CATERPILLAR INC
Form 10-Q
August 03, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q
[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2016
OR
[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission File Number: 1-768
CATERPILLAR INC.
(Exact name of registrant as specified in its charter)

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of “large accelerated filer”, “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer x Accelerated filer o

Non-accelerated filer o Smaller reporting company o
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x
At June 30, 2016, 584,231,181 shares of common stock of the registrant were outstanding.

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* Item omitted because no answer is called for or item is not applicable.

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Part I. FINANCIAL INFORMATION

Item 1. Financial Statements

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

	Three Months Ended June 30	
	2016	2015
Sales and revenues:		
Sales of Machinery, Energy & Transportation	$9,645	$11,583
Revenues of Financial Products	697	734
Total sales and revenues	10,342	12,317
Operating costs:		
Cost of goods sold	7,419	8,674
Selling, general and administrative expenses	1,123	1,318
Research and development expenses	468	510
Interest expense of Financial Products	148	148
Other operating (income) expenses	399	334
Total operating costs	9,557	10,984
Operating profit	785	1,333
Interest expense excluding Financial Products	130	125
Other income (expense)	84	(72)
Consolidated profit before taxes	739	1,136
Provision (benefit) for income taxes	184	335
Profit of consolidated companies	555	801
Equity in profit (loss) of unconsolidated affiliated companies	(2)	2
Profit of consolidated and affiliated companies	553	803
Less: Profit (loss) attributable to noncontrolling interests	3	1
Profit [1]	$550	$802
Profit per common share	$0.94	$1.33
Profit per common share – diluted [2]	$0.93	$1.31
Weighted-average common shares outstanding (millions)		
– Basic	584.1	603.2

– Diluted[2]	588.6	610.7
Cash dividends declared per common share	$1.54	$1.47

[1] Profit attributable to common stockholders.
[2] Diluted by assumed exercise of stock-based compensation awards using the treasury stock method.

See accompanying notes to Consolidated Financial Statements.

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Caterpillar Inc.
Consolidated Statement of Comprehensive Income
(Unaudited)
(Dollars in millions)

	Three Months Ended June 30	
	2016	2015
Profit of consolidated and affiliated companies	$553	$803
Other comprehensive income (loss), net of tax:		
Foreign currency translation, net of tax (provision)/benefit of: 2016 - $(20); 2015 - $30	(103)	216
Pension and other postretirement benefits:		
Current year prior service credit (cost), net of tax (provision)/benefit of: 2016 - $0; 2015 - $0	(1)	—
Amortization of prior service (credit) cost, net of tax (provision)/benefit of: 2016 - $6; 2015 - $5	(9)	(9)
Derivative financial instruments:		
Gains (losses) deferred, net of tax (provision)/benefit of: 2016 - $11; 2015 - $(7)	(18)	11
(Gains) losses reclassified to earnings, net of tax (provision)/benefit of: 2016 - $(1); 2015 - $(15)	1	25
Available-for-sale securities:		
Gains (losses) deferred, net of tax (provision)/benefit of: 2016 - $(3); 2015 - $4	10	(6)
(Gains) losses reclassified to earnings, net of tax (provision)/benefit of: 2016 - $10; 2015 - $0	(20)	(1)
Total other comprehensive income (loss), net of tax	(140)	236
Comprehensive income	413	1,039
Less: comprehensive income attributable to the noncontrolling interests	(3)	7
Comprehensive income attributable to stockholders	$410	$1,046

See accompanying notes to Consolidated Financial Statements.

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

	Six Months Ended June 30	
	2016	2015
Sales and revenues:		
Sales of Machinery, Energy & Transportation	$18,425	$23,544
Revenues of Financial Products	1,378	1,475
Total sales and revenues	19,803	25,019
Operating costs:		
Cost of goods sold	14,241	17,434
Selling, general and administrative expenses	2,211	2,567
Research and development expenses	976	1,034
Interest expense of Financial Products	300	298
Other operating (income) expenses	796	651
Total operating costs	18,524	21,984
Operating profit	1,279	3,035
Interest expense excluding Financial Products	259	254
Other income (expense)	84	122
Consolidated profit before taxes	1,104	2,903
Provision (benefit) for income taxes	276	856
Profit of consolidated companies	828	2,047
Equity in profit (loss) of unconsolidated affiliated companies	(3)	4
Profit of consolidated and affiliated companies	825	2,051
Less: Profit (loss) attributable to noncontrolling interests	4	4
Profit [1]	$821	$2,047
Profit per common share	$1.41	$3.39
Profit per common share – diluted [2]	$1.40	$3.34
Weighted-average common shares outstanding (millions)		
– Basic	583.4	604.1
– Diluted [2]	588.2	611.8
Cash dividends declared per common share	$1.54	$1.47

[1] Profit attributable to common stockholders.
[2] Diluted by assumed exercise of stock-based compensation awards using the treasury stock method.

See accompanying notes to Consolidated Financial Statements.

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Caterpillar Inc.
Consolidated Statement of Comprehensive Income
(Unaudited)
(Dollars in millions)

	Six Months Ended June 30	
	2016	2015
Profit of consolidated and affiliated companies	$825	$2,051
Other comprehensive income (loss), net of tax:		
Foreign currency translation, net of tax (provision)/benefit of: 2016 - $12; 2015 - $(55)	305	(570)
Pension and other postretirement benefits:		
Current year prior service credit (cost), net of tax (provision)/benefit of: 2016 - $(69); 2015 - $0	117	—
Amortization of prior service (credit) cost, net of tax (provision)/benefit of: 2016 - $11; 2015 - $9	(19)	(18)
Derivative financial instruments:		
Gains (losses) deferred, net of tax (provision)/benefit of: 2016 - $5; 2015 - $2	(9)	(3)
(Gains) losses reclassified to earnings, net of tax (provision)/benefit of: 2016 - $(6); 2015 - $(29)	10	49
Available-for-sale securities:		
Gains (losses) deferred, net of tax (provision)/benefit of: 2016 - $(8); 2015 - $0	16	2
(Gains) losses reclassified to earnings, net of tax (provision)/benefit of: 2016 - $9; 2015 - $1	(18)	(3)
Total other comprehensive income (loss), net of tax	402	(543)
Comprehensive income	1,227	1,508
Less: comprehensive income attributable to the noncontrolling interests	(4)	4
Comprehensive income attributable to stockholders	$1,223	$1,512

See accompanying notes to Consolidated Financial Statements.

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

	June 30, 2016	December 31, 2015
Assets		
Current assets:		
Cash and short-term investments	$6,764	$ 6,460
Receivables – trade and other	6,326	6,695
Receivables – finance	9,201	8,991
Prepaid expenses and other current assets	1,857	1,662
Inventories	9,458	9,700
Total current assets	33,606	33,508
Property, plant and equipment – net	15,916	16,090
Long-term receivables – trade and other	1,180	1,170
Long-term receivables – finance	13,689	13,651
Noncurrent deferred and refundable income taxes	2,536	2,489
Intangible assets	2,652	2,821
Goodwill	6,677	6,615
Other assets	2,044	1,998
Total assets	$78,300	$ 78,342
Liabilities		
Current liabilities:		
Short-term borrowings:		
Machinery, Energy & Transportation	$263	$ 9
Financial Products	7,220	6,958
Accounts payable	5,104	5,023
Accrued expenses	3,127	3,116
Accrued wages, salaries and employee benefits	1,265	1,994
Customer advances	1,259	1,146
Dividends payable	450	448
Other current liabilities	1,635	1,671
Long-term debt due within one year:		
Machinery, Energy & Transportation	1,055	517
Financial Products	5,805	5,360
Total current liabilities	27,183	26,242
Long-term debt due after one year:		
Machinery, Energy & Transportation	8,434	8,960
Financial Products	15,546	16,209
Liability for postemployment benefits	8,533	8,843
Other liabilities	3,301	3,203
Total liabilities	62,997	63,457
Commitments and contingencies (Notes 10 and 13)		
Stockholders' equity		

Common stock of $1.00 par value:		
Authorized shares: 2,000,000,000		
Issued shares: (6/30/16 and 12/31/15 – 814,894,624) at paid-in amount	5,277	5,238
Treasury stock (6/30/16 – 230,663,443 shares; 12/31/15 – 232,572,734 shares) at cost	(17,579)	(17,640)
Profit employed in the business	29,167	29,246
Accumulated other comprehensive income (loss)	(1,633)	(2,035)
Noncontrolling interests	71	76
Total stockholders’ equity	15,303	14,885
Total liabilities and stockholders’ equity	$78,300	$ 78,342

See accompanying notes to Consolidated Financial Statements.

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

	Common stock	Treasury stock	Profit employed in the business	Accumulated other comprehensive income (loss)	Noncontrolling interests	Total
Six Months Ended June 30, 2015						
Balance at December 31, 2014	$5,016	$(15,726)	$28,515	$ (1,059)	$ 80	$16,826
Profit of consolidated and affiliated companies	—	—	2,047	—	4	2,051
Foreign currency translation, net of tax	—	—	—	(562)	(8)	(570)
Pension and other postretirement benefits, net of tax	—	—	—	(18)	—	(18)
Derivative financial instruments, net of tax	—	—	—	46	—	46
Available-for-sale securities, net of tax	—	—	—	(1)	—	(1)
Dividends declared	—	—	(885)	—	—	(885)
Distribution to noncontrolling interests	—	—	—	—	(7)	(7)
Common shares issued from treasury stock for stock-based compensation: 2,674,058	(74)	107	—	—	—	33
Stock-based compensation expense	193	—	—	—	—	193
Net excess tax benefits from stock-based compensation	7	—	—	—	—	7
Common shares repurchased: 6,208,074 [1]	—	(525)	—	—	—	(525)
Balance at June 30, 2015	$5,142	$(16,144)	$29,677	$ (1,594)	$ 69	$17,150
Six Months Ended June 30, 2016						
Balance at December 31, 2015	$5,238	$(17,640)	$29,246	$ (2,035)	$ 76	$14,885
Profit of consolidated and affiliated companies	—	—	821	—	4	825
Foreign currency translation, net of tax	—	—	—	305	—	305
Pension and other postretirement benefits, net of tax	—	—	—	98	—	98
Derivative financial instruments, net of tax	—	—	—	1	—	1
Available-for-sale securities, net of tax	—	—	—	(2)	—	(2)
Dividends declared	—	—	(900)	—	—	(900)
Distribution to noncontrolling interests	—	—	—	—	(9)	(9)
Common shares issued from treasury stock for stock-based compensation: 1,909,291	(108)	61	—	—	—	(47)
Stock-based compensation expense	146	—	—	—	—	146
Net excess tax benefits from stock-based compensation	(5)	—	—	—	—	(5)
Other	6	—	—	—	—	6
Balance at June 30, 2016	$5,277	$(17,579)	$29,167	$ (1,633)	$ 71	$15,303

[1] See Note 11 regarding shares repurchased.

See accompanying notes to Consolidated Financial Statements.

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

	Six Months Ended June 30	
	2016	2015
Cash flow from operating activities:		
Profit of consolidated and affiliated companies	$825	$2,051
Adjustments for non-cash items:		
Depreciation and amortization	1,494	1,514
Other	368	142
Changes in assets and liabilities, net of acquisitions and divestitures:		
Receivables – trade and other	573	383
Inventories	305	332
Accounts payable	208	(326)
Accrued expenses	1	(71)
Accrued wages, salaries and employee benefits	(743)	(801)
Customer advances	93	98
Other assets – net	(127)	215
Other liabilities – net	(197)	(179)
Net cash provided by (used for) operating activities	2,800	3,358
Cash flow from investing activities:		
Capital expenditures – excluding equipment leased to others	(580)	(656)
Expenditures for equipment leased to others	(1,025)	(815)
Proceeds from disposals of leased assets and property, plant and equipment	383	367
Additions to finance receivables	(4,643)	(4,577)
Collections of finance receivables	4,466	4,477
Proceeds from sale of finance receivables	42	74
Investments and acquisitions (net of cash acquired)	(38)	(63)
Proceeds from sale of businesses and investments (net of cash sold)	—	168
Proceeds from sale of securities	195	128
Investments in securities	(243)	(119)
Other – net	(14)	(75)
Net cash provided by (used for) investing activities	(1,457)	(1,091)
Cash flow from financing activities:		
Dividends paid	(898)	(846)
Distribution to noncontrolling interests	—	(7)
Common stock issued, including treasury shares reissued	(47)	33
Treasury shares purchased	—	(525)
Excess tax benefit from stock-based compensation	4	18
Proceeds from debt issued (original maturities greater than three months):		
Machinery, Energy & Transportation	1	3
Financial Products	2,840	3,688
Payments on debt (original maturities greater than three months):		

Machinery, Energy & Transportation	(7)	(509)
Financial Products	(3,324)	(5,580)
Short-term borrowings – net (original maturities three months or less)	391	1,972
Net cash provided by (used for) financing activities	(1,040)	(1,753)
Effect of exchange rate changes on cash	1	(34)
Increase (decrease) in cash and short-term investments	304	480
Cash and short-term investments at beginning of period	6,460	7,341
Cash and short-term investments at end of period	$6,764	$7,821

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

See accompanying notes to Consolidated Financial Statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1.A. Nature of operations

Information in our financial statements and related commentary are presented in the following categories:

Machinery, Energy & Transportation – Represents the aggregate total of Construction Industries, Resource Industries, Energy & Transportation and All Other operating segments and related corporate items and eliminations.

Financial Products – Primarily includes the company's Financial Products Segment. This category includes Caterpillar Financial Services Corporation (Cat Financial), Caterpillar Financial Insurance Services (Insurance Services) and their respective subsidiaries.

B. Basis of presentation

In the opinion of management, the accompanying unaudited financial statements include all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of (a) the consolidated results of operations for the three and six months ended June 30, 2016 and 2015, (b) the consolidated comprehensive income for the three and six months ended June 30, 2016 and 2015, (c) the consolidated financial position at June 30, 2016 and December 31, 2015, (d) the consolidated changes in stockholders' equity for the six months ended June 30, 2016 and 2015 and (e) the consolidated cash flow for the six months ended June 30, 2016 and 2015. The financial statements have been prepared in conformity with generally accepted accounting principles in the United States of America (U.S. GAAP) and pursuant to the rules and regulations of the Securities and Exchange Commission.

Interim results are not necessarily indicative of results for a full year. The information included in this Form 10-Q should be read in conjunction with the audited financial statements and notes thereto included in our company's annual report on Form 10-K for the year ended December 31, 2015 (2015 Form 10-K), which were retrospectively adjusted in the Current Report on Form 8-K filed with the SEC on May 16, 2016.

The December 31, 2015 financial position data included herein is derived from the audited consolidated financial statements included in the 2015 Form 10-K, which were retrospectively adjusted in the Current Report on Form 8-K filed with the SEC on May 16, 2016, but does not include all disclosures required by U.S. GAAP. Certain amounts for prior periods have been reclassified to conform to the current period financial statement presentation. See Note 1C., Note 2, Note 7 and Note 15 for more information.

Unconsolidated Variable Interest Entities (VIEs)

We have affiliates, suppliers and dealers that are VIEs of which we are not the primary beneficiary. Although we have provided financial support, we do not have the power to direct the activities that most significantly impact the economic performance of each entity.

Our maximum exposure to loss from VIEs for which we are not the primary beneficiary was as follows:

(Millions of dollars)	June 30, 2016	December 31, 2015
Receivables - trade and other	$ 39	$ 19
Receivables - finance	209	466
Long-term receivables - finance	262	62

Other assets	35	35
Guarantees	213	175
Total	$ 758	$ 757

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C. Change in Accounting Principle

Effective January 1, 2016, we changed our accounting principle for recognizing actuarial gains and losses and expected returns on plan assets for our defined benefit pension and other postretirement benefit plans. Prior to 2016, actuarial gains and losses were recognized as a component of Accumulated other comprehensive income (loss) and were generally amortized into earnings in future periods. Under the new principle, actuarial gains and losses will be immediately recognized through net benefit cost upon the annual remeasurement in the fourth quarter, or on an interim basis as triggering events warrant remeasurement. In addition, we have changed our policy for recognizing the expected returns on plan assets from a market-related value method (based on a three-year smoothing of asset returns) to a fair value method. We believe these changes are preferable as they accelerate the recognition of changes in fair value of plan assets and actuarial gains and losses in our Consolidated Statement of Results of Operations, provide greater transparency of our economic obligations in accounting results and better align with the fair value principles by recognizing the effects of economic and interest rate changes on pension and other postretirement benefit assets and liabilities in the year in which the gains and losses are incurred. These changes have been applied retrospectively to prior years. As of January 1, 2015, the cumulative effect of the change resulted in a decrease of $5.4 billion in Profit employed in the business and a corresponding increase of $5.4 billion in Accumulated other comprehensive income (loss), both net of tax of $2.9 billion.

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Following are the changes to financial statement line items as a result of the accounting principle change for the periods presented in the accompanying unaudited consolidated financial statements:

Consolidated Statement of Results of Operations
(Dollars in millions except per share data)

	Three Months Ended June 30, 2016			Three Months Ended June 30, 2015		
	As Reported	Previous Accounting Method	Effect of Accounting Change	Recast	Previously Reported	Effect of Accounting Change
Cost of goods sold	$7,419	$ 7,480	$ (61)	$8,674	$8,762	$ (88)
Selling, general and administrative expenses	$1,123	$ 1,156	$ (33)	$1,318	$1,389	$ (71)
Research and development expenses	$468	$ 479	$ (11)	$510	$532	$ (22)
Other operating (income) expenses	$399	$ 399	$ —	$334	$356	$ (22)
Total operating costs	$9,557	$ 9,662	$ (105)	$10,984	$11,187	$ (203)
Operating profit	$785	$ 680	$ 105	$1,333	$1,130	$ 203
Other income (expense)	$84	$ 43	$ 41	$(72)	$(13)	$ (59)
Consolidated profit before taxes	$739	$ 593	$ 146	$1,136	$992	$ 144
Provision for income taxes	$184	$ 136	$ 48	$335	$283	$ 52
Profit of consolidated companies	$555	$ 457	$ 98	$801	$709	$ 92
Profit of consolidated and affiliated companies	$553	$ 455	$ 98	$803	$711	$ 92
Profit	$550	$ 452	$ 98	$802	$710	$ 92
Profit per common share	$0.94	$ 0.77	$ 0.17	$1.33	$1.18	$ 0.15
Profit per common share - diluted	$0.93	$ 0.77	$ 0.16	$1.31	$1.16	$ 0.15

	Six Months Ended June 30, 2016			Six Months Ended June 30, 2015		
	As Reported	Previous Accounting Method	Effect of Accounting Change	Recast	Previously Reported	Effect of Accounting Change
Cost of goods sold	$14,241	$ 14,361	$ (120)	$17,434	$17,605	$ (171)
Selling, general and administrative expenses	$2,211	$ 2,280	$ (69)	$2,567	$2,707	$ (140)
Research and development expenses	$976	$ 997	$ (21)	$1,034	$1,078	$ (44)
Other operating (income) expenses	$796	$ 796	$ —	$651	$674	$ (23)
Total operating costs	$18,524	$ 18,734	$ (210)	$21,984	$22,362	$ (378)
Operating profit	$1,279	$ 1,069	$ 210	$3,035	$2,657	$ 378
Other income (expense)	$84	$ 47	$ 37	$122	$144	$ (22)
Consolidated profit before taxes	$1,104	$ 857	$ 247	$2,903	$2,547	$ 356
Provision for income taxes	$276	$ 197	$ 79	$856	$726	$ 130
Profit of consolidated companies	$828	$ 660	$ 168	$2,047	$1,821	$ 226
Profit of consolidated and affiliated companies	$825	$ 657	$ 168	$2,051	$1,825	$ 226
Profit	$821	$ 653	$ 168	$2,047	$1,821	$ 226
Profit per common share	$1.41	$ 1.12	$ 0.29	$3.39	$3.01	$ 0.38
Profit per common share - diluted	$1.40	$ 1.11	$ 0.29	$3.34	$2.98	$ 0.36

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Consolidated Statement of Comprehensive Income
(Dollars in millions)

	Three Months Ended June 30, 2016			Three Months Ended June 30, 2015		
	As Reported	Previous Accounting Method	Effect of Accounting Change	Recast	Previously Reported	Effect of Accounting Change
Profit of consolidated and affiliated companies	$553	$ 455	$ 98	$803	$ 711	$ 92
Pension and other postretirement benefits:						
Current year actuarial gain (loss), net of tax	$—	$ —	$ —	$—	$ 19	$ (19)
Amortization of actuarial (gain) loss, net of tax	$—	$ 79	$ (79)	$—	$ 109	$ (109)
Total other comprehensive income (loss), net of tax	$(140)	$ (61)	$ (79)	$236	$ 364	$ (128)
Comprehensive income	$413	$ 394	$ 19	$1,039	$ 1,075	$ (36)
Comprehensive income attributable to stockholders	$410	$ 391	$ 19	$1,046	$ 1,082	$ (36)

	Six Months Ended June 30, 2016			Six Months Ended June 30, 2015		
	As Reported	Previous Accounting Method	Effect of Accounting Change	Recast	Previously Reported	Effect of Accounting Change
Profit of consolidated and affiliated companies	$825	$ 657	$ 168	$2,051	$ 1,825	$ 226
Foreign currency translation, net of tax	$305	$ 308	$ (3)	$(570)	$ (575)	$ 5
Pension and other postretirement benefits:						
Current year actuarial gain (loss), net of tax	$—	$ (3)	$ 3	$—	$ 24	$ (24)
Amortization of actuarial (gain) loss, net of tax	$—	$ 158	$ (158)	$—	$ 218	$ (218)
Total other comprehensive income (loss), net of tax	$402	$ 560	$ (158)	$(543)	$ (306)	$ (237)
Comprehensive income	$1,227	$ 1,217	$ 10	$1,508	$ 1,519	$ (11)
Comprehensive income attributable to stockholders	$1,223	$ 1,213	$ 10	$1,512	$ 1,523	$ (11)

Consolidated Statement of Financial Position
(Dollars in millions)

	June 30, 2016		
	As Reported	Previous Accounting Method	Effect of Accounting Change
Noncurrent deferred and refundable income taxes	$2,536	$ 2,543	$ (7)
Liability for postemployment benefits	$8,533	$ 8,550	$ (17)
Profit employed in the business	$29,167	$ 33,961	$ (4,794)
Accumulated other comprehensive income (loss)	$(1,633)	$ (6,437)	$ 4,804

December 31, 2015
Recast

		Previously Reported	Effect of Accounting Change
Profit employed in the business	$29,246	$ 34,208	$ (4,962)
Accumulated other comprehensive income (loss)	$(2,035)	$ (6,997)	$ 4,962

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Consolidated Statement of Changes in Stockholders' Equity
(Dollars in millions)

	Six Months Ended June 30, 2016		
	As Reported	Previous Accounting Method	Effect of Accounting Change
Profit of consolidated and affiliated companies	$825	$ 657	$ 168
Foreign currency translation, net of tax	$305	$ 308	$ (3)
Pension and other postretirement benefits, net of tax	$98	$ 253	$ (155)
Balance at June 30, 2016	$15,303	$ 15,293	$ 10

	Six Months Ended June 30, 2015		
	Recast	Previously Reported	Effect of Accounting Change
Profit of consolidated and affiliated companies	$2,051	$ 1,825	$ 226
Foreign currency translation, net of tax	$(570)	$ (575)	$ 5
Pension and other postretirement benefits, net of tax	$(18)	$ 224	$ (242)
Balance at June 30, 2015	$17,150	$ 17,161	$ (11)

Consolidated Statement of Cash Flow
(Millions of dollars)

	Six Months Ended June 30, 2016		
Cash flow from operating activities:	As Reported	Previous Accounting Method	Effect of Accounting Change
Profit of consolidated and affiliated companies	$825	$ 657	$ 168
Adjustments for non-cash items: Other	$368	$ 405	$ (37)
Other assets – net	$(127)	$ (206)	$ 79
Other liabilities – net	$(197)	$ 13	$ (210)

	Six Months Ended June 30, 2015		
Cash flow from operating activities:	Recast	Previously Reported	Effect of Accounting Change
Profit of consolidated and affiliated companies	$2,051	$ 1,825	$ 226
Adjustments for non-cash items: Other	$142	$ 120	$ 22
Other assets – net	$215	$ 85	$ 130
Other liabilities – net	$(179)	$ 199	$ (378)

2. New accounting guidance

Revenue recognition – In May 2014, the Financial Accounting Standards Board (FASB) issued new revenue recognition guidance to provide a single, comprehensive revenue recognition model for all contracts with customers.

Under the new guidance, an entity will recognize revenue to depict the transfer of promised goods or services to customers at an amount that the entity expects to be entitled to in exchange for those goods or services. A five step model has been introduced for an entity to apply when recognizing revenue. The new guidance also includes enhanced disclosure requirements, and is effective January 1, 2018, with early adoption permitted for January 1, 2017. Entities have the option to apply the new guidance under a retrospective approach to each prior reporting period presented, or a modified retrospective approach with the cumulative effect of initially applying the new guidance recognized at the date of initial application within the Consolidated Statement of Changes in Stockholders' Equity. We plan to adopt the new guidance effective January 1, 2018 and are in the process of evaluating the effect of the new guidance on our financial statements.

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Variable interest entities (VIE) – In February 2015, the FASB issued accounting guidance on the consolidation of VIEs. The new guidance revises previous guidance by establishing an analysis for determining whether a limited partnership or similar entity is a VIE and whether outsourced decision-maker fees are considered variable interests. In addition, the new guidance revises how a reporting entity evaluates economics and related parties when assessing who should consolidate a VIE. The guidance was effective January 1, 2016 and did not have a material impact on our financial statements.

Presentation of debt issuance costs – In April 2015, the FASB issued accounting guidance which requires debt issuance costs to be presented in the balance sheet as a direct deduction from the carrying value of the associated debt liability. Prior to the issuance of the new guidance, debt issuance costs were required to be presented in the balance sheet as an asset. The guidance was effective January 1, 2016 and was applied retrospectively. The adoption did not have a material impact on our financial statements.

Fair value disclosures for investments in certain entities that calculate net asset value per share – In May 2015, the FASB issued accounting guidance which removes the requirement to categorize within the fair value hierarchy investments measured at net asset value (or its equivalent) as a practical expedient for fair value. The new guidance requires that the amount of these investments continue to be disclosed to reconcile the fair value hierarchy disclosure to the balance sheet. The guidance was effective January 1, 2016 and was applied retrospectively. The adoption did not have a material impact on our financial statements.

Simplifying the measurement of inventory – In July 2015, the FASB issued accounting guidance which requires that inventory be measured at the lower of cost or net realizable value. Prior to the issuance of the new guidance, inventory was measured at the lower of cost or market. Replacing the concept of market with the single measurement of net realizable value is intended to create efficiencies for preparers. Inventory measured using the last-in, first-out (LIFO) method and the retail inventory method are not impacted by the new guidance. The guidance is effective January 1, 2017. We do not expect the adoption to have a material impact on our financial statements.

Simplifying the accounting for measurement-period adjustments – In September 2015, the FASB issued accounting guidance which eliminates the requirement for an acquirer in a business combination to restate prior period financial statements for measurement period adjustments. An acquirer in a business combination is required to report provisional amounts when measurements are incomplete at the end of the reporting period covering the business combination. Prior to the issuance of the new guidance, an acquirer was required to adjust such provisional amounts by restating prior period financial statements. Under the new guidance, the acquirer will recognize the measurement-period adjustment in the period the adjustment is determined. The guidance was effective January 1, 2016 and was applied prospectively. The adoption did not have a material impact on our financial statements.

Balance sheet classification of deferred taxes - In November 2015, the FASB issued accounting guidance that requires all deferred tax assets and liabilities, along with any related valuation allowance, to be classified as noncurrent on the Consolidated Statement of Financial Position. Previous guidance requires the deferred taxes for each jurisdiction to be presented as a net current asset or liability and net noncurrent asset or liability. As a result of the new guidance, each jurisdiction will now only have one net noncurrent deferred tax asset or liability. The new guidance does not change the existing requirement that only permits offsetting deferred tax assets and liabilities within a single jurisdiction. We had the option to apply the new guidance prospectively or retrospectively. The new guidance is effective January 1, 2017, with early adoption permitted. We adopted the new guidance effective January 1, 2016 and applied it retrospectively. The adoption resulted in the reclassification of current deferred tax assets and liabilities to noncurrent assets and liabilities on the Consolidated Statement of Financial Position. For the year ended December 31, 2015, Deferred and refundable income taxes were reduced by $910 million (the remaining balance of $616 million was reclassified to Prepaid expenses and other current assets), Noncurrent deferred and refundable income taxes were increased by $835 million, Other current liabilities were reduced by $59 million and Other liabilities were reduced by

$16 million.

Recognition and measurement of financial assets and financial liabilities - In January 2016, the FASB issued accounting guidance that affects the accounting for equity investments, financial liabilities accounted for under the fair value option and the presentation and disclosure requirements for financial instruments. Under the new guidance, all equity investments in unconsolidated entities (other than those accounted for using the equity method of accounting) will generally be measured at fair value through earnings. There will no longer be an available-for-sale classification for equity securities with readily determinable fair values. For financial liabilities when the fair value option has been elected, changes in fair value due to instrument-specific credit risk will be recognized separately in other comprehensive income. In addition, the FASB clarified guidance related to the valuation allowance assessment when recognizing deferred tax

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assets resulting from unrealized losses on available-for-sale debt securities. The new guidance is effective January 1, 2018, with the cumulative effect adjustment from initially applying the new guidance recognized in the Consolidated Statement of Financial Position as of the beginning of the year of adoption. The impact on our financial statements at the time of adoption will primarily be based on changes in the fair value of our available-for-sale equity securities subsequent to January 1, 2018, which will be recorded through earnings.

Lease accounting - In February 2016, the FASB issued accounting guidance that revises the accounting for leases. Under the new guidance, lessees are required to recognize a right-of-use asset and a lease liability for all leases. The new guidance will continue to classify leases as either financing or operating, with classification affecting the pattern of expense recognition. The accounting applied by a lessor under the new guidance will be substantially equivalent to current lease accounting guidance. The new guidance is effective January 1, 2019 with early adoption permitted. The new standard is required to be applied with a modified retrospective approach to each prior reporting period presented and provides for certain practical expedients. We are in the process of evaluating the effect of the new guidance on our financial statements.

Stock-based compensation - In March 2016, the FASB issued accounting guidance to simplify several aspects of the accounting for share-based payments. The new guidance changes how reporting entities account for certain aspects of share-based payments, including the accounting for income taxes and the classification of the tax impact on the Consolidated Statement of Cash Flow. The new guidance is effective January 1, 2017 with early adoption permitted. We are in the process of evaluating the effect of the new guidance on our financial statements.

Measurement of credit losses on financial instruments - In June 2016, the FASB issued accounting guidance to introduce a new model for recognizing credit losses on financial instruments based on an estimate of current expected credit losses. The new guidance will apply to loans, accounts receivable, trade receivables, other financial assets measured at amortized cost, loan commitments and other off-balance sheet credit exposures. The new guidance will also apply to debt securities and other financial assets measured at fair value through other comprehensive income. The new guidance is effective January 1, 2020, with early adoption permitted beginning January 1, 2019. We are in the process of evaluating the effect of the new guidance on our financial statements.

3. Stock-based compensation

Accounting for stock-based compensation requires that the cost resulting from all stock-based payments be recognized in the financial statements based on the grant date fair value of the award. Our stock-based compensation primarily consists of stock options, restricted stock units (RSUs), performance-based restricted stock units (PRSUs) and stock-settled stock appreciation rights (SARs). Awards granted prior to 2015 generally vest three years after the date of grant (cliff vesting). The awards granted in 2015 and 2016 generally vest according to a three-year graded vesting schedule. Beginning in 2015, PRSUs were granted. PRSUs generally have a three-year performance period and cliff vest at the end of the period based upon achievement of performance targets established at the time of grant.

Upon separation from service, if the participant is 55 years of age or older with more than five years of service, the participant meets the criteria for a "Long Service Separation" and all outstanding stock options, SARs and RSUs will vest. Outstanding PRSUs granted to employees with a "Long Service Separation" will vest at the end of the performance period based upon achievement of the performance target. For awards granted prior to 2016, if the "Long Service Separation" criteria are met, the vested options/SARs will have a life that is the lesser of ten years from the original grant date or five years from the separation date. For awards granted in 2016, the vested options/SARs will have a life equal to ten years from the original grant date.

We recognized pretax stock-based compensation expense in the amount of $45 million and $146 million for the three and six months ended June 30, 2016, respectively and $58 million and $193 million for the three and six months ended June 30, 2015, respectively.

The following table illustrates the type and fair value of the stock-based compensation awards granted during the six months ended June 30, 2016 and 2015, respectively:

	Six Months Ended June 30, 2016			Six Months Ended June 30, 2015		
	Shares Granted	Weighted-Average Fair Value Per Share	Weighted-Average Grant Date Stock Price	Shares Granted	Weighted-Average Fair Value Per Share	Weighted-Average Grant Date Stock Price
Stock options	4,243,272	$ 20.64	$ 74.77	7,939,497	$ 23.61	$ 83.34
RSUs	1,085,505	$ 68.04	$ 74.77	1,690,661	$ 77.55	$ 83.02
PRSUs	614,347	$ 64.71	$ 74.77	132,068	$ 77.47	$ 82.90

The following table provides the assumptions used in determining the fair value of the stock-based awards for the six months ended June 30, 2016 and 2015, respectively:

	Grant Year	
	2016	2015
Weighted-average dividend yield	3.23%	2.27%
Weighted-average volatility	31.1%	28.4%
Range of volatilities	22.5-33.4%	19.9-35.9%
Range of risk-free interest rates	0.62-1.73%	0.22-2.08%
Weighted-average expected lives	8 years	8 years

As of June 30, 2016, the total remaining unrecognized compensation expense related to nonvested stock-based compensation awards was $261 million, which will be amortized over the weighted-average remaining requisite service periods of approximately 2.0 years.

4. Derivative financial instruments and risk management

Our earnings and cash flow are subject to fluctuations due to changes in foreign currency exchange rates, interest rates and commodity prices. 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 exposures. Our policy specifies that derivatives are not to be used for speculative purposes. Derivatives that we use are primarily foreign currency forward, option and cross currency contracts, interest rate swaps and commodity forward and option contracts. Our derivative activities are subject to the management, direction and control of our senior financial officers. Risk management practices, including the use of financial derivative instruments, are presented to the Audit Committee of the Board of Directors at least annually.

All derivatives are recognized on the Consolidated Statement of Financial Position at their fair value. On the date the derivative contract is entered into, we designate the derivative as (1) a hedge of the fair value of a recognized asset or liability (fair value hedge), (2) a hedge of a forecasted transaction or the variability of cash flow (cash flow hedge) or (3) an undesignated instrument. Changes in the fair value of a derivative that is qualified, designated and highly effective as a fair value hedge, along with the gain or loss on the hedged recognized asset or liability that is attributable to the hedged risk, are recorded in current earnings. Changes in the fair value of a derivative that is qualified, designated and highly effective as a cash flow hedge are recorded in Accumulated other comprehensive income (loss) (AOCI), to the extent effective, on the Consolidated Statement of Financial Position until they are reclassified to earnings in the same period or periods during which the hedged transaction affects earnings. Changes in the fair value of undesignated derivative instruments and the ineffective portion of designated derivative instruments are reported in current earnings. Cash flows from designated derivative financial instruments are classified within the same category as the item being hedged on the Consolidated Statement of Cash Flow. Cash flows from undesignated derivative financial instruments are included in the investing category on the Consolidated Statement of Cash Flow.

We formally document all relationships between hedging instruments and hedged items, as well as the risk-management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives that are designated as fair value hedges to specific assets and liabilities on the Consolidated Statement of Financial Position and linking cash flow hedges to specific forecasted transactions or variability of cash flow.

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We also formally assess, both at the hedge's inception and on an ongoing basis, whether the designated derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flow of hedged items. When a derivative is determined not to be highly effective as a hedge or the underlying hedged transaction is no longer probable, we discontinue hedge accounting prospectively, in accordance with the derecognition criteria for hedge accounting.

Foreign Currency Exchange Rate Risk

Foreign currency exchange rate movements create a degree of risk by affecting the U.S. dollar value of sales made and costs incurred in foreign currencies. Movements in foreign currency rates also affect our competitive position as these changes may affect business practices and/or pricing strategies of non-U.S.-based competitors. Additionally, we have balance sheet positions denominated in foreign currencies, thereby creating exposure to movements in exchange rates.

Our Machinery, Energy & Transportation operations purchase, manufacture and sell products in many locations around the world. As we have a diversified revenue and cost base, we manage our future foreign currency cash flow exposure on a net basis. We use foreign currency forward and option contracts to manage unmatched foreign currency cash inflow and outflow. Our objective is to minimize the risk of exchange rate movements that would reduce the U.S. dollar value of our foreign currency cash flow. Our policy allows for managing anticipated foreign currency cash flow for up to five years. As of June 30, 2016, the maximum term of these outstanding contracts was approximately 51 months.

We generally designate as cash flow hedges at inception of the contract any Australian dollar, Brazilian real, British pound, Canadian dollar, Chinese yuan, euro, Indian rupee, Japanese yen, Mexican peso, Norwegian krona, Singapore dollar, Swiss franc or Thailand baht forward or option contracts that meet the requirements for hedge accounting and the maturity extends beyond the current quarter-end. Designation is performed on a specific exposure basis to support hedge accounting. The remainder of Machinery, Energy & Transportation foreign currency contracts are undesignated.

As of June 30, 2016, $5 million of deferred net losses, net of tax, included in equity (AOCI in the Consolidated Statement of Financial Position), are expected to be reclassified to current earnings (Other income (expense) in the Consolidated Statement of Results of Operations) over the next twelve months when earnings are affected by the hedged transactions. The actual amount recorded in Other income (expense) will vary based on exchange rates at the time the hedged transactions impact earnings.

In managing foreign currency risk for our Financial Products operations, our objective is to minimize earnings volatility resulting from conversion and the remeasurement of net foreign currency balance sheet positions, and future transactions denominated in foreign currencies. Our policy allows the use of foreign currency forward, option and cross currency contracts to offset the risk of currency mismatch between our receivables and debt, and exchange rate risk associated with future transactions denominated in foreign currencies. Our foreign currency forward, option and cross currency contracts are primarily undesignated. We designate fixed-to-fixed cross currency contracts as cash flow hedges to protect against movements in exchange rates on foreign currency fixed rate intercompany loans.

Interest Rate Risk

Interest rate movements create a degree of risk by affecting the amount of our interest payments and the value of our fixed-rate debt. Our practice is to use interest rate derivatives to manage our exposure to interest rate changes.

Our Machinery, Energy & Transportation 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. We designate fixed-to-floating interest rate swaps as fair value hedges at inception of the contract, and we designate certain forward rate agreements as cash flow hedges at inception of the contract.

As of June 30, 2016, $4 million of deferred net losses, net of tax, included in equity (AOCI in the Consolidated Statement of Financial Position), related to Machinery, Energy & Transportation forward rate agreements, are expected to be reclassified to current earnings (Interest expense excluding Financial Products in the Consolidated Statement of Results of Operations) over the next twelve months.

Financial Products operations has a match-funding policy that addresses interest rate risk by aligning the interest rate profile (fixed or floating rate) of Cat Financial's debt portfolio with the interest rate profile of their receivables portfolio within predetermined ranges on an ongoing basis. In connection with that policy, we use interest rate derivative instruments to modify the debt structure to match assets within the receivables portfolio. This matched funding reduces the volatility

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of margins between interest-bearing assets and interest-bearing liabilities, regardless of which direction interest rates move.

Our policy allows us to use fixed-to-floating, floating-to-fixed and floating-to-floating interest rate swaps to meet the match-funding objective. We designate fixed-to-floating interest rate swaps as fair value hedges to protect debt against changes in fair value due to changes in the benchmark interest rate. We designate most floating-to-fixed interest rate swaps as cash flow hedges to protect against the variability of cash flows due to changes in the benchmark interest rate.

As of June 30, 2016, less than $1 million of deferred net gains, net of tax, included in equity (AOCI in the Consolidated Statement of Financial Position), related to Financial Products floating-to-fixed interest rate swaps, are expected to be reclassified to current earnings (Interest expense of Financial Products in the Consolidated Statement of Results of Operations) over the next twelve months. The actual amount recorded in Interest expense of Financial Products will vary based on interest rates at the time the hedged transactions impact earnings.

We have, at certain times, liquidated fixed-to-floating and floating-to-fixed interest rate swaps at both Machinery, Energy & Transportation and Financial Products. The gains or losses associated with these swaps at the time of liquidation are amortized into earnings over the original term of the previously designated hedged item.

Commodity Price Risk

Commodity price movements create a degree of risk by affecting the price we must pay for certain raw material. Our policy is to use commodity forward and option contracts to manage the commodity risk and reduce the cost of purchased materials.

Our Machinery, Energy & Transportation operations purchase base and precious metals 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 subject to price changes on energy products such as natural gas and diesel fuel purchased for operational use.

Our objective is to minimize volatility in the price of these commodities. Our policy allows us to enter into commodity forward and option contracts to lock in the purchase price of a portion of these commodities within a five-year horizon. All such commodity forward and option contracts are undesignated.

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

(Millions of dollars)	Consolidated Statement of Financial Position Location	Asset (Liability) Fair Value June 30, 2016	December 31, 2015
Designated derivatives			
Foreign exchange contracts			
Machinery, Energy & Transportation	Receivables – trade and other	$45	$ 12
Machinery, Energy & Transportation	Accrued expenses	(54)	(25)
Machinery, Energy & Transportation	Other liabilities	(7)	—
Financial Products	Long-term receivables – trade and other	8	—
Financial Products	Accrued expenses	(2)	—
Interest rate contracts			
Financial Products	Receivables – trade and other	—	1
Financial Products	Long-term receivables – trade and other	50	51
Financial Products	Accrued expenses	(4)	(4)
		$36	$ 35
Undesignated derivatives			
Foreign exchange contracts			
Machinery, Energy & Transportation	Receivables – trade and other	$4	$ 2
Machinery, Energy & Transportation	Accrued expenses	(6)	(9)
Financial Products	Receivables – trade and other	6	3
Financial Products	Long-term receivables – trade and other	26	36
Financial Products	Accrued expenses	(9)	(6)
Commodity contracts			
Machinery, Energy & Transportation	Receivables – trade and other	4	—
Machinery, Energy & Transportation	Accrued expenses	(2)	(12)
		$23	$ 14

The total notional amounts of the derivative instruments are as follows:

(Millions of dollars)	June 30, 2016	December 31, 2015
Machinery, Energy & Transportation	$ 2,442	$ 2,040
Financial Products	$ 4,222	$ 3,539

The notional amounts of the derivative financial instruments do not represent amounts exchanged by the parties. The amounts exchanged by the parties are calculated by reference to the notional amounts and by other terms of the derivatives, such as foreign currency exchange rates, interest rates or commodity prices.

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

Fair Value Hedges

(Millions of dollars)	Classification	Three Months Ended June 30, 2016 Gains (Losses) on Derivatives	Three Months Ended June 30, 2016 Gains (Losses) on Borrowings	Three Months Ended June 30, 2015 Gains (Losses) on Derivatives	Three Months Ended June 30, 2015 Gains (Losses) on Borrowings
Interest rate contracts					
Financial Products	Other income (expense)	$ (3)	$ 3	$ (13)	$ 12
		$ (3)	$ 3	$ (13)	$ 12

	Classification	Six Months Ended June 30, 2016 Gains (Losses) on Derivatives	Six Months Ended June 30, 2016 Gains (Losses) on Borrowings	Six Months Ended June 30, 2015 Gains (Losses) on Derivatives	Six Months Ended June 30, 2015 Gains (Losses) on Borrowings
Interest rate contracts					
Financial Products	Other income (expense)	$ —	$ (1)	$ (14)	$ 13
		$ —	$ (1)	$ (14)	$ 13

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Cash Flow Hedges

	Three Months Ended June 30, 2016			
		Recognized in Earnings		
(Millions of dollars)	Amount of Gains (Losses) Recognized in AOCI (Effective Portion)	Classification of Gains (Losses)	Amount of Gains (Losses) Reclassified from AOCI to Earnings	Recognized in Earnings (Ineffective Portion)
Foreign exchange contracts				
Machinery, Energy & Transportation	$ (22)	Other income (expense)	$ 6	$ —
Financial Products	(6)	Other income (expense)	(6)	—
Interest rate contracts				
Machinery, Energy & Transportation	—	Interest expense excluding Financial Products	(1)	—
Financial Products	(1)	Interest expense of Financial Products	(1)	—
	$ (29)		$ (2)	$ —

	Three Months Ended June 30, 2015			
		Recognized in Earnings		
	Amount of Gains (Losses) Recognized in AOCI (Effective Portion)	Classification of Gains (Losses)	Amount of Gains (Losses) Reclassified from AOCI to Earnings	Recognized in Earnings (Ineffective Portion)
Foreign exchange contracts				
Machinery, Energy & Transportation	$ 18	Other income (expense)	$ (37)	$ —
Interest rate contracts				
Machinery, Energy & Transportation	—	Interest expense excluding Financial Products	(1)	—
Financial Products	—	Interest expense of Financial Products	(2)	—
	$ 18		$ (40)	$ —

	Six Months Ended June 30, 2016			
		Recognized in Earnings		
	Amount of Gains (Losses) Recognized in AOCI (Effective Portion)	Classification of Gains (Losses)	Amount of Gains (Losses) Reclassified from AOCI to Earnings	Recognized in Earnings (Ineffective Portion)

Foreign exchange contracts				
Machinery, Energy & Transportation	$(6)	Other income (expense)	$ (4)	$ —
Financial Products	(6)	Other income (expense)	(6)	—
Interest rate contracts				
Machinery, Energy & Transportation	—	Interest expense excluding Financial Products	(3)	—
Financial Products	(2)	Interest expense of Financial Products	(3)	—
	$(14)		$ (16)	$ —

	Six Months Ended June 30, 2015			
		Recognized in Earnings		
	Amount of Gains (Losses) Recognized in AOCI (Effective Portion)	Classification of Gains (Losses)	Amount of Gains (Losses) Reclassified from AOCI to Earnings	Recognized in Earnings (Ineffective Portion)
Foreign exchange contracts				
Machinery, Energy & Transportation	$(7)	Other income (expense)	$ (72)	$ —
Interest rate contracts				
Machinery, Energy & Transportation	—	Interest expense excluding Financial Products	(3)	—
Financial Products	2	Interest expense of Financial Products	(3)	—
	$(5)		$ (78)	$ —

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

(Millions of dollars)	Classification of Gains (Losses)	Three Months Ended June 30, 2016	Three Months Ended June 30, 2015
Foreign exchange contracts			
Machinery, Energy & Transportation	Other income (expense)	$ —	$ 26
Financial Products	Other income (expense)	(24)	4
Commodity contracts			
Machinery, Energy & Transportation	Other income (expense)	6	(1)
		$ (18)	$ 29

	Classification of Gains (Losses)	Six Months Ended June 30, 2016	Six Months Ended June 30, 2015
Foreign exchange contracts			
Machinery, Energy & Transportation	Other income (expense)	$ 22	$ (29)
Financial Products	Other income (expense)	(28)	(24)
Commodity contracts			
Machinery, Energy & Transportation	Other income (expense)	6	(7)
		$ —	$ (60)

We enter into International Swaps and Derivatives Association (ISDA) master netting agreements within Machinery, Energy & Transportation and Financial Products that permit the net settlement of amounts owed under their respective derivative contracts. Under these master netting agreements, net settlement generally permits the company or the counterparty to determine the net amount payable for contracts due on the same date and in the same currency for similar types of derivative transactions. The master netting agreements generally also provide for net settlement of all outstanding contracts with a counterparty in the case of an event of default or a termination event.

Collateral is generally not required of the counterparties or of our company under the master netting agreements. As of June 30, 2016 and December 31, 2015, no cash collateral was received or pledged under the master netting agreements.

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The effect of the net settlement provisions of the master netting agreements on our derivative balances upon an event of default or termination event is as follows:

June 30, 2016				Gross Amounts Not Offset in the Statement of Financial Position		
(Millions of dollars)	Gross Amount of Recognized Assets	Gross Amounts Offset in the Statement of Financial Position	Net Amount of Assets Presented in the Statement of Financial Position	Financial Instruments	Cash Collateral Received	Net Amount of Assets
Derivatives						
Machinery, Energy & Transportation	$ 53	$ —	$ 53	$ (51)	$ —	$ 2
Financial Products	90	—	90	(11)	—	79
Total	$ 143	$ —	$ 143	$ (62)	$ —	$ 81

June 30, 2016				Gross Amounts Not Offset in the Statement of Financial Position		
(Millions of dollars)	Gross Amount of Recognized Liabilities	Gross Amounts Offset in the Statement of Financial Position	Net Amount of Liabilities Presented in the Statement of Financial Position	Financial Instruments	Cash Collateral Pledged	Net Amount of Liabilities
Derivatives						
Machinery, Energy & Transportation	$ (69)	$ —	$ (69)	$ 51	$ —	$ (18)
Financial Products	(15)	—	(15)	11	—	(4)
Total	$ (84)	$ —	$ (84)	$ 62	$ —	$ (22)

December 31, 2015				Gross Amounts Not Offset in the Statement of Financial Position		
(Millions of dollars)	Gross Amount of Recognized Assets	Gross Amounts Offset in the Statement of Financial Position	Net Amount of Assets Presented in the Statement of Financial	Financial Instruments	Cash Collateral Received	Net Amount of Assets

			Position			
Derivatives						
Machinery, Energy & Transportation	$ 14	$ —	$ 14	$ (14)	$ —	$ —
Financial Products	91	—	91	(5)	—	86
Total	$ 105	$ —	$ 105	$ (19)	$ —	$ 86

December 31, 2015				Gross Amounts Not Offset in the Statement of Financial Position		
(Millions of dollars)	Gross Amount of Recognized Liabilities	Gross Amounts Offset in the Statement of Financial Position	Net Amount of Liabilities Presented in the Statement of Financial Position	Financial Instruments	Cash Collateral Pledged	Net Amount of Liabilities
Derivatives						
Machinery, Energy & Transportation	$ (46)	$ —	$ (46)	$ 14	$ —	$ (32)
Financial Products	(10)	—	(10)	5	—	(5)
Total	$ (56)	$ —	$ (56)	$ 19	$ —	$ (37)

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5. Inventories

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

(Millions of dollars)	June 30, 2016	December 31, 2015
Raw materials	$ 2,394	$ 2,467
Work-in-process	1,906	1,857
Finished goods	4,916	5,122
Supplies	242	254
Total inventories	$ 9,458	$ 9,700

6. Investments in unconsolidated affiliated companies

Investments in unconsolidated affiliated companies, included in Other assets in the Consolidated Statement of Financial Position, were as follows:

Caterpillar’s investments in unconsolidated affiliated companies: