprecedented opportunity now and in the years ahead. We're aggressively pursuing improvement – utilizing our leadership position, strong cash flow and global capabilities in engineering, purchasing, sales and manufacturing to enhance the value customers and stockholders receive from an investment in Caterpillar.

Sales and revenues of \$9.360 billion were up \$1.777 billion, or 23 percent, compared to \$7.583 billion in the second quarter of 2004. Improving **sales volume** and **price realization** drove the increase in sales and revenues.

Profit of \$760 million, or \$1.08 a share, was up 34 percent compared to profit of \$566 million in the second quarter of 2004. The main contributors were improved price realization and sales volume, partially offset by higher **core operating costs**, about half of which were material costs.

We're very pleased that this quarter marks another improvement in our profitability as measured by return on sales – 8.1 percent this quarter compared to 7.5 percent a year ago. Somewhat better prices were a positive factor in the profit improvement, and for the most part, we expect the price increases announced earlier this year to hold in the marketplace. That said, we are closely monitoring the competitive landscape and are determined to hold our market position. Further, our results continue to be positively driven by literally hundreds of **6 Sigma** projects, which are being completed every month.

The outlook for 2005 has been increased over previously reported levels. Sales and revenues are now expected to be up 18 to 20 percent from 2004. The profit outlook for 2005 has also been improved to reflect an estimated profit range of \$4.00 to \$4.20 per share.

The previous outlook reflected sales and revenues up 16 to 18 percent, and profit per share of \$3.89 to \$4.03, up 35 to 40 percent from 2004.

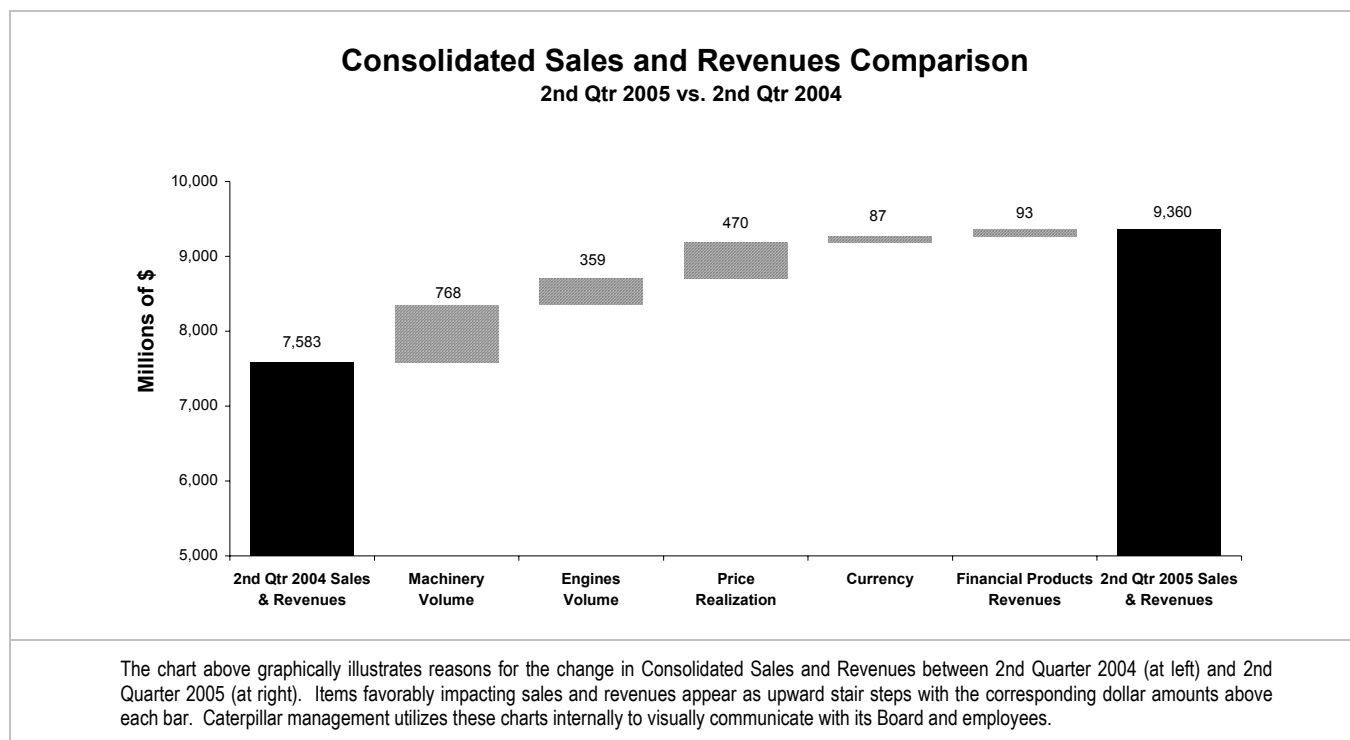
The strength of our markets is clearly not a blip on the radar. Key indicators such as low interest rates, robust commodity prices and needed investment for capacity in electric power and energy production point to continued growth. While this growth is expected to continue in the near term, we're laying a solid foundation for our future by staying focused on prudently managing our cost structure and margins while continuing to invest in new products and production capacity to meet strong customer demand.

*Note: Glossary of terms included on pages 37-38; first occurrence of terms shown in bold italics.*

## B. Consolidated Results of Operations

### THREE MONTHS ENDED JUNE 30, 2005 COMPARED WITH THREE MONTHS ENDED JUNE 30, 2004

#### SALES AND REVENUES



Sales and revenues for the second quarter of 2005 were \$9.360 billion, up \$1.777 billion or 23 percent from second quarter 2004. **Machinery** volume was up \$768 million, **Engines** volume was up \$359 million, price realization improved \$470 million, and **currency** had a positive impact on sales of \$87 million, due primarily to a stronger euro compared with second quarter 2004. In addition, **Financial Products** revenues increased \$93 million.

#### Sales and Revenues by Geographic Region

(Millions of dollars)										
	Total	% Change	North America	% Change	EAME	% Change	Latin America	% Change	Asia/Pacific	% Change
<b>2nd Quarter 2005</b>										
Machinery.....	\$ 6,026	25%	\$ 3,321	24%	\$ 1,430	23%	\$ 526	52%	\$ 749	15%
Engines <sup>1</sup> .....	2,758	22%	1,226	22%	949	29%	251	42%	332	-6%
Financial Products <sup>2</sup> .....	576	19%	410	20%	84	1%	35	21%	47	57%
	<u>\$ 9,360</u>	23%	<u>\$ 4,957</u>	23%	<u>\$ 2,463</u>	24%	<u>\$ 812</u>	47%	<u>\$ 1,128</u>	9%
<b>2nd Quarter 2004</b>										
Machinery.....	\$ 4,836		\$ 2,674		\$ 1,163		\$ 346		\$ 653	
Engines <sup>1</sup> .....	2,264		1,001		733		177		353	
Financial Products <sup>2</sup> .....	483		341		83		29		30	
	<u>\$ 7,583</u>		<u>\$ 4,016</u>		<u>\$ 1,979</u>		<u>\$ 552</u>		<u>\$ 1,036</u>	

<sup>1</sup> Does not include internal engine transfers of \$537 million and \$447 million in 2005 and 2004, respectively. Internal engine transfers are valued at prices comparable to those for unrelated parties.

<sup>2</sup> Does not include revenues earned from **Machinery and Engines** of \$80 million and \$150 million in 2005 and 2004, respectively.

## Machinery Sales

Machinery sales were \$6.026 billion in the second quarter of 2005 – up \$1.190 billion or 25 percent from the second quarter of 2004. Sales volume was \$768 million of the increase, price realization accounted for \$366 million, and the remaining \$56 million was due to currency. Sales volume benefited from continued strong growth in dealer sales to end users in all regions and in nearly all industries.

Dealer machine inventory declined during the second quarters of both 2004 and 2005, which is a normal seasonal development. The decline during the second quarter of 2005 was greater than a year ago, reflecting dealer efforts to maintain inventories in line with deliveries. As a result, the inventory decline had a slightly moderating effect on quarter-over-quarter sales growth. Worldwide, machine inventories in months of sales are at historical lows for this time of the year.

- **North America** sales were up \$647 million or 24 percent. Benefiting from strong demand in most applications, sales volume increased \$421 million and price realization added \$226 million. Low interest rates and rising home prices supported housing construction, and nonresidential construction benefited from record corporate profits and favorable credit conditions. Mining remained strong – the result of higher coal and metals prices.
- **EAME** sales were up \$267 million or 23 percent -- \$162 million from higher volume, \$69 million from improved price realization, and \$36 million from a favorable currency impact, primarily due to the stronger euro. Sales volume in Europe, where the economy remained weak, was up slightly, the result of a continued recovery in housing construction and some improvement in business investment. Higher metals and energy prices allowed robust economic growth to continue in both Africa/Middle East (AME) and the Commonwealth of Independent States (CIS). As a result, sales volume in those two regions increased significantly.
- **Latin America** sales increased \$180 million or 52 percent -- \$132 million from higher volume, \$37 million from improved price realization, and the remaining \$11 million was due to currency. The region continued to benefit from increased capital inflows, higher metals and energy prices, and low domestic interest rates. Sales increased rapidly in most countries and in most applications throughout Latin America.
- **Asia/Pacific** sales were up \$96 million or 15 percent -- \$53 million from higher volume, \$34 million from improved price realization and the remaining \$9 million due to currency. Robust mining activity drove sales gains in Australia, India and Indonesia. Sales in China improved over the past three quarters but remained below last year's record second quarter. The Chinese government's administrative actions to slow construction last year caused sales to drop sharply in the last half of 2004. A return to more normal conditions, along with increased financing from Cat Financial, contributed to the improved sales.

## Engines Sales

Engines sales were \$2.758 billion in the second quarter of 2005, up \$494 million or 22 percent from the second quarter of 2004. Sales volume was \$359 million of the increase, price realization added \$104 million, and the favorable impact of currency accounted for \$31 million of the increase.

Dealer engine inventory increased at a slower rate during the second quarter of 2005, compared to the rate of increase during the second quarter of 2004. The lower rate of dealer inventory increases during the second quarter of 2005 had a slight moderating effect on quarter-over-quarter sales growth. Overall, dealer engine inventories are in line with selling rates.

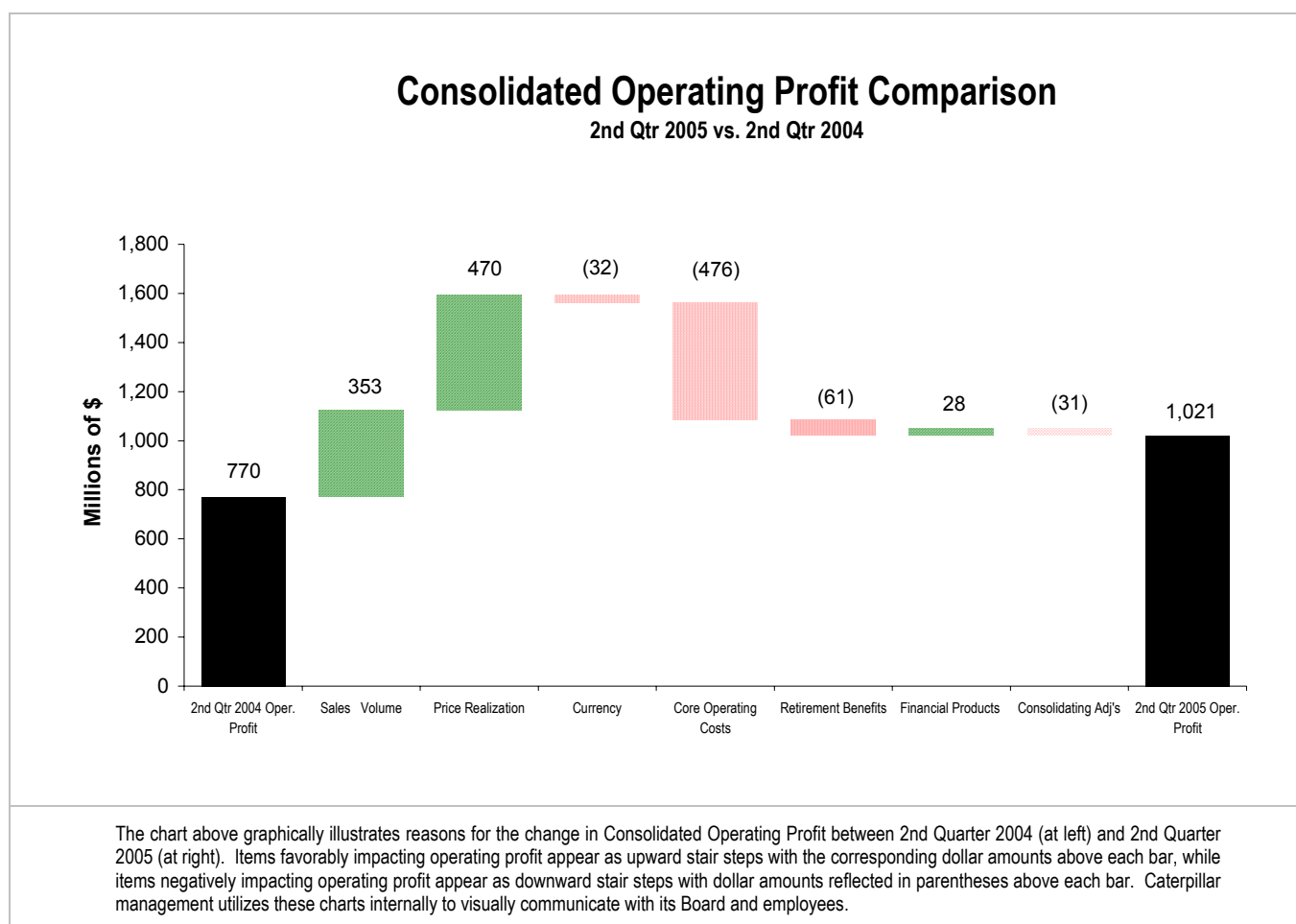
- **North America** sales were up 22 percent. Sales of on-highway truck engines increased 23 percent, as the industry continued to expand and we maintained our leadership position. On-highway truck growth was a result of increased tonnage versus a year ago, healthy freight carrier profitability and aging fleet replacements. Sales to the petroleum sector increased 69 percent, as high energy prices drove exploration and production. Sales to the electric power sector increased 12 percent, benefiting from investment in data and communication systems, and the impact of tax credits for investment in natural gas generators. Sales to the marine sector were about flat.
- **EAME** sales were up 29 percent. Sales into the electric power sector were up 67 percent, driven by strong demand for prime and standby generator sets, and incremental sales from the acquisition of Turbomach. Sales into the marine sector rose 46 percent, primarily due to strong tugboat demand to support port and shipping activity. Sales of engines to the petroleum sector were down 37 percent with reduced sales of turbines and turbine related services for petroleum projects in the Africa/Middle East region, due primarily to timing of major projects quarter to quarter.

- **Latin America** sales were up 42 percent. Sales of petroleum engines increased 29 percent driven by investments in production capacity. Sales of electric power engines were up 50 percent, primarily influenced by sales of generator sets for disaster preparedness.
- **Asia/Pacific** sales were down 6 percent. Sales of engines to the petroleum sector declined 18 percent primarily as a result of lower sales of turbines and related services due to the timing of major infrastructure projects. Partially offsetting the decrease was a 36 percent increase in marine engine sales driven by strong demand for oceangoing vessels and workboats. Sales to the electric power sector increased 2 percent driven by general business investment in construction and real estate development.

### Financial Products Revenues

Financial Products revenues were \$576 million, up \$93 million or 19 percent from second quarter 2004. The increase was due primarily to a \$69 million favorable impact from continued growth of **earning assets** at Cat Financial.

### OPERATING PROFIT



Second-quarter operating profit improved \$251 million, or 33 percent over a year ago, driven by higher price realization and sales volume. In addition, Financial Products contributed \$28 million to the increase in operating profit.

The improvement in price realization was primarily a result of price increases taken over the past year. Most of the price increases taken during the second quarter of 2005 were not fully realized in the quarter as a result of the timing of the increases and price protection policies.

Partially offsetting the favorable items were \$476 million in higher core operating costs, \$61 million of higher retirement benefits and a \$32 million unfavorable impact of currency on operating profit. Manufacturing costs represented \$400 million of the total increase in core operating costs. Approximately two-thirds of the manufacturing cost increase was attributable to variable cost increases – 90 percent of which resulted from higher material costs (primarily steel) with the remainder related to supply chain inefficiencies. The other one-third of the increase in manufacturing costs was the result of a 15 percent, or approximately \$130 million, increase in period manufacturing costs to support a 24 percent increase in Machinery and Engines sales volume.

Non-manufacturing related core operating costs were up \$76 million – a result of higher Research and Development (R&D) and Selling, General and Administrative (SG&A) expenses to support product programs and the growth in volume. As a percent of sales and revenues, the total of SG&A and R&D expenses were lower than the second quarter of 2004.

#### **Operating Profit by Principal Line of Business**

<b>(Millions of dollars)</b>	<b>2<sup>nd</sup> Quarter 2004</b>	<b>2<sup>nd</sup> Quarter 2005</b>	<b>Change \$</b>
Machinery <sup>1</sup> .....	\$ 538	\$ 676	\$ 138
Engines <sup>1</sup> .....	149	265	116
Financial Products .....	114	142	28
<b>Consolidating Adjustments</b> .....	(31)	(62)	(31)
Consolidated Operating Profit .....	<u>\$ 770</u>	<u>\$ 1,021</u>	<u>\$ 251</u>

<sup>1</sup> Caterpillar operations are highly integrated; therefore, the company uses a number of allocations to determine lines of business operating profit for Machinery and Engines.

#### **Operating Profit by Principal Line of Business**

- **Machinery** operating profit of \$676 million was up \$138 million, or 26 percent, from second quarter 2004. The favorable impact of improved price realization and higher sales volume was partially offset by higher core operating costs, higher **retirement benefits** and the unfavorable impact of currency.
- **Engines** operating profit of \$265 million was up \$116 million, or 78 percent, from second quarter 2004. The favorable impact of higher sales volume and improved price realization was partially offset by higher core operating costs, higher retirement benefits and the unfavorable impact of currency.
- **Financial Products** operating profit of \$142 million was up \$28 million, or 25 percent, from second quarter 2004. The increase was primarily due to a \$33 million impact from the growth of earning assets and a \$12 million impact of lower provision for credit losses due to improved portfolio health, partially offset by a \$11 million increase in operating expenses primarily related to growth at Cat Financial. In addition, there was a \$9 million unfavorable impact due to favorable reserve adjustments being higher in 2004 than in 2005 at Cat Insurance.

## Reconciliation of Machinery and Engine Sales by Geographic Region to External Sales by Marketing Segment

(Millions of Dollars)	Three months ended June 30,	
	2005	2004
North America Geographic Region.....	\$ 4,547	\$ 3,675
Engine sales included in the Power Products segment.....	(1,226)	(1,001)
Company owned dealer sales included in the All Other segment.....	(207)	(133)
Other* .....	(129)	(145)
North America Marketing external sales .....	<u>\$ 2,985</u>	<u>\$ 2,396</u>
EAME Geographic Region.....	\$ 2,379	\$ 1,896
Power Products sales not included in the EAME Marketing segment.....	(907)	(713)
Other* .....	(267)	(158)
EAME Marketing external sales .....	<u>\$ 1,205</u>	<u>\$ 1,025</u>
Latin America Geographic Region .....	\$ 777	\$ 523
Power Products sales not included in the Latin America Marketing segment .....	(212)	(164)
Other* .....	33	39
Latin America Marketing external sales .....	<u>\$ 598</u>	<u>\$ 398</u>
Asia/Pacific Geographic Region .....	\$ 1,081	\$ 1,006
Power Products sales not included in the Asia/Pacific Marketing segment.....	(246)	(251)
Other* .....	(187)	(190)
Asia/Pacific Marketing external sales .....	<u>\$ 648</u>	<u>\$ 565</u>

\* Mostly represents external sales of Construction and Mining Products and All Other segments.

## OTHER PROFIT/LOSS ITEMS

- **Other income/expense** was income of \$90 million compared with income of \$50 million in the second quarter of 2004 for a favorable impact of \$40 million. The change was primarily due to the favorable impact of currency gains of \$33 million.
- **The provision for income taxes** in the second quarter reflects an estimated annual tax rate of 29 percent, excluding the discrete items discussed below, and compares to a 27 percent rate in 2004. The increase is primarily due to the impact of the American Jobs Creation Act permitting only 80 percent of Extraterritorial Income Exclusion (ETI) benefits in 2005 as well as a change in our geographic mix of profits.

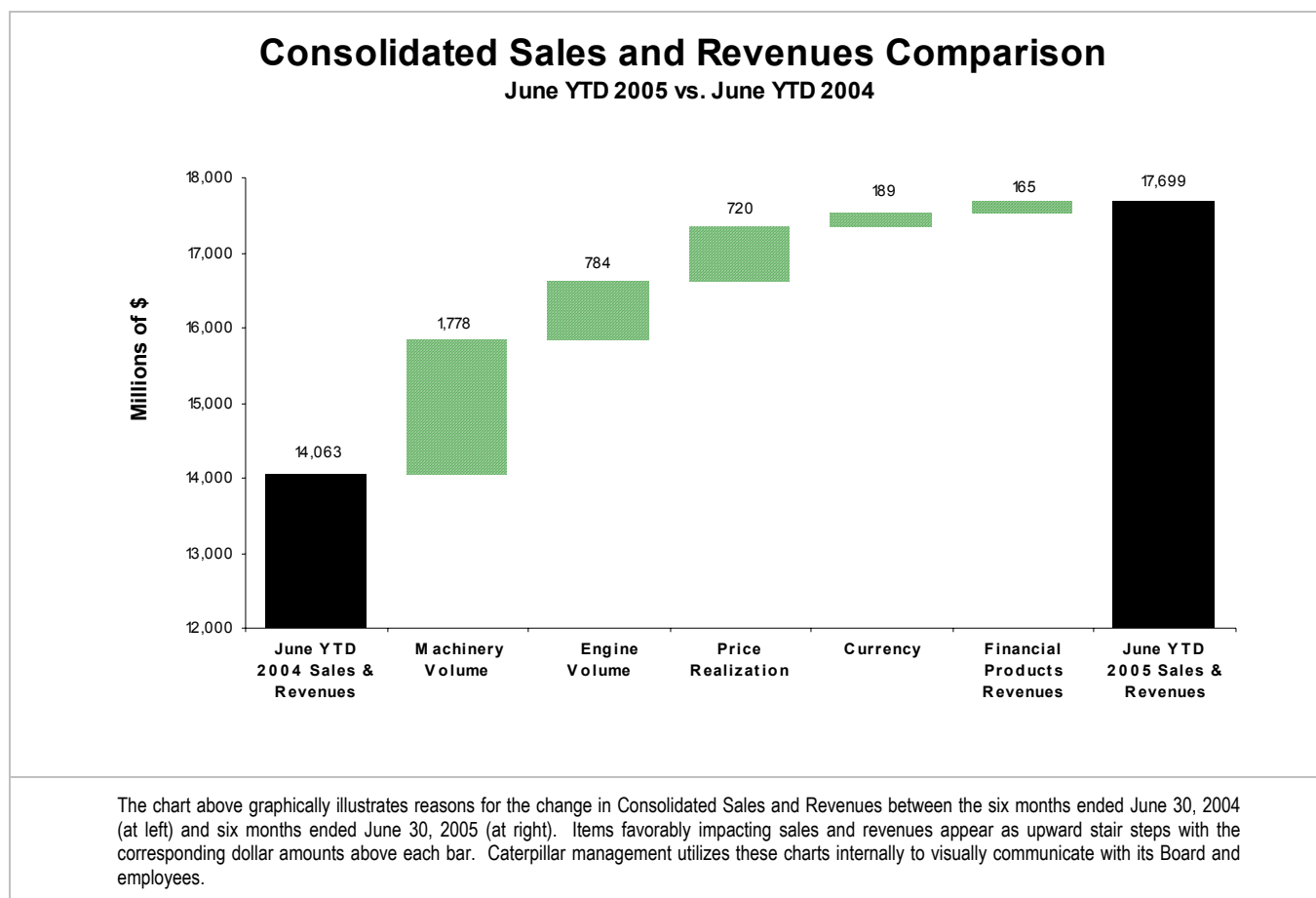
In the second quarter, we completed our evaluation of the repatriation provisions of the American Jobs Creation Act and recognized an income tax charge of \$49 million under the provisions of the Act. We expect to repatriate earnings of approximately \$1.4 billion in 2005, which includes \$500 million subject to the preferential tax treatment allowed by the Act. In connection with our current repatriation plan, we now intend to indefinitely reinvest earnings of a few selected non-U.S. subsidiaries and have recognized an income tax benefit of \$38 million. The net impact of these items is an \$11 million discrete charge to our second quarter provision for income taxes.

- **The equity in profit/loss of unconsolidated affiliated companies** favorably impacted profit by \$15 million over second quarter 2004, primarily driven by increased profitability at Shin Caterpillar Mitsubishi Ltd. (SCM).



## SIX MONTHS ENDED JUNE 30, 2005 COMPARED WITH SIX MONTHS ENDED JUNE 30, 2004

### SALES AND REVENUES



Sales and revenues for the six months ended June 30, 2005 were \$17.699 billion, up \$3.636 billion or 26 percent from the first six months of 2004. Machinery volume was up \$1.778 billion, Engines volume was up \$784 million, price realization improved \$720 million, and currency had a positive impact on sales of \$189 million, due primarily to a stronger euro compared with the six months ended June 30, 2004. In addition, Financial Products revenues increased \$165 million.

### Sales and Revenues by Geographic Region

(Millions of dollars)

	Total	% Change	North America	% Change	EAME	% Change	Latin America	% Change	Asia/Pacific	% Change
<b>Six months ended June 30, 2005</b>										
Machinery.....	\$ 11,426	27%	\$ 6,249	26%	\$ 2,785	31%	\$ 966	51%	\$ 1,426	13%
Engines <sup>1</sup> .....	5,147	25%	2,426	30%	1,692	31%	408	10%	621	7%
Financial Products <sup>2</sup> .....	1,126	17%	800	18%	171	2%	66	12%	89	53%
	<u>\$ 17,699</u>	26%	<u>\$ 9,475</u>	26%	<u>\$ 4,648</u>	30%	<u>\$ 1,440</u>	34%	<u>\$ 2,136</u>	12%
<b>Six months ended June 30, 2004</b>										
Machinery.....	\$ 8,988		\$ 4,957		\$ 2,126		\$ 641		\$ 1,264	
Engines <sup>1</sup> .....	4,114		1,871		1,292		372		579	
Financial Products <sup>2</sup> .....	961		677		167		59		58	
	<u>\$ 14,063</u>		<u>\$ 7,505</u>		<u>\$ 3,585</u>		<u>\$ 1,072</u>		<u>\$ 1,901</u>	

<sup>1</sup> Does not include internal engine transfers of \$1,156 million and \$931 million in 2005 and 2004, respectively. Internal engine transfers are valued at prices comparable to those for unrelated parties.

<sup>2</sup> Does not include revenues earned from Machinery and Engines of \$142 million and \$189 million in 2005 and 2004, respectively.

## **Machinery Sales**

Machinery sales were \$11.426 billion for the six months ended June 30, 2005 – up \$2.438 billion or 27 percent from the six months ended June 30, 2004. Sales volume was \$1.778 billion of the increase, price realization accounted for \$534 million, and the remaining \$126 million was due to currency. The world economy, particularly in the investment sectors, continued good growth, allowing dealers in all regions to increase deliveries in nearly all industries. Dealers added slightly more to their inventories than in the first half of 2004, which positively affected first half of 2005 sales growth. However, worldwide machine inventories at the end of June 2005, relative to delivery rates, were at historical lows for this time of year.

- **North America** sales were up \$1.292 billion or 26 percent. Benefiting from strong demand in most applications, sales volume increased \$980 million and price realization added \$312 million. The increase in sales volume resulted largely from higher dealer deliveries than last year. Deliveries into mining continued to advance rapidly as both metals and coal prices averaged well above last year and mines increased production. Deliveries in general construction benefited from low mortgage interest rates, which caused housing construction to grow, and favorable business cash flow, which led to an improvement in nonresidential construction.
- **EAME** sales were up \$659 million or 31 percent -- \$445 million from higher volume, \$117 million from improved price realization, and \$97 million from a favorable currency impact, primarily due to the stronger euro. While the European economy had a weak first half, sales volume increased slightly due to the favorable impact of low interest rates on housing. Economic growth was robust in both Africa/Middle East and the CIS, driven by much higher energy and metals prices. These two regions accounted for disproportionate shares of the sales volume growth.
- **Latin America** sales increased \$325 million or 51 percent -- \$252 million from higher volume, \$57 million from improved price realization, and the remaining \$16 million due to the favorable currency impact of a stronger Brazilian real. The regional economy, which benefited significantly from the recovery in commodity prices, continued a solid recovery. Both mining production and construction rose. Dealers in most countries increased deliveries significantly.
- **Asia/Pacific** sales were up \$162 million or 13 percent -- \$101 million from higher volume, \$48 million from improved price realization and the remaining \$13 million due to currency. Australia, Indonesia and India, where mining boomed, largely accounted for the increase in sales volume. While sales volume in China trailed that of last year, the quarter-to-quarter pattern in sales volume improved.

## **Engines Sales**

Engines sales were \$5.147 billion in the six months ended June 30, 2005, up \$1.033 billion or 25 percent from the six months ended June 30, 2004. Sales volume was \$784 million of the increase, price realization added \$186 million, and the favorable impact of currency accounted for \$63 million of the increase. Dealers also increased their engine inventories to accommodate higher deliveries, which contributed to first half over first half volume growth. Overall, dealer inventories relative to deliveries decreased during the first half of 2005, and are at about the same level as last year.

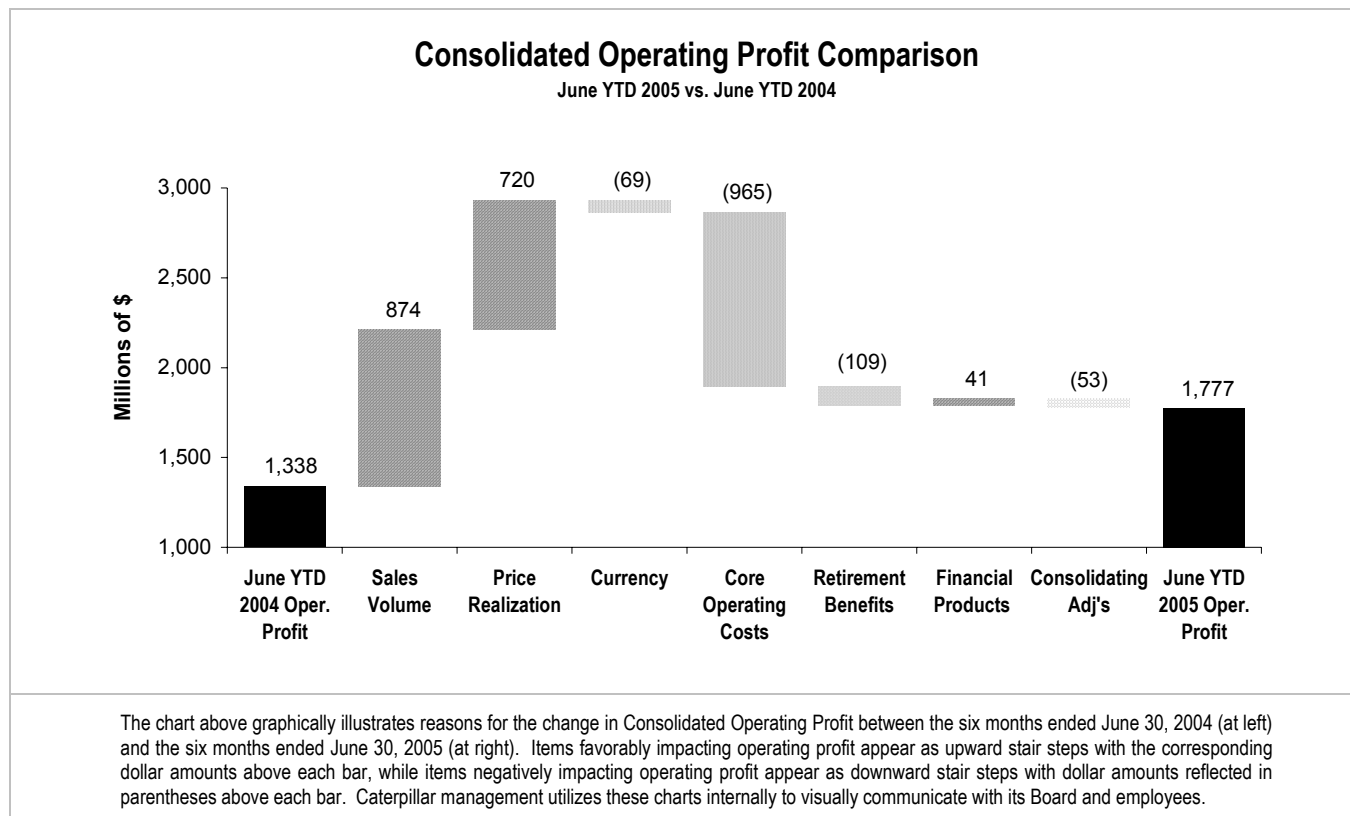
- **North America** sales were up 30 percent. Sales of on-highway truck engines increased 31 percent, as the industry continued to expand and we maintained our leadership position. Sales to the petroleum sector increased 60 percent driven by increases in exploration and production. Sales to the electric power sector increased 8 percent, benefiting from investment in data and communication systems. Increased electric power sales were partially offset by reduced sales of turbines and turbine related services due to less favorable economics for small power plants. Sales to the marine sector were up 21 percent with higher demand for workboats.
- **EAME** sales were up 31 percent. Sales into the electric power sector were up 66 percent, driven by strong demand for prime and standby generator sets, and incremental sales from the acquisition of Turbomach. Sales into the marine sector rose 56 percent, benefiting from increased demand for port support and inland waterways workboats. Sales of engines to the petroleum sector were down 27 percent with reduced sales of turbines and turbine related services for petroleum projects in the Africa/Middle East region, due primarily to timing of major projects first half to first half.
- **Latin America** sales were up 10 percent. Sales of petroleum engines increased 11 percent driven by investments in production capacity. Sales of electric power engines were up 15 percent, primarily influenced by sales of generator sets for disaster preparedness.

- **Asia/Pacific** sales were up 7 percent. Sales of engines to the marine sector increased 40 percent driven by strong demand for oceangoing vessels and workboats. Sales to the electric power sector increased 6 percent driven by general business investment in construction and real estate development. Sales of engines to the petroleum sector increased 5 percent, with all of the increase coming from turbines and turbine related services to support investments in exploration and production.

## **Financial Products Revenues**

Financial Products revenues were \$1.126 billion, an increase of \$165 million or 17 percent from the first six months of 2004. The increase was due primarily to a \$134 million favorable impact from continued growth of earning assets at Cat Financial.

## **OPERATING PROFIT**



Higher sales and revenues in all regions and most industries resulted in a favorable operating profit impact of \$439 million, or 33 percent compared to the first six months of 2004. This increase was driven by higher sales volume of \$874 million and higher price realization of \$720 million. In addition, Financial Products contributed \$41 million to the increase in operating profit.

The improvement in price realization was primarily a result of price increases taken over the past year. Most of the price increases taken during the second quarter of 2005 were not fully realized in the quarter as a result of the timing of the increases and price protection policies.

Partially offsetting the favorable items were \$965 million in higher core operating costs, \$109 million of higher retirement benefits and a \$69 million unfavorable impact of currency on operating profit. Manufacturing costs represented \$839 million of the total increase in core operating costs. Roughly two-thirds of the manufacturing cost increase was attributable to variable cost increases – approximately three-fourths of which resulted from higher material costs (primarily steel) with the remainder related to supply chain inefficiencies. The remaining one-third of the increase in manufacturing costs was the result of a 13 percent, or approximately \$230 million, increase in period manufacturing costs to support a 26 percent increase in Machinery and Engines sales. Non-manufacturing related core operating costs were up \$126 million – a result of higher SG&A and R&D expenses to support the growth in volume and product programs. As a percent of sales and revenues, the total of SG&A and R&D expenses were lower than the six months ended June 30, 2004.

#### Operating Profit by Principal Line of Business

(Millions of dollars)	Six Months Ended June 30, 2004	Six Months Ended June 30, 2005	Change \$
Machinery <sup>1</sup> .....	\$ 979	\$ 1,172	\$ 193
Engines <sup>1</sup> .....	190	448	258
Financial Products .....	225	266	41
Consolidating Adjustments .....	(56)	(109)	(53)
Consolidated Operating Profit .....	\$ 1,338	\$ 1,777	\$ 439

<sup>1</sup> Caterpillar operations are highly integrated; therefore, the company uses a number of allocations to determine lines of business operating profit for Machinery and Engines.

#### Operating Profit by Principal Line of Business

- **Machinery** operating profit of \$1.172 billion was up \$193 million, or 20 percent, from the six months ended June 30, 2004. The favorable impact of higher sales volume and improved price realization was partially offset by higher core operating costs, higher retirement benefits and the unfavorable impact of currency.
- **Engines** operating profit of \$448 million was up \$258 million, or 136 percent, from the six months ended June 30, 2004. The favorable impact of higher sales volume and improved price realization was partially offset by higher core operating costs, higher retirement benefits, and the unfavorable impact of currency.
- **Financial Products** operating profit of \$266 million was up \$41 million, or 18 percent, from the six months ended June 30, 2004. The increase was primarily due to a \$62 million impact from the growth of earning assets and a \$16 million impact of lower provision for credit losses due to improved portfolio health at Cat Financial. These favorable items were partially offset by a \$22 million increase in operating expenses primarily related to growth at Cat Financial and an \$11 million unfavorable impact due to favorable reserve adjustments being higher in 2004 than in 2005 at Cat Insurance.

## Reconciliation of Machinery and Engine Sales by Geographic Region to External Sales by Marketing Segment

(Millions of Dollars)	Six months ended June 30,	
	2005	2004
North America Geographic Region.....	\$ 8,675	\$ 6,828
Engine sales included in the Power Products segment.....	(2,426)	(1,871)
Company owned dealer sales included in the All Other segment.....	(408)	(256)
Other* .....	(274)	(268)
North America Marketing external sales .....	<u>\$ 5,567</u>	<u>\$ 4,433</u>
EAME Geographic Region.....	\$ 4,477	\$ 3,418
Power Products sales not included in the EAME Marketing segment .....	(1,579)	(1,246)
Other* .....	(580)	(317)
EAME Marketing external sales .....	<u>\$ 2,318</u>	<u>\$ 1,855</u>
Latin America Geographic Region .....	\$ 1,374	\$ 1,013
Power Products sales not included in the Latin America Marketing segment .....	(379)	(349)
Other* .....	90	80
Latin America Marketing external sales .....	<u>\$ 1,085</u>	<u>\$ 744</u>
Asia/Pacific Geographic Region .....	\$ 2,047	\$ 1,843
Power Products sales not included in the Asia/Pacific Marketing segment.....	(438)	(390)
Other* .....	(363)	(355)
Asia/Pacific Marketing external sales .....	<u>\$ 1,246</u>	<u>\$ 1,098</u>

\* Mostly represents external sales of Construction and Mining Products and All Other segments.

## OTHER PROFIT/LOSS ITEMS

- **Other income/expense** was income of \$198 million compared with income of \$111 million in the six months ended June 30, 2004 for a favorable impact of \$87 million. The change was primarily due to the favorable impact of currency gains of \$74 million.
- **The provision for income taxes** in the first six months reflects an estimated annual tax rate of 29 percent, excluding the discrete items discussed below, and compares to a 27 percent rate in 2004. The increase is primarily due to the impact of the American Jobs Creation Act permitting only 80 percent of Extraterritorial Income Exclusion (ETI) benefits in 2005 as well as a change in our geographic mix of profits.

In the six months ended June 30, 2005, we completed our evaluation of the repatriation provisions of the American Jobs Creation Act and recognized an income tax charge of \$49 million under the provisions of the Act. We expect to repatriate earnings of approximately \$1.4 billion in 2005, which includes \$500 million subject to the preferential tax treatment allowed by the Act. In connection with our current repatriation plan, we have changed our intention of repatriating earnings of a few selected non-U.S. subsidiaries and have recognized an income tax benefit of \$38 million. The net impact of these items is an \$11 million discrete charge to our June year-to-date provision for income taxes.

- **The equity in profit/loss of unconsolidated affiliated companies** favorably impacted profit by \$23 million over six months ended June 30, 2004, primarily driven by increased profitability at SCM.

## GLOSSARY OF TERMS

1. **Consolidating Adjustments** – Eliminations of transactions between Machinery and Engines and Financial Products.
2. **Core Operating Costs** – Machinery and Engines operating cost change adjusted for volume. It excludes the impact of currency and retirement benefits.

3. **Currency** – With respect to sales and revenues, currency represents the translation impact on sales resulting from changes in foreign currency exchange rates versus the U.S. dollar. With respect to operating profit, currency represents the net translation impact on sales and operating costs resulting from changes in foreign currency exchange rates versus the U.S. dollar. Currency includes the impacts on sales and operating profit for the Machinery and Engines lines of business only; currency impacts on the Financial Products line of business are included in the Financial Products portions of the respective analyses. With respect to profit before tax, currency represents the net translation impact on sales, operating costs and other income/expense resulting from changes in foreign currency exchange rates versus the U.S. dollar. Also included in the currency impact on other income/expense are the effects of currency forward and option contracts entered into by the company to reduce the risk of fluctuations in exchange rates and the net effect of changes in foreign currency exchange rates on our foreign currency assets and liabilities.
4. **EAME** – Geographic region including Europe, Africa, the Middle East and the Commonwealth of Independent States (CIS).
5. **Earning Assets** – These assets consist primarily of total net finance receivables plus retained interests in securitized trade receivables, plus equipment on operating leases, less accumulated depreciation at Cat Financial. Net finance receivables represent the gross receivables amount less unearned income and the allowance for credit losses.
6. **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. Reciprocating engines meet power needs ranging from 5 to over 22,000 horsepower (4 to over 16 200 kilowatts). Turbines range from 1,200 to 20,500 horsepower (900 to 15 000 kilowatts).
7. **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 active investor in independent power projects using Caterpillar power generation equipment and services.
8. **Latin America** – Geographic region including the Central and South American countries and Mexico.
9. **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-scrappers, track and wheel excavators, backhoe loaders, log skidders, log loaders, off-highway trucks, articulated trucks, paving products, telescopic handlers, skid steer loaders and related parts. Also includes logistics services for other companies.
10. **Machinery and Engines** – Due to the highly integrated nature of operations, represents the aggregate total of the Machinery and Engines lines of business and includes primarily our manufacturing, marketing and parts distribution operations.
11. **Price Realization** – The impact of net price changes excluding currency.
12. **Retirement Benefits** – Cost of defined benefit pension plans, defined contribution plans and retirement healthcare and life insurance.
13. **Sales Volume** – With respect to sales and revenues, sales volume represents the impact of changes in the quantities sold for machines, engines and parts. With respect to operating profit, sales volume represents the impact of changes in the quantities sold for machines, engines and parts combined with the net operating profit impact of changes in the relative weighting of machines, engines and parts sales with respect to total sales.
14. **6 Sigma** – On a technical level, 6 Sigma represents a measure of variation that achieves 3.4 defects per million opportunities. At Caterpillar, 6 Sigma represents a much broader cultural philosophy to drive continuous improvement throughout the value chain. It is a fact-based, data-driven methodology that we are using to improve processes, enhance quality, cut costs, grow our business and deliver greater value to our customers through Black Belt-led project teams. At Caterpillar, 6 Sigma goes beyond mere process improvement; it has become the way we work as teams to process business information, solve problems and manage our business successfully.

## C. Liquidity & Capital Resources

### Sources of funds

We generate our capital resources primarily through operations and collections of certificated retained interests in trade receivables. Collections of certificated retained interests take place when Cat Financial collects cash on their portion of the securitized trade receivables they have placed in a trust. Through the second quarter of 2005, operating cash flow was \$996 million. Through the second quarter of 2004, operating cash flow was negative \$4.6 billion, and collections of certificated retained interests in trade receivables were \$4.5 billion totaling negative \$121 million. The increase from negative \$121 million through the second quarter of 2004 to positive \$996 million through the second quarter of 2005 is primarily the result of higher profitability and lower pension contributions. We have not had collections of certificated retained interests in trade receivables in 2005 because the trust did not meet the criteria for a qualifying special purpose entity (QSPE). We therefore consolidated the trust and included the assets and related cash flows in "Receivables—trade and other" in the Consolidated Statement of Financial Position and the Consolidated Statement of Cash Flow, respectively. In June 2005, the trust was terminated, and the receivables held by the trust were transferred back to Cat Financial, who then transferred an undivided interest in the receivables to conduit purchasers. In accordance with Statement of Financial Accounting Standard 140 (SFAS 140) "Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities" the latter transfer was accounted for as a sale.

We anticipate that the majority of future capital resource requirements will be funded by operating cash flow, which is largely sourced from profits. See our Outlook on page 54.

Total debt as of June 30, 2005, was \$24.5 billion, an increase of \$952 million from year-end 2004. Debt related to Machinery and Engines increased \$520 million, primarily to fund the stock repurchase program, capital expenditures and the payment of dividends. Debt related to Financial Products increased \$432 million due to growth at Cat Financial. We have two global credit facilities with a syndicate of banks totaling \$5.0 billion available in the aggregate to both Machinery and Engines and Financial Products to support commercial paper programs. Based on management's allocation decision, which can be revised at any time, the portion of the facility available to Cat Financial at June 30, 2005 was \$4.4 billion. The five-year facility of \$2.5 billion expires in September 2009. The 364-day facility of \$2.5 billion expires in September 2005. The facility expiring in September 2005 has a provision that allows Caterpillar or Cat Financial to obtain a one-year loan in September 2005 that would mature in September 2006. Our total credit commitments as of June 30, 2005 were:

	(Millions of dollars)		
	Consolidated	Machinery and Engines	Financial Products
Credit lines available:			
Global credit facility.....	\$ 5,000	\$ 600	\$ 4,400
Other external .....	2,100	820	1,280
Total credit lines available.....	7,100	1,420	5,680
Less: Global credit facility supporting commercial paper.....	4,373	508	3,865
Less: Utilized credit.....	661	105	556
Available credit .....	\$ 2,066	\$ 807	\$ 1,259

We also generate funding through the securitization and sale of receivables/leases where the investors and/or the securitization trusts have limited or no recourse to Caterpillar or Cat Financial. During the first six months of 2005 Cat Financial received \$850 million in net proceeds from a public securitization of retail installment sale contracts and finance leases, which included cash proceeds and retained interests.

We do not generate material funding through structured finance transactions.

### Machinery and Engines

Net cash provided by operating activities was \$853 million compared with \$96 million for the same period a year ago. The favorable change is due to higher profit and lower pension contributions in 2005. Through the six months ended June 2005, pension contributions were \$80 million compared with \$554 million in the same period a year ago.

Pursuant to the share repurchase program authorized by the Board of Directors in October 2003, \$839 million was spent to purchase 18.5 million shares through the second quarter of 2005. There were 677 million shares outstanding at the end of the second quarter 2005. The goal of the share repurchase program, which expires in October 2008, is to reduce the company's outstanding shares to 640 million.

Capital expenditures, excluding equipment leased to others, during the six months ended June 30, 2005 were \$385 million, an increase of \$123 million from the same period a year ago. The increase is a result of increased spending to support growth and new product introductions.

## Financial Products

Operating cash flow was \$556 million through the second quarter 2005, compared with \$565 million for the same period a year ago. Cash used to purchase equipment leased to others was \$608 million through the second quarter of 2005, an increase of \$74 million from the same period a year ago. In addition, net cash used for finance receivables was \$1,282 million through the second quarter of 2005, compared to \$851 million through the second quarter of 2004.

Financial Products total borrowings were \$20.2 billion at June 30, 2005, an increase of \$432 million from December 31, 2004 due to financing a higher amount of assets. Debt repayment in Financial Products depends primarily on timely repayment and collectibility of the receivables portfolio. At June 30, 2005, finance receivables past due over 30 days were 2.10 percent, compared with 2.57 percent at the end of June 30, 2004. The allowance for credit losses was 1.38 percent of finance receivables, net of unearned income, at June 30, 2005, compared to 1.47 percent at June 30, 2004. Receivables written off due to uncollectibility, net of recoveries on receivables previously written off, were \$8 million and \$27 million for the six months ended June 30, 2005 and 2004, respectively.

## 2004 Cash Flow Reclassification

In the fourth quarter of 2004, we changed how we classify cash flows related to trade receivables securitized through Cat Financial and wholesale inventory receivables financed by Cat Financial. Amounts reported in the Consolidated Statement of Cash Flow for the six months ended June 30, 2004 have been reclassified to conform to this presentation. These reclassifications had no impact on the Increase in Cash and Short-term Investments on the Consolidated Statement of Cash Flow.

Consolidated cash flow for the six months ended June 30, 2004 has been reclassified as follows:

(Millions of dollars)	Six Months Ended June 30, 2004		
	Previous Classification <sup>1</sup>	Change	As Reclassified
<b>Consolidated Statement of Cash Flow</b>			
Receivables – trade and other .....	\$ (340)	\$ (5,168)	\$ (5,508)
<b>Net cash provided by (used for) operating activities .....</b>	<b>571</b>	<b>(5,168)</b>	<b>(4,597)</b>
Additions to finance receivables.....	(10,802)	6,581	(4,221)
Collections of finance receivables.....	8,292	(5,353)	2,939
Proceeds from sale of finance receivables .....	1,181	(536)	645
Collections of retained interests in securitized trade receivables.....	-	4,476	4,476
<b>Net cash provided by (used for) investing activities .....</b>	<b>(1,891)</b>	<b>5,168</b>	<b>3,277</b>

<sup>1</sup> Certain amounts do not agree to prior period reported amounts due to unrelated reclassifications.

## D. Critical Accounting Policies

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect reported amounts. The more significant estimates include: residual values for leased assets, fair market values for goodwill impairment tests, warranty liability, and reserves for product liability and insurance losses, postretirement benefits, post-sale discounts, credit losses and income taxes. We have incorporated many years of data into the determination of each of these estimates and we have not historically experienced significant adjustments. These assumptions are reviewed at least annually with the Audit Committee of the Board of Directors. Following are the methods and assumptions used in determining our estimates and an indication of the risks inherent in each.



**Residual values for leased assets** - Determined based on the product, specifications, application and hours of usage. Each product has its own model for evaluation that includes market value cycles and forecasts. Consideration is also given to the amount of assets that will be returned from lease during a given time frame. Residual values could decline due to economic factors, obsolescence or other adverse circumstances.

**Fair market values for goodwill impairment tests** - Determined for each reporting unit by discounting projected cash flow for five years and adding a year-five residual value based upon a market Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA) multiple. The estimated fair value could be impacted by changes in interest rates, growth rates, costs, capital expenditures and market conditions.

**Warranty liability** - Determined by applying historical claim rate experience to the current field population and dealer inventory. Historical claim rates are developed using a rolling average of actual warranty payments. Effective in the third quarter of 2004, we refined our process to utilize more detailed claim rates by product. This provides more comprehensive product warranty information for management. This change did not have a material impact on our financial statements. Warranty payments may differ from those estimated if actual claim rates are higher or lower than our historical rates. Our warranty liability also includes deferred revenue related to extended warranty contracts, which is recognized in income when the related costs are incurred.

**Product liability and insurance loss reserve** - Determined based upon reported claims in process of settlement and actuarial estimates for losses incurred but not reported. Loss reserves, including incurred but not reported reserves, are based on estimates and ultimate settlements may vary significantly from such estimates due to increased claims frequency or severity over historical levels.

**Postretirement benefits** - Primary actuarial assumptions are determined as follows:

- The U.S. expected long-term rate of return on plan assets is based on our estimate of long-term passive returns for equities and fixed income securities weighted by the allocation of our plan assets. Based on historical performance, we increase the passive returns due to our active management of the plan assets. A similar process is used to determine the rate for our non-U.S. pension plans. This rate is impacted by changes in general market conditions, but because it represents a long-term rate, it is not significantly impacted by short-term market swings. Changes in our allocation of plan assets would also impact this rate. For example, a shift to more fixed income securities would lower the rate. A decrease in the rate would increase our expense.
- The assumed discount rate is used to discount future benefit obligations back to today's dollars. The U.S. discount rate is based on the Moody's Aa bond yield as of our measurement date, November 30, and represents the rate at which our benefit obligations could effectively be settled. A similar process is used to determine the assumed discount rate for our non-U.S. plans. This rate is sensitive to changes in interest rates. A decrease in the discount rate would increase our obligation and future expense.
- The expected rate of compensation increase is used to develop benefit obligations using projected pay at retirement. It represents average long-term salary increases. This rate is influenced by our long-term compensation policies. An increase in the rate would increase our obligation and expense.
- The assumed health care trend rate represents the rate at which health care costs are assumed to increase and is based on historical and expected experience. Changes in our projections of future health care costs due to general economic conditions and those specific to health care (e.g. technology driven cost changes) will impact this trend rate. An increase in the trend rate would increase our obligation and expense.

**Post-sale discount reserve** – The company extends numerous merchandising programs that provide discounts to dealers as products are sold to end users. The reserve is determined based on historical data adjusted for known changes in merchandising programs. Discounts paid may differ from those estimated if actual program usage is higher or lower than our historical or expected rates.

**Credit loss reserve** – The allowance for credit losses is evaluated on a regular basis and adjusted based upon management's best estimate of probable losses inherent in our finance receivables. In estimating probable losses, we review accounts that are past due, non-performing, or in bankruptcy. We also review accounts that may be at risk using information available about the customer, such as financial statements, news reports, and published credit ratings. We also use general information regarding industry trends and the general economic environment. Using an estimate of current fair market value of collateral and factoring in credit enhancements, such as additional collateral and third party guarantees, we arrive at an estimated loss for specific accounts and estimate an additional amount for the remainder of the finance receivables based upon historical trends. Adverse economic conditions or other factors that might cause deterioration of the financial health of our customers could change the timing and level of payments received and thus necessitate a change in our estimated losses.

**Income tax reserve** – Despite our belief that our tax return positions are consistent with applicable tax law, we believe that certain positions are likely to be challenged by taxing authorities. Settlement of any challenge can result in no change, a complete disallowance, or some partial adjustment reached through negotiations or litigation. Significant judgment is required in evaluating our tax reserves. Our reserves are adjusted in light of changing facts and circumstances, such as the progress of our tax audits. Our income tax expense includes the impact of reserve provisions and changes to reserves that we consider appropriate, as well as related interest. Unfavorable settlement of any particular issue would require use of our cash. Favorable resolution would be recognized as a reduction to income tax expense at the time of resolution.

## **EMPLOYMENT**

At the end of the second quarter, worldwide employment was 82,248 compared with 72,916 one year ago. The increase was primarily due to about 5,000 hourly labor additions to support higher volume, the conversion of about 2,000 supplemental employees to full-time employment, and approximately 900 employees from acquisitions.

## **OTHER MATTERS**

### **Environmental and Legal Matters**

The company is regulated by federal, state, and international environmental laws governing our use of substances and control of emissions in all our operations. Compliance with these existing laws has not had a material impact on our capital expenditures or earnings.

We are cleaning up hazardous waste at a number of locations, often with other companies, pursuant to federal and state laws. When it is likely we will pay clean-up costs at a site and those costs can be estimated, the costs are charged against our earnings. In formulating that estimate, we do not consider amounts expected to be recovered from insurance companies and others.

The amount recorded for environmental clean up is not material and is included in "Accrued expenses" in the Consolidated Statement of Financial Position. If a range of liability estimates is available on a particular site, we accrue at the lower end of that range. We cannot estimate costs on sites in the very early stages of clean up. Currently, we have several sites in the very early stages of clean up, and there is no more than a remote chance that a material amount for clean up will be required.

We have disclosed certain individual legal proceedings in this filing. Additionally, we are involved in other unresolved legal actions that arise in the normal course of business, the most prevalent involve disputes related to product design, manufacture and performance liability (including claimed asbestos and welding fumes exposure), contracts, employment issues, and intellectual property rights. Although it is not possible to predict with certainty the outcome of these unresolved legal actions or the range of probable loss, we believe that these unresolved legal actions will not individually or in the aggregate have a material impact on our consolidated financial position, liquidity or results of operations.

On January 16, 2002, Caterpillar commenced an action in the Circuit Court of the Tenth Judicial Circuit of Illinois in Peoria, Illinois, against Navistar International Transportation Corporation and International Truck and Engine Corporation (collectively Navistar). The lawsuit arises out of a long-term purchase contract between Caterpillar and Navistar effective May 31, 1988, as amended from time to time (the Purchase Agreement). The pending complaint alleges that Navistar breached its contractual obligations by: (i) paying Caterpillar \$8.08 less per fuel injector than the agreed upon price for new unit injectors delivered by Caterpillar; (ii) refusing to pay contractually agreed upon surcharges owed as a result of Navistar ordering less than planned volumes of replacement unit injectors; and (iii) refusing to pay contractually agreed upon interest stemming from Navistar's late payments. As of June 30, 2005, the net past due receivable from Navistar regarding the foregoing and included in "Long-term receivables – trade and other" in the Consolidated Statement of Financial Position totaled \$139 million. The pending complaint also has claims alleging that Newstream Enterprises and Navistar, collectively and individually, failed to pay the applicable price to Caterpillar for shipments of unit injectors to Newstream. In January 2005, Caterpillar and Franklin Power Products, Inc. resolved claims similar to those currently pending against Newstream, and Franklin has been dismissed from the lawsuit. As of June 30, 2005, the net past due receivables for the foregoing, included in "Long-term receivables – trade and other" in the Consolidated Statement of Financial Position totaled \$12 million. The pending complaint further alleges that Sturman Industries, Inc. and Sturman Engine Systems, Inc. colluded with Navistar to utilize technology that Sturman Industries, Inc. misappropriated from Caterpillar to help Navistar develop its G2 fuel system, and tortiously interfered with the Purchase Agreement and Caterpillar's prospective economic relationship with Navistar. The pending complaint further alleges that the two parties' collusion led Navistar to select Sturman Engine Systems, Inc., and another company, instead of Caterpillar, to develop and manufacture the G2 fuel system.

On May 7, 2002 International Truck and Engine Corporation (International) commenced an action against Caterpillar in the Circuit Court of DuPage County, Illinois regarding a long-term agreement term sheet ("term sheet") (the "first lawsuit"). In its sixth amended complaint in the first lawsuit, International alleged that the term sheet constitutes a legally binding contract for the sale of heavy-duty engines at specified prices through the end of 2006, alleged that Caterpillar breached the term sheet by, among other things, raising certain prices effective October 1, 2002, and also alleged that Caterpillar breached an obligation to negotiate a comprehensive long-term agreement referenced in the term sheet. International sought declaratory and injunctive relief as well as damages in an amount to be determined at trial. Caterpillar denied International's claims and filed a counterclaim seeking a declaration that the term sheet had been effectively terminated. Caterpillar also asserted that pursuant to a subsequent agreement International released Caterpillar from certain of its claims. On September 24, 2003 the Appellate Court of Illinois, ruling on an interlocutory appeal, issued an order consistent with Caterpillar's position that, even if the court subsequently determines that the term sheet is a binding contract, it is indefinite in duration and was therefore terminable at will by Caterpillar upon reasonable notice. On April 12, 2005 International commenced a second, related action against Caterpillar in the Circuit Court of DuPage County, Illinois (the "second lawsuit"). The second lawsuit contains allegations that are similar to the allegations contained in the first lawsuit. International also alleges in the second lawsuit that Caterpillar materially breached the subsequent agreement. On June 15, 2005 International voluntarily dismissed its complaint in the first lawsuit. Caterpillar's counterclaims remain at issue in the first lawsuit. No trial dates are currently scheduled for either of the cases pending in the Circuit Court of DuPage County. Neither of these cases are related to the breach of contract action brought by Caterpillar against Navistar which is currently pending in the Circuit Court of Peoria County, Illinois.

In a letter dated November 15, 2004, the EPA proposed a civil penalty of \$641,392 to Caterpillar for the alleged failure to comply with certain requirements of the Federal Clean Air Act. The EPA alleges that Caterpillar constructed a facility in Emporia, Kansas, and failed to comply with Section 112(g)(2)(B) of the Clean Air Act. Caterpillar sold the Emporia facility in December 2002. We are seeking a settlement of this matter with all concerned parties and we believe the outcome will not have a material adverse effect on our consolidated financial position, liquidity, or results of operations.

During the second quarter of 2005, the Internal Revenue Service (IRS) completed its field examination of our 1995 through 1999 U.S. tax returns. In connection with this examination, we received notices of certain adjustments proposed by the IRS, primarily related to foreign sales corporation (FSC) commissions, foreign tax credit calculations, and R&D credits. We disagree with these proposed adjustments and intend to vigorously dispute this matter through applicable IRS and judicial procedures, as appropriate. Although the final resolution of the proposed adjustments is uncertain, in the opinion of our management the ultimate disposition of these matters will not have a material adverse effect on our consolidated financial position, liquidity, or results of operations.

## **E. Retirement Benefits**

We recognized pension expense of \$90 million and \$186 million for the three and six months ended June 30, 2005, as compared to \$67 million and \$141 million for the three months and six months ended June 30, 2004. The increase in expense was primarily a result of both the amortization of actuarial losses resulting from a declining discount rate and plan changes from the new UAW labor agreement (discussed below), partially offset by the impact of expected asset returns on plan assets. SFAS 87, "Employers' Accounting for Pensions" requires companies to discount future benefit obligations back to today's dollars using a discount rate that is based on high-quality fixed-income investments. A decrease in the discount rate increases the pension benefit obligation. This increase is amortized into earnings as an actuarial loss. SFAS 87 also requires companies to use an expected long-term rate of asset return for computing current year pension expense. Differences between the actual and expected returns are amortized into earnings as actuarial gains and losses. At the end of 2004, unrecognized actuarial losses related to pension were \$3.28 billion. The majority of the unrecognized actuarial losses are due to declining discount rates in recent years.

Other postretirement benefit expense was \$92 million and \$181 million for the three and six months ended June 30, 2005, as compared to \$65 million and \$132 million for the three and six months ended June 30, 2004. The increase in expense is primarily the result of plan changes from the new UAW labor agreement, the amortization of actuarial losses resulting from an increase in expected health care inflation and a declining discount rate, partially offset by changes to the U.S. salaried and management other postretirement benefit plan (discussed below). Unrecognized actuarial losses for other postretirement benefit plans were \$1.23 billion at the end of 2004. These losses reflect a declining discount rate, an increase in expected health care inflation and higher than expected benefit costs.

The unrecognized actuarial losses for both pensions and other postretirement benefits will be impacted in future periods by actual asset returns, actual health care inflation, discount rate changes and other factors that impact these expenses. These losses will be amortized on a straight-line basis over the average remaining service period of active employees expected to receive benefits under the benefit plans. At the end of 2004, the average remaining service period of active employees was 13 years for our U.S. pension plans, 12 years for our non-U.S. pension plans and 8 years for other postretirement benefit plans. We expect our amortization of net actuarial losses to increase approximately \$100 million in 2005 as compared to 2004, primarily because of a decrease in the discount rate.

SFAS 87 requires the recognition of an Additional Minimum Liability if the market value of plan assets is less than the accumulated benefit obligation as of the measurement date. Due to the continued decline in the discount rate, the funded status of our pension plans has declined during 2005. Based on quarter-end plan asset values and assumed discount rate, we would be required to increase the Additional Minimum Liability by approximately \$2.3 billion at December 31, 2005, which would include an offset of the \$1.0 billion prepaid asset position of certain U.S. plans. This would result in a decrease in Accumulated Other Comprehensive Income (a component of Shareholders' Equity on the Consolidated Statement of Financial Position) of approximately \$1.5 billion after-tax. Final determination of this potential adjustment will not be known until the measurement date, which is November 30, 2005. The adjustment amount is dependent on several factors including our assumed discount rate, actual returns on our pension plan assets, company contributions and benefit plan changes. The company has adequate liquidity resources to fund plans, as it deems necessary.

The agreement reached with the UAW in January 2005 included changes to both pension and other postretirement benefits. Pension plan changes included increases in basic benefit payments, increases in the allowance provided to employees who retire before age 62 as well as annual lump-sum payments to retirees during the first three years of the contract. Other postretirement benefit changes included several changes to our retiree medical plan design that resulted in a net increase in company cost sharing with retirees.

- Changes to the pension plan resulted in an increase in the pension obligation of approximately \$230 million. This reflects a discount rate of 5.8%. The increase will be amortized into earnings on a straight-line basis over 10 years, the average remaining service period of active employees impacted by the plan change. In addition, there will be an ongoing increase in expense as a result of the benefit changes. In total, full year 2005 pension expense (and annual expense until the plan change is fully amortized) will increase approximately \$30 million. In addition to the increase in pension expense, the plan changes increased the Additional Minimum Pension Liability by approximately \$230 million.
- Changes to the other postretirement plan resulted in an increase in the benefit obligation of approximately \$620 million. This also reflects a discount rate of 5.8%. The increase will be amortized into earnings on a straight-line basis over 16 years, the average remaining life expectancy of plan participants that are fully eligible for benefits (as they comprise almost all of the plan). In addition, there will be an ongoing increase in expense as a result of the benefit changes. In total, full year 2005 other postretirement benefit expense (and annual expense until the plan change is fully amortized) will increase approximately \$70 million.

In April 2005, amendments were made to our U.S. salaried and management other postretirement benefit plan that increase employee cost sharing and resulted in a decrease in the benefit obligation of approximately \$190 million. This reflects a discount rate of 5.7%. The decrease will be amortized into earnings on a straight-line basis over 9 years, the average remaining service period of active employees impacted by the plan change. In addition, there will be an ongoing decrease in expense as a result of the benefit changes. 2005 other postretirement benefit expense will decrease approximately \$18 million. After 2005, the annual expense (until the plan change is fully amortized) will decrease approximately \$24 million.

We have no ERISA funding requirements in 2005 and do not expect to make any significant contributions to our U.S. pension plans this year. We made contributions to non-U.S. pension plans during the three and six months ended June 30, 2005 of \$30 million and \$80 million, respectively, and anticipate additional contributions of approximately \$180 million during 2005. We also expect to make a \$200 million cash contribution to our other postretirement benefit plans during 2005 in addition to our funding of ongoing cash benefit payments of approximately \$360 million. We have adequate liquidity resources to fund all U.S. and non-U.S. plans.

## **F. Supplemental Consolidating Data**

We are providing supplemental consolidating data for the purpose of additional analysis. The data has been grouped as follows:

**Consolidated** – Caterpillar Inc. and its subsidiaries.

**Machinery and Engines** – The Machinery and Engines data contained in the schedules on pages 46 to 53 are “non-GAAP financial measures” as defined by the Securities and Exchange Commission in Regulation G. These non-GAAP financial measures have no standardized meaning prescribed by U.S. GAAP, and therefore, are unlikely to be comparable with the calculation of similar measures for other companies. Management does not intend these items to be considered in isolation or as a substitute for the related GAAP measures. Caterpillar defines Machinery and Engines as it is presented in the supplemental data as Caterpillar Inc. and its subsidiaries with Financial Products accounted for on the equity basis. Machinery and Engines information relates to our design, manufacturing, marketing and sales of our products. Financial Products information relates to the financing to customers and dealers for the purchase and lease of Caterpillar and other equipment. The nature of these businesses is different especially with regard to the financial position and cash flow items. Caterpillar management utilizes this presentation internally to highlight these differences. We also believe this presentation will assist readers in understanding our business.

**Financial Products** – our finance and insurance subsidiaries, primarily Cat Financial and Cat Insurance.

**Consolidating Adjustments** – eliminations of transactions between Machinery and Engines and Financial Products.

Pages 46 to 53 reconcile Machinery and Engines with Financial Products on the Equity Basis to Caterpillar Inc. Consolidated financial information. Certain amounts for prior periods have been reclassified to conform to the current period financial statement presentation.

**Caterpillar Inc.**  
**Supplemental Data for Results of Operations**  
**For The Three Months Ended June 30, 2005**  
**(Unaudited)**  
**(Millions of dollars)**

	<b>Consolidated</b>	<b>Supplemental Consolidating Data</b>		
		<b>Machinery and Engines <sup>1</sup></b>	<b>Financial Products</b>	<b>Consolidating Adjustments</b>
<b>Sales and revenues:</b>				
Sales of Machinery and Engines .....	\$ 8,784	\$ 8,784	\$ -	\$ -
Revenues of Financial Products .....	576	-	656	(80) <sup>2</sup>
Total sales and revenues .....	9,360	8,784	656	(80)
<b>Operating costs:</b>				
Cost of goods sold .....	6,890	6,890	-	-
Selling, general and administrative expenses .....	789	689	111	(11) <sup>3</sup>
Research and development expenses .....	268	268	-	-
Interest expense of Financial Products .....	184	-	189	(5) <sup>4</sup>
Other operating expenses .....	208	(4)	214	(2) <sup>3</sup>
Total operating costs .....	8,339	7,843	514	(18)
<b>Operating profit</b> .....	1,021	941	142	(62)
Interest expense excluding Financial Products .....	65	67	-	(2) <sup>4</sup>
Other income (expense) .....	90	21	9	60 <sup>5</sup>
<b>Consolidated profit before taxes</b> .....	1,046	895	151	-
Provision for income taxes .....	315	262	53	-
Profit of consolidated companies .....	731	633	98	-
Equity in profit (loss) of unconsolidated affiliated companies .....	29	26	3	-
Equity in profit of Financial Products' subsidiaries .....	-	101	-	(101) <sup>6</sup>
<b>Profit</b> .....	\$ 760	\$ 760	\$ 101	\$ (101)

<sup>1</sup> Represents Caterpillar Inc. and its subsidiaries with Financial Products accounted for on the equity basis.

<sup>2</sup> Elimination of Financial Products revenues earned from Machinery and Engines.

<sup>3</sup> Elimination of net expenses recorded by Machinery and Engines paid to Financial Products.

<sup>4</sup> Elimination of interest expense recorded between Financial Products and Machinery and Engines.

<sup>5</sup> Elimination of discount recorded by Machinery and Engines on receivables sold to Financial Products and of interest earned between Machinery and Engines and Financial Products.

<sup>6</sup> Elimination of Financial Products profit due to equity method of accounting.

**Caterpillar Inc.**  
**Supplemental Data for Results of Operations**  
**For The Three Months Ended June 30, 2004**  
**(Unaudited)**  
**(Millions of dollars)**

	<b>Consolidated</b>	<b>Supplemental Consolidating Data</b>		
		<b>Machinery and Engines <sup>1</sup></b>	<b>Financial Products</b>	<b>Consolidating Adjustments</b>
<b>Sales and revenues:</b>				
Sales of Machinery and Engines .....	\$ 7,100	\$ 7,100	\$ -	\$ -
Revenues of Financial Products .....	483	-	633	(150) <sup>2</sup>
Total sales and revenues .....	7,583	7,100	633	(150)
<b>Operating costs:</b>				
Cost of goods sold .....	5,563	5,563	-	-
Selling, general and administrative expenses .....	744	638	118	(12) <sup>3</sup>
Research and development expenses .....	214	214	-	-
Interest expense of Financial Products .....	121	-	123	(2) <sup>4</sup>
Other operating expenses .....	171	(2)	278	(105) <sup>3</sup>
Total operating costs .....	6,813	6,413	519	(119)
<b>Operating profit</b> .....	770	687	114	(31)
Interest expense excluding Financial Products ...	59	60	-	(1) <sup>4</sup>
Other income (expense) .....	50	15	5	30 <sup>5</sup>
<b>Consolidated profit before taxes</b> .....	761	642	119	-
Provision for income taxes .....	209	168	41	-
Profit of consolidated companies .....	552	474	78	-
Equity in profit (loss) of unconsolidated affiliated companies .....	14	13	1	-
Equity in profit of Financial Products' subsidiaries .....	-	79	-	(79) <sup>6</sup>
<b>Profit</b> .....	<u>\$ 566</u>	<u>\$ 566</u>	<u>\$ 79</u>	<u>\$ (79)</u>

<sup>1</sup> Represents Caterpillar Inc. and its subsidiaries with Financial Products accounted for on the equity basis.

<sup>2</sup> Elimination of Financial Products revenues earned from Machinery and Engines.

<sup>3</sup> Elimination of net expenses recorded by Machinery and Engines paid to Financial Products.

<sup>4</sup> Elimination of interest expense recorded between Financial Products and Machinery and Engines.

<sup>5</sup> Elimination of discount recorded by Machinery and Engines on receivables sold to Financial Products and of interest earned between Machinery and Engines and Financial Products.

<sup>6</sup> Elimination of Financial Products profit due to equity method of accounting.

**Caterpillar Inc.**  
**Supplemental Data for Results of Operations**  
**For The Six Months Ended June 30, 2005**  
**(Unaudited)**  
**(Millions of dollars)**

	<b>Consolidated</b>	<b>Supplemental Consolidating Data</b>		
		<b>Machinery and Engines<sup>1</sup></b>	<b>Financial Products</b>	<b>Consolidating Adjustments</b>
<b>Sales and revenues:</b>				
Sales of Machinery and Engines .....	\$ 16,573	\$ 16,573	\$ -	\$ -
Revenues of Financial Products .....	1,126	-	1,268	(142) <sup>2</sup>
Total sales and revenues .....	17,699	16,573	1,268	(142)
<b>Operating costs:</b>				
Cost of goods sold .....	13,105	13,105	-	-
Selling, general and administrative expenses .....	1,533	1,337	218	(22) <sup>3</sup>
Research and development expenses .....	509	509	-	-
Interest expense of Financial Products .....	354	-	362	(8) <sup>4</sup>
Other operating expenses .....	421	2	422	(3) <sup>3</sup>
Total operating costs .....	15,922	14,953	1,002	(33)
<b>Operating profit</b> .....	1,777	1,620	266	(109)
Interest expense excluding Financial Products .....	130	133	-	(3) <sup>4</sup>
Other income (expense) .....	198	75	17	106 <sup>5</sup>
<b>Consolidated profit before taxes</b> .....	1,845	1,562	283	-
Provision for income taxes .....	547	448	99	-
Profit of consolidated companies .....	1,298	1,114	184	-
Equity in profit (loss) of unconsolidated affiliated companies .....	43	38	5	-
Equity in profit of Financial Products' subsidiaries .....	-	189	-	(189) <sup>6</sup>
<b>Profit</b> .....	<u>\$ 1,341</u>	<u>\$ 1,341</u>	<u>\$ 189</u>	<u>\$ (189)</u>

<sup>1</sup> Represents Caterpillar Inc. and its subsidiaries with Financial Products accounted for on the equity basis.

<sup>2</sup> Elimination of Financial Products revenues earned from Machinery and Engines.

<sup>3</sup> Elimination of net expenses recorded by Machinery and Engines paid to Financial Products.

<sup>4</sup> Elimination of interest expense recorded between Financial Products and Machinery and Engines.

<sup>5</sup> Elimination of discount recorded by Machinery and Engines on receivables sold to Financial Products and of interest earned between Machinery and Engines and Financial Products.

<sup>6</sup> Elimination of Financial Products profit due to equity method of accounting.



**Caterpillar Inc.**  
**Supplemental Data for Results of Operations**  
**For The Six Months Ended June 30, 2004**  
**(Unaudited)**  
**(Millions of dollars)**

	<b>Consolidated</b>	<b>Supplemental Consolidating Data</b>		
		<b>Machinery and Engines <sup>1</sup></b>	<b>Financial Products</b>	<b>Consolidating Adjustments</b>
<b>Sales and revenues:</b>				
Sales of Machinery and Engines .....	\$ 13,102	\$ 13,102	\$ -	\$ -
Revenues of Financial Products .....	961	-	1,150	(189) <sup>2</sup>
Total sales and revenues .....	14,063	13,102	1,150	(189)
<b>Operating costs:</b>				
Cost of goods sold .....	10,264	10,264	-	-
Selling, general and administrative expenses .....	1,417	1,224	217	(24) <sup>3</sup>
Research and development expenses .....	445	445	-	-
Interest expense of Financial Products .....	240	-	245	(5) <sup>4</sup>
Other operating expenses .....	359	-	463	(104) <sup>3</sup>
Total operating costs .....	12,725	11,933	925	(133)
<b>Operating profit</b> .....	1,338	1,169	225	(56)
Interest expense excluding Financial Products ...	116	118	-	(2) <sup>4</sup>
Other income (expense) .....	111	49	8	54 <sup>5</sup>
<b>Consolidated profit before taxes</b> .....	1,333	1,100	233	-
Provision for income taxes .....	367	287	80	-
Profit of consolidated companies .....	966	813	153	-
Equity in profit (loss) of unconsolidated affiliated companies .....	20	18	2	-
Equity in profit of Financial Products' subsidiaries .....	-	155	-	(155) <sup>6</sup>
<b>Profit</b> .....	<u>\$ 986</u>	<u>\$ 986</u>	<u>\$ 155</u>	<u>\$ (155)</u>

<sup>1</sup> Represents Caterpillar Inc. and its subsidiaries with Financial Products accounted for on the equity basis.

<sup>2</sup> Elimination of Financial Products revenues earned from Machinery and Engines.

<sup>3</sup> Elimination of net expenses recorded by Machinery and Engines paid to Financial Products.

<sup>4</sup> Elimination of interest expense recorded between Financial Products and Machinery and Engines.

<sup>5</sup> Elimination of discount recorded by Machinery and Engines on receivables sold to Financial Products and of interest earned between Machinery and Engines and Financial Products.

<sup>6</sup> Elimination of Financial Products profit due to equity method of accounting.

**Caterpillar Inc.**  
**Supplemental Data for Financial Position**  
**At June 30, 2005**  
**(Unaudited)**  
**(Millions of dollars)**

	<b>Supplemental Consolidating Data</b>			
	<b>Consolidated</b>	<b>Machinery and Engines<sup>1</sup></b>	<b>Financial Products</b>	<b>Consolidating Adjustments</b>
<b>Assets:</b>				
Current assets:				
Cash and short-term investments .....	\$ 749	\$ 464	\$ 285	\$ -
Receivables - trade and other .....	7,577	3,308	435	3,834 <sup>2,3</sup>
Receivables - finance .....	5,489	-	9,814	(4,325) <sup>3</sup>
Deferred and refundable income taxes .....	552	487	65	-
Prepaid expenses .....	1,278	1,268	20	(10) <sup>4</sup>
Inventories .....	5,349	5,349	-	-
Total current assets .....	20,994	10,876	10,619	(501)
Property, plant and equipment – net .....	7,593	4,757	2,836	-
Long-term receivables - trade and other .....	845	266	36	543 <sup>3</sup>
Long-term receivables – finance .....	9,932	-	10,512	(580) <sup>3</sup>
Investments in unconsolidated affiliated companies ....	555	514	41	-
Investments in Financial Products subsidiaries .....	-	3,088	-	(3,088) <sup>5</sup>
Deferred income taxes .....	700	1,002	32	(334) <sup>6</sup>
Intangible assets .....	468	461	7	-
Goodwill .....	1,451	1,451	-	-
Other assets .....	2,285	1,044	1,241	-
<b>Total assets .....</b>	<b>\$ 44,823</b>	<b>\$ 23,459</b>	<b>\$ 25,324</b>	<b>\$ (3,960)</b>
<b>Liabilities</b>				
Current liabilities:				
Short-term borrowings .....	5,179	612	4,942	(375) <sup>7</sup>
Accounts payable .....	3,495	3,340	271	(116) <sup>8</sup>
Accrued expenses .....	2,332	1,443	899	(10) <sup>9</sup>
Accrued wages, salaries and employee benefits ...	1,551	1,540	11	-
Customer advances .....	536	536	-	-
Dividends payable .....	169	169	-	-
Deferred and current income taxes payable .....	493	400	100	(7) <sup>6</sup>
Long-term debt due within one year .....	3,441	232	3,209	-
Total current liabilities .....	17,196	8,272	9,432	(508)
Long-term debt due after one year .....	15,857	3,473	12,421	(37) <sup>7</sup>
Liability for postemployment benefits .....	3,271	3,271	-	-
Deferred income taxes and other liabilities .....	794	738	383	(327) <sup>6</sup>
<b>Total liabilities .....</b>	<b>37,118</b>	<b>15,754</b>	<b>22,236</b>	<b>(872)</b>
<b>Stockholders' equity</b>				
Common stock .....	1,704	1,704	888	(888) <sup>5</sup>
Treasury stock .....	(3,965)	(3,965)	-	-
Profit employed in the business .....	10,632	10,632	2,013	(2,013) <sup>5</sup>
Accumulated other comprehensive income .....	(666)	(666)	187	(187) <sup>5</sup>
<b>Total stockholders' equity .....</b>	<b>7,705</b>	<b>7,705</b>	<b>3,088</b>	<b>(3,088)</b>
<b>Total liabilities and stockholders' equity .....</b>	<b>\$ 44,823</b>	<b>\$ 23,459</b>	<b>\$ 25,324</b>	<b>\$ (3,960)</b>

<sup>1</sup> Represents Caterpillar Inc. and its subsidiaries with Financial Products accounted for on the equity basis.

<sup>2</sup> Elimination of receivables between Machinery and Engines and Financial Products.

<sup>3</sup> Reclassification of Machinery and Engines trade receivables purchased by Cat Financial and Cat Financial's wholesale inventory receivables.

<sup>4</sup> Elimination of Machinery and Engines insurance premiums that are prepaid to Financial Products.

<sup>5</sup> Elimination of Financial Products equity which is accounted for on Machinery and Engines on the equity basis.

<sup>6</sup> Reclassification reflecting required netting of deferred tax assets / liabilities by taxing jurisdiction.

<sup>7</sup> Elimination of debt between Machinery and Engines and Financial Products.

<sup>8</sup> Elimination of payables between Machinery and Engines and Financial Products.

<sup>9</sup> Elimination of prepaid insurance in Financial Products' accrued expenses.

**Caterpillar Inc.**  
**Supplemental Data for Financial Position**  
**At December 31, 2004**  
**(Unaudited)**  
**(Millions of dollars)**

	<b>Supplemental Consolidating Data</b>			
	<b>Consolidated</b>	<b>Machinery and Engines<sup>1</sup></b>	<b>Financial Products</b>	<b>Consolidating Adjustments</b>
<b>Assets:</b>				
Current assets:				
Cash and short-term investments.....	\$ 445	\$ 270	\$ 175	\$ -
Receivables - trade and other .....	7,463	3,276	465	3,722 <sup>2,3</sup>
Receivables - finance .....	5,182	-	9,325	(4,143) <sup>3</sup>
Deferred and refundable income taxes .....	398	333	65	-
Prepaid expenses.....	1,369	1,367	16	(14) <sup>4</sup>
Inventories .....	4,675	4,675	-	-
Total current assets.....	19,532	9,921	10,046	(435)
Property, plant and equipment – net .....	7,682	4,820	2,862	-
Long-term receivables - trade and other .....	764	255	37	472 <sup>3</sup>
Long-term receivables – finance .....	9,903	-	10,410	(507) <sup>3</sup>
Investments in unconsolidated affiliated companies .....	517	479	39	(1) <sup>5</sup>
Investments in Financial Products subsidiaries.....	-	3,012	-	(3,012) <sup>6</sup>
Deferred income taxes .....	674	950	27	(303) <sup>7</sup>
Intangible assets .....	315	307	8	-
Goodwill.....	1,450	1,450	-	-
Other assets .....	2,258	1,075	1,183	-
<b>Total assets</b> .....	<b>\$ 43,095</b>	<b>\$ 22,269</b>	<b>\$ 24,612</b>	<b>\$ (3,786)</b>
<b>Liabilities</b>				
Current liabilities:				
Short-term borrowings .....	4,157	93	4,396	(332) <sup>8</sup>
Accounts payable .....	3,580	3,459	205	(84) <sup>9</sup>
Accrued expenses .....	2,261	1,426	855	(20) <sup>10</sup>
Accrued wages, salaries and employee benefits .....	1,730	1,716	14	-
Customer advances.....	447	447	-	-
Dividends payable .....	141	141	-	-
Deferred and current income taxes payable.....	259	212	47	-
Long-term debt due within one year .....	3,531	6	3,525	-
Total current liabilities.....	16,106	7,500	9,042	(436)
Long-term debt due after one year.....	15,837	3,697	12,175	(35) <sup>8</sup>
Liability for postemployment benefits .....	2,986	2,986	-	-
Deferred income taxes and other liabilities .....	699	619	383	(303) <sup>7</sup>
<b>Total liabilities</b> .....	<b>35,628</b>	<b>14,802</b>	<b>21,600</b>	<b>(774)</b>
<b>Stockholders' equity</b>				
Common stock .....	1,231	1,231	888	(888) <sup>6</sup>
Treasury stock .....	(3,277)	(3,277)	-	-
Profit employed in the business .....	9,937	9,937	1,824	(1,824) <sup>6</sup>
Accumulated other comprehensive income .....	(424)	(424)	300	(300) <sup>6</sup>
<b>Total stockholders' equity</b> .....	<b>7,467</b>	<b>7,467</b>	<b>3,012</b>	<b>(3,012)</b>
<b>Total liabilities and stockholders' equity</b> .....	<b>\$ 43,095</b>	<b>\$ 22,269</b>	<b>\$ 24,612</b>	<b>\$ (3,786)</b>

<sup>1</sup> Represents Caterpillar Inc. and its subsidiaries with Financial Products accounted for on the equity basis.

<sup>2</sup> Elimination of receivables between Machinery and Engines and Financial Products.

<sup>3</sup> Reclassification of Machinery and Engines trade receivables purchased by Cat Financial and Cat Financial's wholesale inventory receivables.

<sup>4</sup> Elimination of Machinery and Engines insurance premiums that are prepaid to Financial Products.

<sup>5</sup> Elimination of Machinery and Engines investment in Financial Products subsidiary.

<sup>6</sup> Elimination of Financial Products equity which is accounted for on Machinery and Engines on the equity basis.

<sup>7</sup> Reclassification reflecting required netting of deferred tax assets/liabilities by taxing jurisdiction.

<sup>8</sup> Elimination of debt between Machinery and Engines and Financial Products.

<sup>9</sup> Elimination of payables between Machinery and Engines and Financial Products.

<sup>10</sup> Elimination of prepaid insurance in Financial Products' accrued expenses.

**Caterpillar Inc.**  
**Supplemental Data for Cash Flow**  
**For the Six Months Ended June 30, 2005**  
**(Unaudited)**  
**(Millions of dollars)**

	<b>Supplemental Consolidating Data</b>			
	<b>Consolidated</b>	<b>Machinery and Engines <sup>1</sup></b>	<b>Financial Products</b>	<b>Consolidating Adjustments</b>
<b>Cash flow from operating activities:</b>				
Profit .....	\$ 1,341	\$ 1,341	\$ 189	\$ (189) <sup>2</sup>
Adjustments for non-cash items:				
Depreciation and amortization .....	744	426	318	-
Undistributed profit of Financial Products .....	-	(189)	-	189 <sup>3</sup>
Other .....	(113)	(129)	(94)	110 <sup>4</sup>
Changes in assets and liabilities:				
Receivables - trade and other .....	(742)	(256)	19	(505) <sup>4,5</sup>
Inventories.....	(674)	(674)	-	-
Accounts payable and accrued expenses.....	236	118	131	(13) <sup>4</sup>
Other – net .....	204	216	(7)	(5) <sup>4</sup>
Net cash provided by (used for) operating activities .....	996	853	556	(413)
<b>Cash flow from investing activities:</b>				
Capital expenditures - excluding equipment leased to others.....	(402)	(385)	(17)	-
Expenditures for equipment leased to others.....	(608)	-	(608)	-
Proceeds from disposals of property, plant and equipment.....	304	18	286	-
Additions to finance receivables .....	(5,159)	-	(16,035)	10,876 <sup>5</sup>
Collection of finance receivables .....	3,444	-	13,894	(10,450) <sup>5</sup>
Proceeds from the sale of finance receivables.....	859	-	859	-
Net intercompany borrowings.....	-	(67)	(9)	76 <sup>6</sup>
Investments and acquisitions (net of cash acquired)...	(8)	(8)	-	-
Other – net.....	51	13	38	-
Net cash provided by (used for) investing activities .....	(1,519)	(429)	(1,592)	502
<b>Cash flow from financing activities:</b>				
Dividends paid .....	(280)	(280)	-	-
Common stock issued, including treasury shares reissued .....	278	278	-	-
Treasury shares purchased .....	(839)	(839)	-	-
Net intercompany borrowings.....	-	9	67	(76) <sup>6</sup>
Proceeds from long-term debt issued.....	3,719	130	3,589	-
Payments on long-term debt .....	(2,390)	(30)	(2,360)	-
Short-term borrowings – net .....	325	479	(154)	-
Net cash provided by (used for) financing activities.....	813	(253)	1,142	(76)
Effect of exchange rate changes on cash .....	14	23	4	(13) <sup>7</sup>
<b>Increase in cash and short-term investments .....</b>	<b>304</b>	<b>194</b>	<b>110</b>	<b>-</b>
Cash and short-term investments at beginning of period..	445	270	175	-
Cash and short-term investments at end of period .....	<b>\$ 749</b>	<b>\$ 464</b>	<b>\$ 285</b>	<b>\$ -</b>

<sup>1</sup> Represents Caterpillar Inc. and its subsidiaries with Financial Products accounted for on the equity basis.

<sup>2</sup> Elimination of Financial Products profit after tax due to equity method of accounting.

<sup>3</sup> Non-cash adjustment for the undistributed earnings from Financial Products.

<sup>4</sup> Elimination of non-cash adjustments and changes in assets and liabilities related to consolidated reporting.

<sup>5</sup> Reclassification of Cat Financial's cash flow activity from investing to operating for receivables that arose from the sale of inventory.

<sup>6</sup> Net proceeds and payments to/from Machinery and Engines and Financial Products.

<sup>7</sup> Elimination of the effect of exchange on intercompany balances.

**Caterpillar Inc.**  
**Supplemental Data for Cash Flow**  
**For the Six Months Ended June 30, 2004**  
**(Unaudited)**  
**(Millions of dollars)**

	Consolidated	Supplemental Consolidating Data		
		Machinery and Engines <sup>1</sup>	Financial Products	Consolidating Adjustments
<b>Cash flow from operating activities:</b>				
Profit .....	\$ 986	\$ 986	\$ 155	\$ (155) <sup>2</sup>
Adjustments for non-cash items:				
Depreciation and amortization .....	703	408	295	-
Undistributed profit of Financial Products .....	-	(155)	-	155 <sup>3</sup>
Other .....	(58)	(51)	(66)	59 <sup>4</sup>
Changes in assets and liabilities:				
Receivables - trade and other .....	(5,508)	(131)	116	(5,493) <sup>4,5</sup>
Inventories .....	(921)	(921)	-	-
Accounts payable and accrued expenses .....	476	345	(25)	156 <sup>4</sup>
Other - net .....	(275)	(385)	90	20 <sup>4</sup>
Net cash provided by (used for) operating activities .....	(4,597)	96	565	(5,258)
<b>Cash flow from investing activities:</b>				
Capital expenditures - excluding equipment leased to others .....	(293)	(262)	(31)	-
Expenditures for equipment leased to others .....	(535)	(1)	(534)	-
Proceeds from disposals of property, plant and equipment .....	281	13	268	-
Additions to finance receivables .....	(4,221)	-	(7,702)	3,481 <sup>5</sup>
Collection of finance receivables .....	2,939	-	5,670	(2,731) <sup>5</sup>
Proceeds from sale of finance receivables .....	645	-	1,181	(536) <sup>5</sup>
Additions to retained interests in securitized trade receivables .....	-	-	(5,038)	5,038 <sup>6</sup>
Collection of retained interests in securitized trade receivables .....	4,476	-	4,476	-
Net intercompany borrowings .....	-	201	(43)	(158) <sup>7</sup>
Investments and acquisitions (net of cash acquired) .....	(5)	(7)	2	-
Other - net .....	(10)	(8)	(2)	-
Net cash provided by (used for) investing activities .....	3,277	(64)	(1,753)	5,094
<b>Cash flow from financing activities:</b>				
Dividends paid .....	(254)	(254)	-	-
Common stock issued, including treasury shares reissued .....	107	107	-	-
Treasury shares purchased .....	(250)	(250)	-	-
Net intercompany borrowings .....	-	43	(201)	158 <sup>7</sup>
Proceeds from long-term debt issued .....	3,322	255	3,067	-
Payments on long-term debt .....	(1,571)	(29)	(1,542)	-
Short-term borrowings - net .....	45	133	(88)	-
Net cash provided by financing activities .....	1,399	5	1,236	158
Effect of exchange rate changes on cash .....	46	39	1	6 <sup>8</sup>
<b>Increase in cash and short-term investments</b> .....	125	76	49	-
Cash and short-term investments at beginning of period .....	342	220	122	-
Cash and short-term investments at end of period .....	\$ 467	\$ 296	\$ 171	\$ -

<sup>1</sup> Represents Caterpillar Inc. and its subsidiaries with Financial Products accounted for on the equity basis.

<sup>2</sup> Elimination of Financial Products profit after tax due to equity method of accounting.

<sup>3</sup> Non-cash adjustment for the undistributed earnings from Financial Products.

<sup>4</sup> Elimination of non-cash adjustments and changes in assets and liabilities related to consolidated reporting. Receivables amounts include adjustment for consolidated non-cash receipt of retained interests in securitized trade receivables.

<sup>5</sup> Reclassification of Cat Financial's cash flow activity from investing to operating for receivables that arose from the sale of inventory.

<sup>6</sup> Elimination of Cat Financial's additions to retained interests in securitized trade receivables that arose from an intercompany purchase of receivables.

<sup>7</sup> Net proceeds and payments to/from Machinery and Engines and Financial Products.

<sup>8</sup> Elimination of the effect of exchange on intercompany balances.

## **SALES AND REVENUES OUTLOOK**

We project another record year in 2005. We expect sales and revenues will increase 18 to 20 percent, with Machinery and Engines volume increasing about 10 to 12 percent. We expect improved price realization to add over 5 percent, higher Financial Products revenues will add about 2 percent, and the favorable impact of currency will add less than 1 percent.

While economic growth is slowing overall from a very robust 2004, 2005 will be another year of solid economic activity. Record profits, favorable credit conditions and years of past underinvestment are producing attractive investment environments, particularly for industries served by Caterpillar.

- Despite oil prices nearly tripling over the past three years, inflation has continued within central bank target ranges, often on the low side. Outside the United States, most central banks are holding interest rates at or near the lowest level in decades, with little pressure for rate hikes. In Europe, prolonged weak growth makes even lower interest rates possible. Rates within the United States, while rising, still compare favorably with those of the last business cycle. As a result, we project world economic growth will be from 3 to 3.5 percent this year.
- Low interest rates have prompted households to upgrade housing quality. Housing prices are increasing significantly in many countries, encouraging construction to alleviate housing shortages. We expect strong residential construction to continue in most regions this year.
- Demand for metals and energy is outpacing growth in supply, maintaining upward pressure on prices. Governments, particularly in developing countries, are using revenues to upgrade infrastructure, some of which is necessary to support increased commodity production. We do not expect supply pressures to ease substantially this year and as a result, commodity prices should remain high enough to encourage investment.
- Higher oil and natural gas exploration and production are increasing opportunities in powering drill rigs, well servicing and gas compression. The world has little spare production capacity, so we expect exploration will increase.
- Increased international trade and an aging ship fleet are driving strong growth in shipbuilding. Demand for support vessels to cope with port congestion and increased offshore oil and gas production is also increasing.

### **Sales and Revenue Outlook – Midpoint of Range<sup>1</sup>**

<b>(Millions of dollars)</b>	<b>2004 Actual</b>	<b>2005 Outlook<sup>2</sup></b>	<b>% Change</b>
Machinery and Engines			
North America .....	\$ 14,521	\$ 17,700	22%
EAME .....	7,505	9,000	20%
Latin America .....	2,372	2,800	18%
Asia/Pacific .....	3,938	4,200	7%
Total Machinery and Engines .....	28,336	33,700	19%
Financial Products <sup>3</sup> .....	1,970	2,400	22%
Total .....	\$ 30,306	\$ 36,100	19%

<sup>1</sup> The volume stair step in the Consolidating Operating Profit chart on page 56 reflects sales and revenue at the midpoint of the range.

<sup>2</sup> Based on the sales expectations by geographic region, the forecast of Consolidated Sales and Revenues is an increase of 18 to 20 percent versus 2004. For purposes of this chart, numbers are shown at the middle of the outlook range (i.e., 19 percent).

<sup>3</sup> Does not include revenues earned from Machinery and Engines of \$199 million and \$275 million in 2004 and 2005 outlook, respectively.

**North America (United States and Canada)** Machinery and Engines sales are expected to increase about 22 percent in 2005.

- The U.S. Federal Reserve increased interest rates at each of the past nine meetings, but we expect the Fed may soon slow the pace of rate increases. Economic growth is stabilizing below 4 percent, employment gains are in line with growth in the working age population and core inflation remains low. Consequently, we believe the Federal funds rate should end the year at 4 percent or less and the economy will grow about 3.5 percent in 2005.
- U.S. housing starts are on track to exceed 2 million units this year, which would be the best year since 1973. The many positives for housing construction include rising employment, continued low mortgage rates, higher home prices, a move away from mobile homes, increased replacement of older houses and a desire for more second homes.
- Nonresidential construction bottomed in 2004 with sluggish recovery to date. However, all the conditions needed for a sustained, rapid recovery, similar to the last recovery, are in place. Businesses have record cash holdings, banks are easing conditions on commercial loans, bond spreads remain attractive and the existing stock of nonresidential structures is inadequate for today's economy.
- Prices for metals and energy commodities generally increased throughout the second quarter and are well above year-earlier prices. Production of metals increased 12 percent year-to-date and the 1 percent increase in coal production was insufficient to maintain electrical utility stockpiles. The environment for increasing both production and investment should remain very positive for the rest of the year.
- Demand for on-highway trucks is expected to remain high for the rest of the year. Truck tonnage is rising, trucking company profits are high and the truck fleet aged during the last downturn.
- Canadian inflation is below the middle of the central bank's target range, which should allow a low interest rate environment to continue throughout 2005. Mining, energy and construction should do well this year as a result.

**EAME** Machinery and Engines sales are expected to increase about 20 percent in 2005, driven largely by favorable conditions in AME and the CIS.

- The Euro-area economy is entering its fifth year of below-trend growth and its third year of stable interest rates. With leading indicators turning down, the European Central Bank may need to cut interest rates later this year to revive the economy. Manufacturing in the United Kingdom is declining and retail sales are slowing, suggesting a rate cut is likely. We project overall European growth should be less than 2 percent this year.
- Interest rates in Europe have been low enough to benefit housing and investment in some equipment. Housing prices are up sharply in many countries and building permits are increasing for the fourth consecutive year. We expect housing and equipment investment to increase this year.
- We forecast economic growth in AME should exceed 5 percent in 2005 and growth in the CIS should exceed 6 percent, the third year of recovery for both. Both regions are benefiting from higher metals and energy prices as well as pro-growth economic policies in some larger economies, such as Turkey, South Africa and Russia.

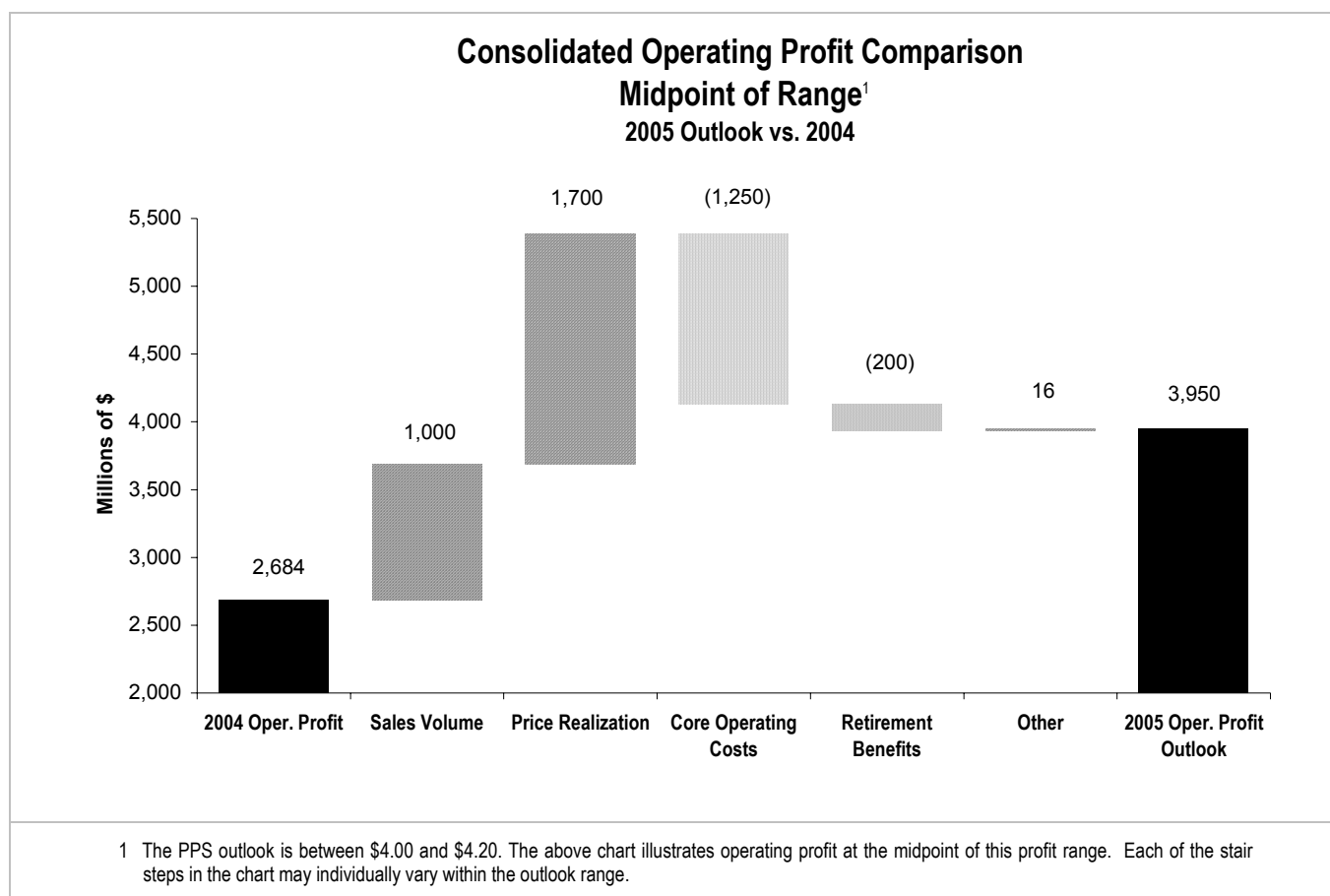
**Latin America** Machinery and Engines sales are expected to increase about 18 percent in 2005.

- Positives for the region include low inflation, relatively low domestic interest rates, higher direct investment inflows and increased metals exports. As a result, we expect economies should grow at least 4 percent in 2005, continuing the recovery that started in late 2003.
- Overall, the region is a net oil exporter and oil prices this year have been higher than governments budgeted. Some of this surplus is being channeled into construction. Mines are increasing production in response to higher metals prices and using some of the profit to further increase capacity. Brazil should continue to benefit from iron ore mining, with production up 38 percent from 2002 and prices more than doubling since that time.

**Asia/Pacific** Machinery and Engines sales are expected to increase about 7 percent in 2005.

- We expect regional economic growth of about 6 percent in 2005. Competitive exchange rates and world economic growth should allow increased exports, and low interest rates should support recoveries in consumer spending and business investment. Growth in nonresidential construction should increase demand for standby electrical power.
- Higher coal and iron ore prices are causing mine production to increase, particularly in Australia, India and Indonesia. We project investments in new mine capacity and supporting infrastructure will continue to grow. Sales in China should improve further.

**Financial Products** revenues are expected to increase 22 percent in 2005 due to higher average earning assets at Cat Financial.



## **PROFIT OUTLOOK**

Our 2005 profit outlook has improved from the end of the first quarter. Profit per share is now expected to be \$4.00 to \$4.20 per share. This outlook is \$.11 to \$.17 per share higher than the previous outlook, which reflected profit growth of 35 to 40 percent from 2004 – \$3.89 to \$4.03 per share.

The primary factors in the profit improvement from 2004 are improved price realization and sales volume. The cost environment remains challenging, and core operating cost increases are expected to partially offset the positive effects of higher sales.



## **G. Safe Harbor Statement under the Securities Litigation Reform Act of 1995**

Certain statements contained in our second-quarter 2005 results release and prepared statements from the related results webcast are forward-looking and involve uncertainties that could significantly impact results. The words "believes," "expects," "estimates," "anticipates," "will be," "should" and similar words or expressions identify forward-looking statements made on behalf of Caterpillar. Uncertainties include factors that affect international businesses, as well as matters specific to the company and the markets it serves.

### **World Economic Factors**

Our projection for 3 to 3.5 percent growth in the world economy assumes central banks will cautiously raise interest rates so as not to slow growth too much. Low interest rates, and continued good economic growth, should encourage further growth in construction and mining. Should central banks raise interest rates aggressively, both the world economic recovery and our Machinery and Engines sales likely would be weaker.

We expect the U.S. economy to continue to grow at about 3.5 percent, which up to now has not created an inflation problem. While the Federal Reserve has raised interest rates, we assume the continuation of moderate growth and low inflation will result in interest rates of 4 percent or less by the end of 2005. Long-term interest rates are expected to rise less than short-term rates. That environment should support further growth in construction and manufacturing, helping to keep commodity prices favorable. Should financial conditions tighten noticeably, causing economic growth to slow below 3 percent, expected improvements in Machinery and Engines sales likely would be lower than projected.

Our projection of increased sales of Machinery and Engines in Europe, Africa, Middle East (EAME) assumes that low interest rates will allow slightly faster economic growth in Europe and that favorable commodity prices will extend healthy recoveries in both Africa and Middle East (AME) and the CIS. Key risks are a significant slowing in the European economy or a collapse in commodity prices. Those developments would likely negatively impact our results.

Favorable commodity prices, increased capital inflows and an improved foreign debt situation are expected to contribute to about 4 percent growth in Latin America. As a result, we project that both mining production and construction spending will increase, supporting an increase in Machinery and Engines sales. This forecast is vulnerable to a significant weakening in commodity prices, slowing in world economic growth, widespread increases in interest rates or political disruptions.

In Asia/Pacific, we project sales growth will be concentrated in Australia, India and Indonesia. Critical assumptions are continued growth in coal demand, low domestic interest rates in most countries, further gains in exports and continued good economic growth in China. Some developments that could lower expected results include reduced demand for thermal and coking coal, significant revaluations of regional currencies, restrictions on regional exports and sharp interest rate hikes, particularly in China.

### **Commodity Prices**

Commodities represent a significant sales opportunity, with prices and production as key drivers. Prices have improved sharply over the past two years and our outlook assumes continued growth in world industrial production will cause metals prices to remain high enough in 2005 to encourage further mine investment. Any unexpected weakening in world industrial production or construction, however, could cause prices to drop sharply to the detriment of our results.

Coal production and prices improved last year and our sales have benefited. We expect these trends to continue in 2005. Should coal prices soften, due to a slowing in world economic growth or otherwise, the ongoing sales recovery would be vulnerable.

Oil and natural gas prices increased sharply over the past two years due to strong demand and high capacity usage. Higher energy prices have not halted economic recoveries since strong demand boosted prices and world production increased. High prices are encouraging more exploration and development and we expect increased production in 2005 will constrain price increases. However, should significant supply cuts occur, such as from OPEC production cuts or political unrest in a major producing country, the resulting oil shortages and price spikes could slow economies, potentially with a depressing impact on our sales.

### **Monetary and Fiscal Policies**

For most companies operating in a global economy, monetary and fiscal policies implemented in the United States and abroad could have a significant impact on economic growth, and accordingly, demand for our product. In general, higher than expected interest rates, reductions in government spending, higher taxes, excessive currency movements, and uncertainty over key policies are some factors likely to lead to slower economic growth and lower industry demand.

With economic data looking more favorable, central banks in developed countries have raised interest rates from the lowest rates in decades. Our outlook assumes that central banks will take great care to ensure that economic recoveries continue and that interest rates will remain low throughout the forecast period. Should central banks raise interest rates more aggressively than anticipated, both economic growth and our sales could suffer.

Budget deficits in many countries have increased, which has limited the ability of governments to boost economies with tax cuts and more spending. Our outlook assumes that governments will not aggressively raise taxes and slash spending to deal with their budget imbalances. Such actions could disrupt growth and negatively affect our sales.

### **Political Factors**

Political factors in the United States and abroad can impact global companies. Our outlook assumes that no major disruptive changes in economic policies occur in either the United States or other major economies. Significant changes in either taxing or spending policies could reduce activities in sectors important to our businesses, thereby reducing sales.

Our outlook assumes that there will be no additional significant military conflicts in either North Korea or the Middle East in the forecast period. Such military conflicts could severely disrupt sales into countries affected, as well as nearby countries.

Our outlook also assumes that there will be no major terrorist attacks. If there is a major terrorist attack, confidence could be undermined, potentially causing a sharp drop in economic activities and our sales. Attacks in major developed economies would be the most disruptive.

Our outlook assumes that efforts by countries to increase their exports will not result in retaliatory countermeasures by other countries to block such exports, particularly in the Asia/Pacific region. Our outlook includes a negative impact from the phase-out of the Extraterritorial Income Exclusion (ETI) as enacted by the American Jobs Creation Act of 2004 (the Act). Our outlook assumes any other tax law changes will not negatively impact our provision for income taxes.

### **Currency Fluctuations**

The company has costs and revenues in many currencies and is therefore exposed to risks arising from currency fluctuations. Our outlook assumes no significant changes in currency values from current rates. Should currency rates change sharply, economic activity and our results could be negatively impacted.

The company's largest manufacturing presence is in the United States, so any unexpected strengthening of the dollar tends to raise the foreign currency costs to our end users and reduce our global competitiveness.

### **Dealer Practices**

The company sells primarily through an independent dealer network. Dealers carry inventories of both new and rental equipment and adjust those inventories based on their assessments of future needs. Such adjustments can impact our results either positively or negatively. The current outlook assumes dealers will increase inventories in line with higher deliveries. Should dealers control inventories more tightly, our sales would be lower.

### **Financial Products Division Factors**

Inherent in the operation of Cat Financial is the credit risk associated with its customers. The creditworthiness of each customer, and the rate of delinquencies, repossessions and net losses on customer obligations are directly impacted by several factors, including, but not limited to, relevant industry and economic conditions, the availability of capital, the experience and expertise of the customer's management team, commodity prices, political events, and the sustained value of the underlying collateral. Additionally, interest rate movements create a degree of risk to our operations by affecting the amount of our interest payments and the value of our fixed rate debt. Our "match funding" policy addresses interest rate risk by aligning the interest rate profile (fixed or floating rate) of our debt portfolio with the interest rate profile of our receivables portfolio (loans and leases with customers and dealers) within pre-determined ranges on an ongoing basis. To achieve our match funding objectives, we issue debt with a similar interest rate profile to our receivables and also use interest rate swap agreements to manage our interest rate risk exposure to interest rate changes and in some cases to lower our cost of borrowed funds. If interest rates move upward more sharply than anticipated, our financial results could be negatively impacted. With respect to our insurance and investment management operations, changes in the equity and bond markets could cause an impairment of the value of our investment portfolio, thus requiring a negative adjustment to earnings.

### **Other Factors**

The rate of infrastructure spending, housing starts, commercial construction and mining plays a significant role in the company's results. Our products are an integral component of these activities and as these activities increase or decrease in the United States or abroad, demand for our products may be significantly impacted.

Projected cost savings or synergies from alliances with new partners could also be negatively impacted by a variety of factors. These factors could include, among other things, higher than expected wages, energy and/or material costs, and/or higher than expected financing costs due to unforeseen changes in tax, trade, environmental, labor, safety, payroll or pension policies in any of the jurisdictions in which the alliances conduct their operations.

Results may be impacted positively or negatively by changes in the sales mix. Our outlook assumes a certain geographic mix of sales as well as a product mix of sales. If actual results vary from this projected geographic and product mix of sales, our results could be negatively impacted.

The company operates in a highly competitive environment and our outlook depends on a forecast of the company's share of industry sales. An unexpected reduction in that share could result from pricing or product strategies pursued by competitors, unanticipated product or manufacturing difficulties, a failure to price the product competitively, or an unexpected buildup in competitors' new machine or dealer owned rental fleets, leading to severe downward pressure on machine rental rates and/or used equipment prices.

The environment remains competitive from a pricing standpoint. Our 2005 sales outlook assumes that the price increases announced in early 2005 will hold in the marketplace. While we expect that the environment will absorb these price actions, delays in the marketplace acceptance would negatively impact our results. Moreover, additional price discounting to maintain our competitive position could result in lower than anticipated price realization.

In general, our results are sensitive to changes in economic growth, particularly those originating in construction, mining and energy. Developments reducing such activities also tend to lower our sales. In addition to the factors mentioned above, our results could be negatively impacted by any of the following:

- Any sudden drop in consumer or business confidence;
- Delays in legislation needed to fund public construction;
- Regulatory or legislative changes that slow activity in key industries; and/or
- Unexpected collapses in stock markets.

This discussion of uncertainties is by no means exhaustive, but is designed to highlight important factors that may impact our outlook. Obvious factors such as general economic conditions throughout the world do not warrant further discussion, but are noted to further emphasize the myriad of contingencies that may cause the company's actual results to differ from those currently anticipated.

#### **Item 4. Controls and Procedures**

##### ***Evaluation of disclosure controls and procedures***

An evaluation was performed under the supervision and with the participation of the company's management, including the Chief Executive Officer (CEO) and Chief Financial Officer (CFO), of the effectiveness of the design and operation of the company's disclosure controls and procedures as of the end of the period covered by this quarterly report. Based on that evaluation, the company's management, including the CEO and CFO, concluded that the company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the company in reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized, and reported within the time periods specified in Securities and Exchange Commission rules and forms. Although the design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote, management's evaluation provided reasonable assurance that these controls will be effective.

##### ***Changes in internal control over financial reporting***

During the last fiscal quarter, there has been no significant change in the company's internal controls over financial reporting that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting.

## **PART II. OTHER INFORMATION**

#### ***Item 1. Legal Proceedings.***

We have disclosed certain individual legal proceedings in this filing. Additionally, we are involved in other unresolved legal actions that arise in the normal course of business, the most prevalent involve disputes related to product design, manufacture and performance liability (including claimed asbestos and welding fumes exposure), contracts, employment issues, and intellectual property rights. Although it is not possible to predict with certainty the outcome of these unresolved legal actions or the range of probable loss, we believe that these unresolved legal actions will not individually or in the aggregate have a material impact on our consolidated financial position, liquidity or results of operations.

On January 16, 2002, Caterpillar commenced an action in the Circuit Court of the Tenth Judicial Circuit of Illinois in Peoria, Illinois, against Navistar International Transportation Corporation and International Truck and Engine Corporation (collectively Navistar). The lawsuit arises out of a long-term purchase contract between Caterpillar and Navistar effective May 31, 1988, as amended from time to time (the Purchase Agreement). The pending complaint alleges that Navistar breached its contractual obligations by: (i) paying Caterpillar \$8.08 less per fuel injector than the agreed upon price for new unit injectors delivered by Caterpillar; (ii) refusing to pay contractually agreed upon surcharges owed as a result of Navistar ordering less than planned volumes of replacement unit injectors; and (iii) refusing to pay contractually agreed upon interest stemming from Navistar's late payments. As of June 30, 2005, the net past due receivable from Navistar regarding the foregoing and included in "Long-term receivables – trade and other" in the Consolidated Statement of Financial Position totaled \$139 million. The pending complaint also has claims alleging that Newstream Enterprises and Navistar, collectively and individually, failed to pay the applicable price to Caterpillar for shipments of unit injectors to Newstream. In January 2005, Caterpillar and Franklin Power Products, Inc. resolved claims similar to those currently pending against Newstream, and Franklin has been dismissed from the lawsuit. As of June 30, 2005, the net past due receivables for the foregoing, included in "Long-term receivables – trade and other" in the Consolidated Statement of Financial Position totaled \$12 million. The pending complaint further alleges that Sturman Industries, Inc. and Sturman Engine Systems, Inc. colluded with Navistar to utilize technology that Sturman Industries, Inc. misappropriated from Caterpillar to help Navistar develop its G2 fuel system, and tortiously interfered with the Purchase Agreement and Caterpillar's prospective economic relationship with Navistar. The pending complaint further alleges that the two parties' collusion led Navistar to select Sturman Engine Systems, Inc., and another company, instead of Caterpillar, to develop and manufacture the G2 fuel system.

On May 7, 2002 International Truck and Engine Corporation (International) commenced an action against Caterpillar in the Circuit Court of DuPage County, Illinois regarding a long-term agreement term sheet ("term sheet") (the "first lawsuit"). In its sixth amended complaint in the first lawsuit, International alleged that the term sheet constitutes a legally binding contract for the sale of heavy-duty engines at specified prices through the end of 2006, alleged that Caterpillar breached the term sheet by, among other things, raising certain prices effective October 1, 2002, and also alleged that Caterpillar breached an obligation to negotiate a comprehensive long-term agreement referenced in the term sheet. International sought declaratory and injunctive relief as well as damages in an amount to be determined at trial. Caterpillar denied International's claims and filed a counterclaim seeking a declaration that the term sheet had been effectively terminated. Caterpillar also asserted that pursuant to a subsequent agreement International released Caterpillar from certain of its claims. On September 24, 2003 the Appellate Court of Illinois, ruling on an interlocutory appeal, issued an order consistent with Caterpillar's position that, even if the court subsequently determines that the term sheet is a binding contract, it is indefinite in duration and was therefore terminable at will by Caterpillar upon reasonable notice. On April 12, 2005 International commenced a second, related action against Caterpillar in the Circuit Court of DuPage County, Illinois (the "second lawsuit"). The second lawsuit contains allegations that are similar to the allegations contained in the first lawsuit. International also alleges in the second lawsuit that Caterpillar materially breached the subsequent agreement. On June 15, 2005 International voluntarily dismissed its complaint in the first lawsuit. Caterpillar's counterclaims remain at issue in the first lawsuit. No trial dates are currently scheduled for either of the cases pending in the Circuit Court of DuPage County. Neither of these cases are related to the breach of contract action brought by Caterpillar against Navistar which is currently pending in the Circuit Court of Peoria County, Illinois.

During the second quarter of 2005, the Internal Revenue Service (IRS) completed its field examination of our 1995 through 1999 U.S. tax returns. In connection with this examination, we received notices of certain adjustments proposed by the IRS, primarily related to foreign sales corporation (FSC) commissions, foreign tax credit calculations, and R&D credits. We disagree with these proposed adjustments and intend to vigorously dispute this matter through applicable IRS and judicial procedures, as appropriate. Although the final resolution of the proposed adjustments is uncertain, in the opinion of our management the ultimate disposition of these matters will not have a material adverse effect on our consolidated financial position, liquidity, or results of operations.

## **Item 2. Changes in Securities, Use of Proceeds and Issuer Purchases of Equity Securities.**

### **Issuer Purchases of Equity Securities**

<b>Period</b>	<b>Total number of Shares Purchased</b>	<b>Average Price Paid per Share</b>	<b>Total Number of Shares Purchased Under the Program</b>	<b>Maximum Number of Shares that May Yet Be Purchased Under the Program</b>
April 1-30, 2005	4,440,000	\$ 45.02	4,440,000	39,244,440 <sup>1</sup>
May 1-31, 2005	6,284,000	44.92	6,284,000	33,887,784 <sup>1</sup>
June 1-30, 2005	-	-	-	36,777,490 <sup>1</sup>
<b>Total</b>	<b>10,724,000</b>	<b>\$ 44.96</b>	<b>10,724,000</b>	

<sup>1</sup> On October 8, 2003, the board of directors approved an extension of the share repurchase program (through October 2008) with the goal of reducing the company's outstanding shares to 320,000,000. The share repurchase program goal has been adjusted for the stock split announced on June 8, 2005 to reflect an adjusted goal of 640,000,000 shares outstanding by October 2008. Amount represents the shares outstanding at the end of the period less 640,000,000.

### **Other Purchases of Equity Securities**

<b>Period</b>	<b>Total number of Shares Purchased<sup>1</sup></b>	<b>Average Price Paid per Share</b>	<b>Total Number of Shares Purchased Under the Program</b>	<b>Maximum Number of Shares that May Yet Be Purchased Under the Program</b>
April 1-30, 2005	984	\$ 44.69	NA	NA
May 1-31, 2005	-	-	NA	NA
June 1-30, 2005	-	-	NA	NA
<b>Total</b>	<b>984</b>	<b>\$ 44.69</b>		

<sup>1</sup> Represents shares delivered back to issuer for the payment of taxes resulting from the release of restricted stock.

**Non-U.S. Employee Stock Purchase Plans**

We have 27 employee stock purchase plans administered outside the United States for our foreign employees. As of June 30, 2005, those plans had approximately 9,100 participants in the aggregate. During the second quarter of 2005, approximately 143,000 shares of Caterpillar common stock or foreign denominated equivalents were distributed under the plans. Participants in some foreign plans have the option of receiving non-U.S. share certificates (foreign-denominated equivalents) in lieu of U.S. shares of Caterpillar Inc. common stock upon withdrawal from the plan. These equivalent certificates are tradable only on the local stock market and are included in our determination of shares outstanding.

**Item 6. Exhibits**

Exhibits:

- 31.1 Certification of James W. Owens, Chairman and Chief Executive Officer of Caterpillar Inc., as required pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of David B. Burritt, Chief Financial Officer of Caterpillar Inc., as required pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32 Certification of James W. Owens, Chairman and Chief Executive Officer of Caterpillar Inc. and David B. Burritt, Chief Financial Officer of Caterpillar Inc., as required pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**CATERPILLAR INC.**

August 4, 2005	<u>/s/ James W. Owens</u> (James W. Owens)	Chairman of the Board and Chief Executive Officer
August 4, 2005	<u>/s/ David B. Burritt</u> (David B. Burritt)	Vice President and Chief Financial Officer
August 4, 2005	<u>/s/ Bradley M. Halverson</u> (Bradley M. Halverson)	Controller and Chief Accounting Officer
August 4, 2005	<u>/s/ James B. Buda</u> (James B. Buda)	Secretary

## SECTION 302 CERTIFICATION

I, James W. Owens, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Caterpillar Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:
  - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

August 4, 2005

/s/ James W. Owens  
(James W. Owens)

Chairman of the Board and  
Chief Executive Officer

## SECTION 302 CERTIFICATION

I, David B. Burritt, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Caterpillar Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:
  - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report; based on such evaluation; and
  - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

August 4, 2005

/s/ David B. Burritt

(David B. Burritt)

Chief Financial Officer

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the quarterly report of Caterpillar Inc. (the "Company") on Form 10-Q for the period ending June 30, 2005 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned hereby certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of our knowledge:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities and Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

August 4, 2005

/s/ James W. Owens  
(James W. Owens)

Chairman of the Board and  
Chief Executive Officer

August 4, 2005

/s/ David B. Burritt  
(David B. Burritt)

Chief Financial Officer

A signed original of this written statement required by Section 906 has been provided to Caterpillar Inc. and will be retained by Caterpillar Inc. and furnished to the Securities and Exchange Commission or its staff upon request.





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