
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549



FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 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 No. 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

Securities registered pursuant to Section 12(b) of the Act:

| <u>Title of each class</u> | <u>Name of each exchange on which registered</u> |
|--|---|
| Common Stock (\$1.00 par value) | Chicago Stock Exchange New York Stock Exchange Pacific Exchange, Inc. |
| Preferred Stock Purchase Rights | Chicago Stock Exchange New York Stock Exchange Pacific Exchange, Inc. |
| 9% Debentures due April 15, 2006 | New York Stock Exchange |
| 9 3/8% Debentures due August 15, 2011 | New York Stock Exchange |
| 9 3/8% Debentures due March 15, 2021 | New York Stock Exchange |
| 8% Debentures due February 15, 2023 | New York Stock Exchange |
| 5.3% Debentures due September 15, 2035 | New York Stock Exchange |

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark whether the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one): Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of December 31, 2005, there were 670,867,219 shares of common stock of the Registrant outstanding, and the aggregate market value of the voting stock held by non-affiliates of the Registrant (assuming only for purposes of this computation that directors and officers may be affiliates) was \$ 37,970,065,775.

Documents Incorporated by Reference

Portions of the documents listed below have been incorporated by reference into the indicated parts of this Form 10-K, as specified in the responses to the item numbers involved.

Part III 2006 Annual Meeting Proxy Statement (Proxy Statement) expected to be filed with the Securities and Exchange Commission (SEC) on April 17, 2006.

Parts I, II, IV General and Financial Information for 2005 containing the information required by SEC Rule 14a-3 for an annual report to security holders filed as Exhibit 13 to this Form 10-K.

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PART I

Item 1. Business.

General

The company was originally organized as Caterpillar Tractor Co. in 1925 in the State of California. In 1986, the company reorganized as Caterpillar Inc. in the State of Delaware. As used herein, the term "Caterpillar," "we," "us," "our," or "the company" refers to Caterpillar Inc. and its subsidiaries unless designated or identified otherwise.

Principal Lines of Business / 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, telehandlers, 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 21,500 horsepower (4 to over 16 000 kilowatts). Turbines range from 1,600 to 20,500 horsepower (1 200 to 15 000 kilowatts).
3. **Financial Products** – A principal line of business consisting primarily of Caterpillar Financial Services Corporation (Cat Financial), Caterpillar Insurance Holdings, Inc. (Cat Insurance), Caterpillar Power Ventures Corporation (Cat Power Ventures) and their 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.

Due to financial information required by Statement of Financial Accounting Standards No. 131, *Disclosures about Segments of an Enterprise and Related Information*, we have also divided our business into nine reportable segments for financial reporting purposes. Information about our reportable segments, including geographic information, appears in Note 25 on pages A-31 through A-35 of Exhibit 13.

Other information about our operations in 2005 and outlook for 2006, including risks associated with foreign operations is incorporated by reference from "Management's Discussion and Analysis" on pages A-38 through A-63 of Exhibit 13.

Company Strengths

Caterpillar is the leader in construction and mining equipment, diesel and natural gas engines and industrial gas turbines in our size range. The company is also a leading services provider through Cat Financial, Caterpillar Logistics Services and Caterpillar Remanufacturing Services. Annual sales and revenues top \$36 billion, making Caterpillar the largest manufacturer in its industry. Caterpillar is also a leading U.S. exporter, with more than one-half of its sales outside the United States. Through a global network of independent dealers, Caterpillar builds long-term relationships with customers around the world. For 80 years, the Caterpillar name has been associated with the highest level of quality products and services. More information is available at www.CAT.com.

Competitive Environment

Caterpillar products and product support services are sold worldwide into a variety of highly competitive markets. In all markets, we compete on the basis of product performance, customer service, quality and price. From time to time, the intensity of competition results in price discounting in a particular industry or region. Such price discounting puts pressure on margins and can negatively impact operating profit.

Outside of the United States, certain competitors enjoy competitive advantages inherent to operating in their home countries.

Machinery

The competitive environment for Caterpillar's machinery business consists of global competitors, regional competitors, and specialized local competitors. Principal global competitors include Komatsu, Volvo Construction Equipment (part of the Volvo Group AB), CNH Global N.V., Hitachi Construction Machinery Co., Ltd., Terex Corporation, JCB, and Ingersoll-Rand Company Limited. Each has a particular product line and/or regional pockets of strength. John Deere Construction and Forestry Division (part of Deere & Co.) is a principal competitor only in North and South America. Some competitors have broad ranges of products that compete with Caterpillar. Others, like Ingersoll-Rand, only offer a limited range of products that compete with Caterpillar.

During 2005, increased demand for construction machinery continued, and most of our competitors saw continued improvement in sales and operating profit. Supply chain and material cost challenges continued for many major competitors. Distribution channel challenges experienced by some competitors moderated somewhat. Asia-based competitors with significant business in China benefited from industry improvements there. Europe-based competitors remain most impacted by the value of the euro. Most North America-based competitors continued to benefit from strong North American industry demand. The competitive environment in the machinery business remains intense, and the financial health of the industry as a whole continues to improve.

Caterpillar's logistics business provides integrated supply chain services for Caterpillar and to over fifty other companies worldwide. It competes with global, regional and local competitors including companies such as DHL and UPS. The unit has grown rapidly since its inception in 1987 and the contract logistics industry is expected to continue to grow at rates above that of the global economy as a whole.

Engines

Caterpillar operates in a very competitive engine/ turbine manufacturing and packaging environment. In North America, on-highway heavy-duty and mid-range diesel engine competitors include but are not limited to Cummins Inc., Volvo Group AB, Mack Trucks, Inc. (part of Volvo Group AB), Detroit Diesel Corp. and Mercedes-Benz (both part of DaimlerChrysler AG), Isuzu Motors, Ltd. and Navistar International Corp. During 2005, these truck engine competitors continued to market heavy-duty and mid-range on-highway emissions-certified engines meeting the current United States Environmental Protection Agency (EPA) emission requirements. Overseas on-highway diesel engine competitors include but are not limited to Mercedes-Benz (part of DaimlerChrysler AG), Volvo Group AB, Mitsubishi Fuso Truck & Bus Corp. (part of Daimler Chrysler AG), Scania AB, MAN Aktiengesellschaft, Iveco Motors, Isuzu Motors, Ltd., Hino Motors, Ltd. and MWM Motores Diesel. In addition, the industry continued strong investment in new technology to meet future on- and off-highway emission regulations in North America, Europe, and Asia.

In the North America off-highway mobile and stationary markets, domestic-based competitors include but are not limited to Cummins Inc., John Deere Power Systems (part of Deere & Co.), Detroit Diesel Corp., Ford Power Products (part of Ford Motor Co.), General Electric Co., Kohler Co., Katolight Corp., Generac Power Systems, Inc., Multiquip Inc., Stewart & Stevenson Services, Inc., Waukesha (part of Dresser Inc.) and other regional companies. Overseas-based off-highway mobile and stationary competitors include but are not limited to Wartsila NSD, MAN B&W Diesel AG, MTU Friedrichshafen GmbH (part of DaimlerChrysler AG), Volvo Penta (part of Volvo Group AB), Mitsubishi Heavy Industries, Ltd., Deutz AG, GE Jenbacher (part of General Electric Co.), Kubota Corp., Isuzu Motors, Ltd., Yanmar Diesel Engine Co. Ltd., Bergen (part of Rolls Royce plc), Rolls-Royce plc, Siemens AG, Alstom, SDMO, Himoina s.l., Atlas Copco AB, Kawasaki Heavy Industries, Ltd., and AKSA Power Generation (Kazanci Holding). Some of these competitors are packagers who source emission-compliant as well as non-compliant engines and turbines and other components from domestic and international suppliers, and market products regionally and internationally through a variety of distribution channels.

During 2005, Caterpillar continued in its leadership position in the North America on-highway truck market. Since the introduction of its five engine models with ACERT® Technology beginning in 2003, the company has shipped over 300,000 ACERT engines into the North America on-highway truck market, and continued to maintain its leadership position in this market. Customer acceptance of Caterpillar ACERT engine performance, quality, and reliability is strong.

Caterpillar also continued to focus investment and resources on leveraging ACERT Technology into off-road markets as well as into more of its engine platforms. The building blocks for ACERT Technology are very flexible and scaleable and are being applied as needed based on engine platform and application. Since October 2004 through year-end 2005, the company has shipped 45 models of Caterpillar machines powered by engines with ACERT Technology with a further 25 models planned for introduction in 2006. A line of nine ACERT industrial engines has been released, and ACERT Technology will be further leveraged throughout Caterpillar's businesses and engine platforms. We expect this to establish Caterpillar as the first company to offer a full line of Tier 3/Stage IIIA emission compliant off-highway engines.

We believe ACERT provides Caterpillar a competitive advantage now and in the future to meet emission and performance requirements, and we plan to continue investing in developing and leveraging ACERT Technology systems and components.

Caterpillar's remanufacturing business provides services for a variety of products and services to Caterpillar and other external clients. The remanufacturing business competes on a regional basis with similarly sized or smaller companies. The company launched the remanufacturing business in the 1970s with engines and is now one of the world's largest remanufacturers, processing more than two million units annually and recycling more than 100 million pounds of remanufactured products each year. The business continues to grow at rates well above that of the global economy as a whole.

Financial Products

Cat Financial, incorporated in Delaware, is a wholly owned finance subsidiary of Caterpillar. Cat Financial's primary business is to provide retail-financing alternatives for Caterpillar products to customers and Caterpillar dealers around the world. Such retail financing is primarily comprised of financing of Caterpillar equipment, machinery and engines. In addition, Cat Financial also provides financing for vehicles, power generation facilities and marine vessels that, in most cases, incorporate Caterpillar products. In addition to retail financing, Cat Financial provides wholesale financing to Caterpillar dealers and purchases short-term dealer receivables from Caterpillar. The various financing plans offered by Cat Financial are designed to increase the opportunity for sales of Caterpillar products and generate financing income for Cat Financial. A significant portion of Cat Financial's activity is conducted in North America. However, Cat Financial has additional offices and subsidiaries in Asia, Australia, Europe and Latin America.

For 25 years, Cat Financial has been providing financing in the various markets in which it participates, contributing to its knowledge of asset values, industry trends, product structuring and customer needs.

In certain instances, Cat Financial's operations are subject to supervision and regulation by state, federal and various foreign governmental authorities, and may be subject to various laws and judicial and administrative decisions imposing various requirements and restrictions, which, among other things, (i) regulate credit granting activities, (ii) establish maximum interest rates, finance charges and other charges, (iii) require disclosures to customers, (iv) govern secured transactions, (v) set collection, foreclosure, repossession and other trade practices, (vi) prohibit discrimination in the extension of credit and administration of loans, and (vii) regulate the use and reporting of information related to a borrower's credit experience.

Cat Financial's retail financing leases and installment sale contracts (total 58 percent*) include:

- Tax leases that are classified as either operating or finance leases for financial accounting purposes, depending on the characteristics of the lease. For tax purposes, Cat Financial is considered the owner of the equipment (17 percent*).
- Finance (non-tax) leases where the lessee is considered the owner of the equipment during the term of the lease and the agreement either requires or allows the customer to purchase the equipment for a fixed price at the end of the term (15 percent*).
- Installment sale contracts, which are equipment loans that enable customers to purchase equipment with a down payment or trade-in and structure payments over time (25 percent*).
- Governmental lease-purchase plans in the United States that offer low interest rates and flexible terms to qualified non-federal government agencies (1 percent*).

Retail notes receivables includes:

- Loans that allow customers and dealers to use their Caterpillar equipment as collateral to obtain financing (20 percent*).

Wholesale notes receivables, finance leases, and installment sale contracts (total 22 percent*) include:

- Inventory/rental programs which provide assistance to dealers by financing their inventory, rental fleets and rental facilities (6 percent*).
- Short-term dealer receivables Cat Financial purchases from Caterpillar and subsidiaries at a discount (16 percent*).

*Indicates the percentage of Cat Financial's total portfolio at December 31, 2005. For more information on the above and Cat Financial's concentration of credit risk, please refer to Note 21 on page A-28 of Exhibit 13.

The retail financing business is highly competitive, with financing for users of Caterpillar equipment available through a variety of sources, principally commercial banks and finance and leasing companies. Cat Financial's competitors include CIT Group Inc.; CitiCapital, a business unit of Citigroup; General Electric Capital Corporation and local banks and finance companies. In addition, many of our manufacturing competitors use below-market interest rate programs (subsidized by the manufacturer) to assist machine sales. Caterpillar and Cat Financial work together to provide a broad array of financial merchandising programs around the world to respond to these competing offers.

Cat Financial's results are largely dependent upon Caterpillar dealers' ability to sell equipment and customers' willingness to enter into financing or leasing agreements. It is also affected by the availability of funds from its financing sources and general economic conditions such as inflation and market interest rates.

Cat Financial has a "match funding" policy that addresses interest rate risk by aligning the interest rate profile (fixed rate or floating rate) of its debt portfolio with the interest rate profile of its receivable portfolio (loans and leases with customers and dealers) within predetermined ranges on an ongoing basis. In connection with that policy, Cat Financial issues debt with a similar interest rate profile to its receivables and also uses interest rate swap agreements to manage its interest rate risk exposure to interest rate changes and in some cases to lower our cost of borrowed funds. For more information regarding match funding, please see Note 3 on pages A-14 and A-15 of Exhibit 13.

In managing foreign currency risk for Cat Financial's operations, the objective is to minimize earnings volatility resulting from conversion and the remeasurement of net foreign currency balance sheet positions. This policy allows the use of foreign currency forward contracts to address the risk of currency mismatch between the receivable and debt portfolios. None of these foreign currency forward and option contracts is designated as a hedge.

Cat Financial provides financing only when acceptable criteria are met. Credit decisions are based on, among other things, the customer's credit history, financial strength, and equipment application. Cat Financial typically maintains a security interest in retail-financed equipment and requires physical damage insurance coverage on financed equipment. Cat Financial finances a significant portion of Caterpillar dealers' sales and inventory of Caterpillar equipment, especially in North America. Cat Financial's competitive position is improved by marketing programs, subsidized by Caterpillar and/or Caterpillar dealers, which allow it to offer below-market interest rates. Under these programs, Caterpillar, or the dealer, subsidizes an amount at the outset of the transaction, which Cat Financial then recognizes as revenue over the term of the financing. Transaction processing time and the supporting technologies continue to drive Cat Financial in its efforts to respond quickly to customers and improve internal processing efficiencies. We believe Cat Financial's web-based Cat Financ*Express*SM transaction processing and information tool currently available in the United States, France, Canada and Australia helps to give Cat Financial a competitive advantage in those areas. Cat Financ*Express* collects information online to provide finance quotes and credit decisions and then prints the related documents, all in a very short time frame.

Caterpillar Insurance Company, a wholly owned subsidiary of Cat Insurance (Cat Insurance and its subsidiaries are referred to herein collectively as Cat Holdings), is a U.S. insurance company domiciled in Missouri and primarily regulated by the Missouri Department of Insurance. The insurance company is licensed to conduct property and casualty insurance business in 49 states and the District of Columbia, and as such, is regulated in those jurisdictions as well. The state of Missouri acts as the lead regulatory authority and monitors the company's financial status to ensure that the company is in compliance with minimum solvency requirements, as well as other financial ratios prescribed by the National Association of Insurance Commissioners.

Caterpillar Life Insurance Company, a wholly owned subsidiary of Caterpillar, is a U.S. insurance company domiciled in Missouri and primarily regulated by the Missouri Department of Insurance. The insurance company is licensed to conduct life and accident and health insurance business in 23 states and the District of Columbia, and as such, is regulated in those jurisdictions as well. As the state of Missouri acts as the lead regulatory authority, it monitors the financial status to ensure that the company is in compliance with minimum solvency requirements, as well as other financial ratios prescribed by the National Association of Insurance Commissioners.

Caterpillar Insurance Co. Ltd., a wholly owned subsidiary of Cat Insurance is a captive insurance company domiciled in Bermuda and regulated by the Bermuda Monetary Authority. The company is a Class 2 insurer (as defined by the Bermuda Insurance Amendment Act of 1995), which primarily insures affiliates and, as such, the Bermuda Monetary Authority requires an Annual Financial Filing for purposes of monitoring compliance with solvency requirements.

Caterpillar Product Services Corporation, a wholly owned subsidiary of Caterpillar, is a warranty company domiciled in Missouri. It is regulated as a special purpose warranty company in a limited number of jurisdictions and conducts the Caterpillar engine extended service contract business (parts and labor) in all states except Virginia and Washington. It also conducts the machine extended service contract program in Italy, France and Germany.

Caterpillar Insurance Services Corporation, a wholly owned subsidiary of Cat Insurance, is a Tennessee insurance brokerage company licensed in all 50 states and the District of Columbia. It provides brokerage services for all property and casualty and life and health lines of business.

Cat Holdings provides protection for claims under the following programs:

- Contractual Liability Insurance to Caterpillar dealers and Original Equipment Manufacturers (OEM) for extended service contracts (parts and labor) offered by third party dealers and OEMs.
- Reinsurance for the worldwide cargo risks of Caterpillar products.
- Contractors' Equipment physical damage insurance for equipment manufactured by Caterpillar, which is leased, rented, or sold by third party dealers.
- Insurance for Caterpillar general liability, employer's liability, auto liability, property, and retiree medical stop loss insurance.
- Brokerage services for property and casualty and life and health business.

Cat Power Ventures, a wholly owned subsidiary of Caterpillar, primarily invests equity and takes an ownership interest in power generation projects throughout the world that utilize Caterpillar power generation equipment. In some cases, these projects also utilize construction and operations and maintenance services that are provided by other Caterpillar subsidiaries. Cat Power Ventures has investments in power projects in Poland, the Dominican Republic, Tunisia, Cambodia and India and has created direct and indirect subsidiaries and affiliates to hold these investments. In December 2005, the company decided that it would no longer invest equity in power generation projects. As a result, Cat Power Ventures will not make any new equity investments in power generation projects and will sell its project investment portfolio. We expect these sales to be completed and for Cat Power Ventures to have ceased operations by the end of 2007.

Business Developments in 2005

Our focus in 2005 was on meeting customer delivery expectations while creating stockholder value. We effectively responded to unprecedented customer demand and reported full-year sales and revenues of \$36.339 billion and profit-per-share of \$4.04, up 40 percent over 2004. In September 2005, Caterpillar was selected as a member of the Dow Jones Sustainability World Index for the fifth consecutive year. The Index recognizes leading sustainability-driven companies worldwide and measures the environmental, economic and social dimensions of their businesses. We strive to be a global leader in sustainability and we promote sustainable development consistent with our business goals, having made sustainable development an enterprise-wide focus in our Vision 2020 strategy.

In October, we introduced our Vision 2020, which set forth new enterprise strategy and goals for 2010 and beyond. Through Vision 2020, we established key enterprise goals for 2010 grouped under the "3Ps" of people, performance and profitable growth. Our people goals include a highly engaged workforce and world-class safety. Our performance goals are related to improved quality and market leadership in every major product group we serve. Our profitable growth goals include a 2010 sales and revenues target and goals for profitable growth.

We also updated our Worldwide Code of Conduct (Code) in October, which was first published in 1974. Our most recent update to our Code builds upon our strong heritage by explicitly describing the values-based culture we are building across our company.

In terms of growing our company, we expanded our remanufacturing operations in 2005 through a series of moves that included the announcement of a new Remanufacturing Division to support the remanufacturing services that we have been providing since the 1970s. We also entered into a series of business transactions aimed at developing and achieving our growth goals for our remanufacturing operations including the purchase of a minority interest in France-based Eurenov S.A., a remanufacturer of automotive and industrial engines, transmissions and components in June and the signing of a memorandum of understanding in August to act as Land Rover's lead global remanufacturing services provider.

In 2005, we announced a number of other efforts to grow our company including the formation of a new Production Systems Division, which will lead an enterprise wide transformation of our manufacturing systems to help set a "gold standard" for quality, safety and speed in industry and a new Caterpillar Global Pipeline group that will have a global focus on the pipeline construction industry. We also announced the expansion of manufacturing operations for the Electric Power Division with a new electric power manufacturing facility in Newberry, South Carolina to open in 2006 and a major expansion of our forestry equipment manufacturing operations in LaGrange, Georgia.

We continued to expand upon our growth initiatives in China in 2005. In January we announced the selection of the city of Qingdao in the Shandong Province as the location for a state-of-the-art research and development center for product and process development in China, continuing to build upon our multi-year strategy for expanding our presence in China. The selection of Qingdao for the center is expected to provide a focal point for product development and accelerate the introduction of company technology into our design and production process in China. We also finalized the acquisition of a minority ownership in Shandong SEM Machinery Co. Ltd., one of China's leading wheel loader manufacturers in March, and in August, we signed three non-binding memoranda of understanding with the Shanghai Lingang Economic Development Co., Ltd., an industrial park development company affiliated with the Shanghai Municipal Government, which allowed us to demonstrate our continued commitment to customer service and growth in the China market.

We also continued to leverage our award-winning ACERT Technology to solidify our position as the emissions reduction leader in both on- and off-highway applications. ACERT Technology enabled us to meet Tier 3 emission requirements ahead of the January 2005 (300 – 750 HP) and January 2006 (175 – 300 HP) implementation dates. In February 2005, the new 1055D paver powered by a C7 ACERT engine rated at 225 HP was shipped nearly a year ahead of the January 2006 implementation date. In March 2005 at CONEXPO/CON-AGG in Las Vegas, Nevada, the company's display included 11 Caterpillar machines powered by engines featuring ACERT Technology. In October 2005, the company invited the media to a ceremony recognizing the production of the 10,000th ACERT machine engine and the 2,500th ACERT industrial engine. These milestones continue to establish the importance of our ACERT Technology, demonstrating the competitive advantage it provides to Caterpillar and the value it provides to our customers and the public at large.

Acquisitions

Information related to acquisitions appears in Note 26 on page A-36 of Exhibit 13.

Order Backlog

The dollar amount of backlog believed to be firm was approximately \$12.2 billion at December 31, 2005 and \$9.1 billion at December 31, 2004. Of the total backlog, approximately \$1.7 billion at December 31, 2005 and \$0.6 billion at December 31, 2004, was not expected to be filled in the following year. Our backlog is generally highest in the first and second quarters because of seasonal buying trends in our industry.

Dealers

Our machines are distributed principally through a worldwide organization of dealers (dealer network), 54 located in the United States and 128 located outside the United States. Worldwide, these dealers serve 182 countries and operate 3,510 places of business, including 1,587 dealer rental outlets. Reciprocating engines are sold principally through the dealer network and to other manufacturers for use in their products. Some of the reciprocating engines manufactured by Perkins Engines Company Limited (Perkins) are also sold through a worldwide network of 140 distributors located in 170 countries along with 3,500 supporting dealers. Most of the electric power generation systems manufactured by FG Wilson are sold through a worldwide network of 200 dealers located in 180 countries.

These dealers do not deal exclusively with our products; however, in most cases sales and servicing of our products are the dealers' principal business. Turbines and large marine reciprocating engines are sold through sales forces employed by the company. At times, these employees are assisted by independent sales representatives.

The company's relationship with each independent dealer within the dealer network is memorialized in a standard sales and service agreement. Pursuant to this agreement, the company grants the dealer the right to purchase and sell its products and to service the products in a specified geographic region. Prices to dealers are established by the company after receiving input from dealers on transactional pricing in the marketplace. The company also agrees to defend its intellectual property and to provide warranty and technical support to the dealer. The agreement further grants the dealer a non-exclusive license to the company's trademarks, service marks and brand names.

In exchange for these rights, the agreement obligates the dealer to develop and promote the sale of the company's products to current and prospective customers in the dealer's region. Each dealer specifically agrees to employ adequate sales and support personnel to market, sell and promote the company's products, demonstrate and exhibit the products, perform the company's product improvement programs, inform the company concerning any features that might affect the safe operation of any of the company's products and maintain detailed books and records of the dealer's financial condition, sales and inventories and make these books and records available at the company's reasonable request.

These sales and service agreements are terminable at will by either party upon 90 days written notice and terminate automatically if the dealer files for bankruptcy protection or upon the occurrence of comparable action seeking protection from creditors.

Patents and Trademarks

Our products are sold primarily under the brands "Caterpillar," "Cat," design versions of "Cat" and "Caterpillar," "Solar Turbines," "MaK," "Perkins," "FG Wilson" and "Olympian." We own a number of patents and trademarks relating to the products we manufacture, which have been obtained over a period of years. These patents and trademarks have been of value in the growth of our business and may continue to be of value in the future. We do not regard any of our business as being dependent upon any single patent or group of patents.

Research and Development

We have always placed strong emphasis on product-oriented research and development relating to the development of new or improved machines, engines and major components. In 2005, 2004, and 2003, we spent \$1,084 million, \$928 million, and \$669 million, or 3.0 percent, 3.1 percent, and 2.9 percent of our sales and revenues, respectively, on our research and development programs.

Employment

As of December 31, 2005, we employed 85,116 persons of whom 41,238 were located outside the United States. From a global, enterprise perspective, we believe our relationship with our employees is very good. We build and maintain a productive, motivated workforce by treating all employees fairly and equitably.

In the United States, most of our 43,878 employees are at-will employees and, therefore, not subject to any type of employment contract or agreement. At select business units, certain highly specialized employees have been hired under employment contracts that specify a term of employment and specify pay and other benefits.

As of December 31, 2005, there were 13,453 U.S. hourly production employees who were covered by collective bargaining agreements with various labor unions. The United Automobile, Aerospace and Agricultural Implement Workers of America (UAW) represents 11,515 Caterpillar employees under a six-year central labor agreement that will expire March 1, 2011. The International Association of Machinists (IAM) represents 1,938 employees under labor agreements that expired on April 30, 2005, and May 29, 2005.

Outside the United States, the company enters into employment contracts and agreements in those countries in which such relationships are mandatory or customary. The provisions of these agreements correspond in each case with the required or customary terms in the subject jurisdiction.

Sales

Sales outside the United States were 53 percent of consolidated sales for 2005, 54 percent for 2004, and 56 percent for 2003.

Environmental Matters

We strive to be a global leader in sustainability and we promote sustainable development consistent with our business goals, in line with our Vision 2020 strategy.

The company is regulated by federal, state, and international environmental laws governing our use of substances and control of emissions. In addition to governing our manufacturing and other operations, these laws often impact the development of our products, including through required compliance with air emissions standards applicable to internal combustion engines. Compliance with these existing laws has not had a material impact on our capital expenditures, earnings, or competitive position.

We are cleaning up contamination at a number of locations, often with other companies, pursuant to federal and state laws. When it is probable 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 or others. The amount recorded for environmental clean-up is not material and is included in Statement 2 on page A-6 of Exhibit 13 under "Accrued Expenses."

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 at any individual site or at all sites in the aggregate will be required.

Available Information

The company files electronically with the Securities and Exchange Commission (SEC) required reports on Form 8-K, Form 10-Q, Form 10-K and Form 11-K; proxy materials; ownership reports for insiders as required by Section 16 of the Securities Exchange Act of 1934; and registration statements on Forms S-3 and S-8, as necessary. The public may read and copy any materials the company has filed with the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at (202) 551-8090. The SEC maintains an Internet site (www.sec.gov) that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC. Copies of our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any amendments to these reports filed or furnished with the SEC are available free of charge through our Internet site (www.CAT.com/secfilings) as soon as reasonably practicable after filing with the SEC. Copies of our board committee charters, our board's Guidelines on Corporate Governance Issues, Worldwide Code of Conduct, and other corporate governance information are available on our Internet site (www.CAT.com/governance), or upon written request to the Corporate Secretary at 100 NE Adams Street, Peoria, Illinois 61629.

Additional company information may be obtained as follows:

Current information -

- phone our Information Hotline - (800) 228-7717 (U.S. or Canada) or (858) 244-2080 (outside U.S. or Canada) to request company publications by mail, listen to a summary of Caterpillar's latest financial results and current outlook, or to request a copy of results by facsimile or mail
- request, view, or download materials on-line or register for email alerts at www.CAT.com/materialsrequest

Historical information -

- view/download on-line at www.CAT.com/historical

Item 1A. Business Risk Factors

An investment in our securities involves a number of risk and uncertainties. You should carefully consider the following risks, together with the cautionary statement under the caption "SAFE HARBOR STATEMENT UNDER THE SECURITIES LITIGATION REFORM ACT OF 1995" in Item 7 of this report and the other information included in this report, before purchasing our securities. The risks described below are not the only ones we face. Additional risks that are currently unknown to us or that we currently consider to be immaterial may also impair our business or adversely affect our financial condition or results of operations. If any of the following risks actually occurs, our business, financial condition or results of operation could be adversely affected. In such case, the trading price of our securities could decline and you may lose all or part of your investment.

Interest Rates

The U. S. Federal Reserve Board has raised interest rates at 14 consecutive meetings and, while hinting the tightening cycle is about over, has not clearly specified at what rate it plans to stop. Overall economic growth has slowed; however, business investment and manufacturing continue to perform strongly. Should the Fed decide to continue with several more rate increases, prospects for business investment and manufacturing could deteriorate sufficiently to impact sales opportunities. In the Eurozone, any additional interest rate increases there could halt an economic recovery that just started in the last half of 2005, jeopardizing a modest improvement in sales.

Production Capacity

The ongoing recovery in the world economy, as well as in Caterpillar sales, has extensively used available productive capacity in many industries and stressed the world's transportation system. Our forecast for 2006 assumes continued good world economic growth, as well as another increase in our sales. As a result, capacity in a number of industries could become even tighter and more vulnerable to disruptions, such as labor disagreements, weather or lack of raw materials. Such disruptions could result in material cost spikes, disruptions in production, or increased inefficiencies, all of which would impair our ability to efficiently meet customer demand.

Metal and Energy Prices

The increase in metals and energy prices since 2002 has significantly boosted demand for machines and engines. Factors causing higher prices, tight supplies and growing demand, are expected to remain in place in 2006. However, metals and energy prices are volatile and a sudden drop in demand, perhaps resulting from weaker economic growth, could cause a collapse in prices. Such an event would weaken economic growth in many developing countries and reduce investments in new production capacity for metals and energy.

Item 1B. Executive Officers of the Registrant as of December 31, 2005 (except as otherwise noted)

| Name and Age | Present Caterpillar Inc. position and date of initial election | Principal positions held during the past five years if other than Caterpillar Inc. position currently held |
|----------------------------|--|--|
| James W. Owens (59) | Chairman and Chief Executive Officer (2004) | <ul style="list-style-type: none">• Group President (1995-2003)• Vice Chairman (2003-2004) |
| Stuart L. Levenick (52) | Group President (2004) | <ul style="list-style-type: none">• Chairman, Shin Caterpillar Mitsubishi Ltd. (2000-2004)• Vice President (2000-2004) |
| Douglas R. Oberhelman (52) | Group President (2001) | <ul style="list-style-type: none">• Vice President (1995-2001) |
| Gerald L. Shaheen (61) | Group President (1998) | |
| G rard R. Vittecoq (57) | Group President (2004) | <ul style="list-style-type: none">• Vice President (2000-2004) |
| Steven H. Wunning (54) | Group President (2004) | <ul style="list-style-type: none">• Vice President (1998-2004) |
| Kent M. Adams (51) | Vice President (2005) | <ul style="list-style-type: none">• Corporate Support Vice President, Caterpillar Financial Services Corporation (2001-2003)• Executive Vice President, Caterpillar Financial Services Corporation (2004) |

| Name and Age | Present Caterpillar Inc. position and date of initial election | Principal positions held during the past five years if other than Caterpillar Inc. position currently held |
|--------------------------------------|--|---|
| Ali M. Bahaj (52) | Vice President (2002) | <ul style="list-style-type: none"> • Director, Division Services, Engine Products Division (1998-2001) • Director, Business Development & Consulting Services (2001-2002) |
| Sidney C. Banwart (60) | Vice President (1998) | |
| Michael J. Baunton (54) | Vice President (1998) | <ul style="list-style-type: none"> • President, Perkins Engine Company Limited (1998 - 2004) |
| Rodney C. Beeler (48) | Vice President (2004) | <ul style="list-style-type: none"> • Manager, Rental and Used Equipment Services Department, North American Commercial Division (2000-2004) |
| Mary H. Bell (45) | Vice President (2004) | <ul style="list-style-type: none"> • Dealer Capability Department Manager, Product Support Division (2000-2002) • Cat Distribution Services General Manager, Logistics Division (2002-2003) |
| James B. Buda (58) | Vice President, General Counsel and Secretary (2001) | <ul style="list-style-type: none"> • Associate General Counsel, UK (1999-2001) |
| David B. Burritt (50) | Vice President and Chief Financial Officer (2004) | <ul style="list-style-type: none"> • General Manager, Strategic & Business Services - Europe, Caterpillar Overseas S.A. (1999-2001) • Corporate 6 Sigma Champion (2001-2002) • Controller (2002 - 2004) |
| Rodney L. Bussell (59) | Vice President (2001) | <ul style="list-style-type: none"> • General Manager, Large Engine Products & Fuel Systems Division (1998-2001) |
| Christopher C. Curfman (53) | Vice President (2004) | <ul style="list-style-type: none"> • Managing Director, Caterpillar of Australia Ltd. (1999-2001) • Managing Director-Marketing, Caterpillar of Australia Ltd. (2001) • Managing Director-Marketing, Asia-Pacific Division (2001-2004) • Alliance Development Director, Global Mining Division (2004) |
| Paolo Fellin (51) | Vice President (2004) | <ul style="list-style-type: none"> • General Manager, Caterpillar Work Tools & Services (1999-2003) • Marketing Manager, North American Commercial Division (2003-2004) |
| Steven L. Fisher (50) | Vice President (2005) | <ul style="list-style-type: none"> • Cost Management & Business Services Manager, Corporate Services Division (1998-2001) • Corporate Business Development Manager, Corporate Services Division (2001) • Reman Products Group General Manager, Product Support Division (2001-2004) • Reman Services General Manager, Product Support Division (2004-2005) |
| Thomas A. Gales (57) | Vice President (2000) | |
| Stephen A. Gosselin (48) | Vice President (2002) | <ul style="list-style-type: none"> • Regional Manager, North American Commercial Division (2000-2002) |
| Hans A. Haefeli (47) | Vice President (2004) | <ul style="list-style-type: none"> • Managing Director Product Supply, Perkins Engines Company Limited (1999-2002) • General Manager, Building Construction Products Division (2002-2003) |
| John S. Heller (51) | Vice President (2004) | <ul style="list-style-type: none"> • Engine Division Technology Manager, Engine Products Division (2000-2001) • Engine Division Technology Manager, Systems & Processes Division (2001-2001) • Director, Corporate Information Services, Systems & Processes Division (2001-2002) • Director, Global IT Solutions, Systems & Processes Division (2002-2004) |
| Richard P. Lavin (53) | Vice President (2001) | <ul style="list-style-type: none"> • Director, Compensation & Benefits (1999-2001) • Chairman, Shin Caterpillar Mitsubishi Ltd. (2005-present) |
| Robert R. Macier (57) ⁽¹⁾ | Vice President (1998) | <ul style="list-style-type: none"> • President, Solar Turbines Incorporated (2002-2005) |
| William D. Mayo (53) | Vice President (2005) | <ul style="list-style-type: none"> • General Manager, Engine Products Division (1998-2001) • Product Manager, Track-Type Tractors Division (2001-2003) • Regional Manager, EAME Marketing Division (2003-2005) |
| Daniel M. Murphy (58) | Vice President (1996) | |
| Gerald Palmer (60) | Vice President (1992) | |
| James J. Parker (55) | Vice President (2001) | <ul style="list-style-type: none"> • Director, Electric Power (1998-2001) |
| Mark R. Pflederer (49) | Vice President (2004) | <ul style="list-style-type: none"> • Electronics & Electrical Business Unit Manager, Control Systems Products Division (1999-2001) • Electronics & Electrical Business Unit Manager, Component Products & Control Systems Division (2001-2003) |

| Name and Age | Present Caterpillar Inc. position and date of initial election | Principal positions held during the past five years if other than Caterpillar Inc. position currently held |
|--|--|--|
| Edward J. Rapp (48) | Vice President (2000) | |
| William J. Rohner (53) | Vice President (2004) | <ul style="list-style-type: none"> • CBL Managing Director, Latin America Division (2000-2004) |
| Christiano V. Schena (56) | Vice President (2002) | <ul style="list-style-type: none"> • General Manager, EAME Product Development Division (2000-2002) • Managing Director, Building Construction Products Europe (2002) |
| William F. Springer (54) | Vice President (2002) | <ul style="list-style-type: none"> • President, Caterpillar Logistics (1998-2002) |
| Gary A. Stroup (56) | Vice President (1992) | <ul style="list-style-type: none"> • President, Solar Turbines Incorporated (1998-2002) |
| James D. Waters (47) | Vice President (2005) | <ul style="list-style-type: none"> • Managing Director, Building Construction Products Division (1999-2002) • Hydraulics/Fabrication Business Unit Manager, Component Products & Control Systems Division/Motion & Power Control Division (2002-2005) |
| Donald G. Western (57) | Vice President (1995) | |
| Robert T. Williams (57) | Vice President (2004) | <ul style="list-style-type: none"> • General Manager, Performance Engine Products Division (1998-2002) • Director-Manufacturing, Operations Support & Technology, Technical Services Division (2002) • Director, Technical Services Division (2003-2004) |
| Bradley M. Halverson (45) | Controller (2004) | <ul style="list-style-type: none"> • Business Resource Manager, Performance Engines Products Division (1998-2001) • Business Resource Manager, Large Engine Products & Fuel Systems Division (2001) • Business Resource Manager, Large Power Systems Division (2002) • Corporate Business Development Manager, Corporate Services Division (2002-2004) |
| Kevin E. Colgan (53) | Treasurer (2001) | <ul style="list-style-type: none"> • Vice President, Caterpillar Financial Services Corporation (1997-2001) |
| (1) Retired effective January 1, 2006. | | |

Item 2. Properties.

General Information

Caterpillar's operations are highly integrated. Although the majority of our plants are involved primarily in the production of either machines or engines, several plants are involved in the manufacturing of both. In addition, several plants are involved in the manufacturing of components which are used in the assembly of both machines and engines. Caterpillar's parts distribution centers are involved in the storage and distribution of parts for machines and engines. Also, the research and development activities carried on at our Technical Center (as described below) involve both machines and engines.

Properties we own are believed to be generally well maintained and adequate for present use. Through planned capital expenditures, we expect these properties to remain adequate for future needs. Properties we lease are covered by leases expiring over terms of generally one to 10 years. We anticipate no difficulty in retaining occupancy of any leased facilities, either by renewing leases prior to expiration or by replacing them with equivalent leased facilities.

Headquarters

Our corporate headquarters are in Peoria, Illinois. Additional marketing headquarters are located both inside and outside the United States. The Financial Products Division is headquartered in leased offices located in Nashville, Tennessee.

Distribution

Distribution of our parts is conducted from parts distribution centers inside and outside the United States. Caterpillar Logistics Services, Inc., distributes other companies' products utilizing certain of our distribution facilities as well as other non-Caterpillar facilities located both inside and outside the United States. We also own or lease other storage facilities that support distribution activities.

Changes in Fixed Assets

During the five years ended December 31, 2005, changes in our investment in property, plant and equipment were as follows (stated in millions of dollars):

| Year | Expenditures | | Acquisitions | | Provision for Depreciation | Disposals and Other Adjustments | Net Increase (Decrease) During Period |
|------|--------------|--------------|--------------|--------------|----------------------------|---------------------------------|---------------------------------------|
| | U.S. | Outside U.S. | U.S. | Outside U.S. | | | |
| 2001 | \$ 1,345 | \$ 623 | \$ 2 | \$ 32 | \$ (1,070) | \$ (280) | \$ 652 |
| 2002 | \$ 1,030 | \$ 743 | \$ 15 | \$ 0 | \$ (1,199) | \$ (151) | \$ 438 |
| 2003 | \$ 1,000 | \$ 765 | \$ 0 | \$ 0 | \$ (1,332) | \$ (191) | \$ 242 |
| 2004 | \$ 1,212 | \$ 902 | \$ 10 | \$ 44 | \$ (1,366) | \$ (371) | \$ 431 |
| 2005 | \$ 1,383 | \$ 1,032 | \$ 0 | \$ 0 | \$ (1,444) | \$ (665) | \$ 306 |

At December 31, 2005, the net book value of properties located outside the United States represented about 40.8 percent of the net book value of all properties reflected in our consolidated financial position. Additional information about our investment in property, plant and equipment appears in Note 1F on page A-10 and Note 10 on page A-19 of Exhibit 13.

Technical Center, Training Centers, Demonstration Areas, and Proving Grounds

We own a Technical Center located in Mossville, Illinois, and various other training centers, demonstration areas and proving grounds located both inside and outside the United States.

Manufacturing, Remanufacturing, and Overhaul

Manufacturing, remanufacturing and overhaul of our products are conducted at the following locations. These facilities are believed to be suitable for their intended purposes with adequate capacities for current and projected needs for existing products.

Manufacturing

Inside the U.S.

California

- Gardena
- San Diego

Florida

- Jacksonville

Georgia

- Alpharetta
- Griffin
- Jefferson
- LaGrange
- Toccoa
- Thomasville

Illinois

- Aurora
- Champaign¹
- Decatur
- Dixon
- East Peoria
- Joliet
- Mapleton
- Mossville
- Peoria
- Pontiac
- Sterling
- Woodridge¹

Indiana

- Lafayette

Kansas

- Wamego

Kentucky

- Danville

Michigan

- Menominee

Minnesota

- Grand Rapids¹
- Minneapolis
- New Ulm

Mississippi

- Oxford

Missouri

- Boonville
- West Plains

North Carolina

- Clayton
- Franklin
- Morganton
- Sanford

Ohio

- Dayton¹

South Carolina

- Greenville
- Sumter

Tennessee

- Dyersburg

Texas

- Channelview
- Waco

Outside the U.S.

Australia

- Burnie
- Melbourne

Belgium

- Gosselies

Brazil

- Curitiba
- Piracicaba

England

- Barwell
- Desford
- Peterborough
- Peterlee
- Skinningrove
- Stafford
- Stockton
- Wimborne
- Wolverhampton

France

- Arras
- Grenoble
- Rantigny

Germany

- Kiel
- Rostock

Hungary

- Gödöllő

India

- Bangalore²
- Pondicherry
- Thiruvallur

Indonesia

- Jakarta

Italy

- Anagni
- Atessa
- Bazzano
- Fano
- Frosinone
- Jesi
- Marignano
- Milan
- Minerbio

Japan

- Akashi¹
- Sagamihara¹

Mexico

- Monterrey
- Reynosa

- Saltillo
- Tijuana
- Torreón

The Netherlands

- s'-Hertogenbosch

Northern Ireland

- Larne
- Monkstown
- Springvale

Peoples Republic of China

- Erliban¹
- Guangzhou
- Qingzhou¹
- Shunde
- Tianjin²
- Xuzhou²

Poland

- Janów Lubelski

Russia

- Tosno

South Africa

- Boksburg

Switzerland

- Riazzino

Tunisia

- Sfax

Remanufacturing and Overhaul

Inside the U.S.

Louisiana

- New Orleans

Mississippi

- Corinth
- Prentiss County

South Carolina

- Summerville

Texas

- De Soto
- Mabank

Outside the U.S.

Australia

- Melbourne

Belgium

- Gosselies

Canada

- Edmonton

England

- Rushden
- Shrewsbury

France

- Chaumont¹

Indonesia

- Bandung²

Malaysia

- Kuala Lumpur¹

Mexico

- Nuevo Laredo
- Tijuana
- Veracruz

Nigeria

- Port Harcourt²

Poland

- Radom¹

Scotland

- Aberdeen

¹ Facility of affiliated company (50 percent or less owned)

² Facility of partially owned subsidiary (more than 50 percent, less than 100 percent)

Item 3. 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 of these unresolved actions 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 adverse effect 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, among other things, 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 September 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. As of September 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 September 30, 2005, International Truck and Engine Corporation (International) commenced an action against Caterpillar in the Circuit Court of the Tenth Judicial Circuit of Illinois in Peoria, Illinois. The lawsuit states that it arises out of the May 31, 1988 Purchase Agreement described above. The Complaint alleges, among other things, that Caterpillar procured the May 31, 1988 Purchase Agreement by fraudulently misrepresenting or concealing information related to the business of selling fuel injectors to International, and that Caterpillar breached the Purchase Agreement. International's Complaint does not specify the amount of damages being sought. Caterpillar intends to defend itself vigorously in this case.

On May 7, 2002, 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 contained allegations similar to the allegations contained in the first lawsuit. International also alleged in the second lawsuit that Caterpillar materially breached the subsequent agreement. On June 15, 2005, International voluntarily dismissed its complaint in the first lawsuit. The second lawsuit has been consolidated with Caterpillar's counterclaims from the first lawsuit.

Trial is currently scheduled to begin on during the third quarter of 2006. This case is not 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, 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.

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 research and development credits. We disagree with these proposed adjustments and are vigorously disputing 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.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Information required by Item 5 is incorporated by reference from "Price Ranges" and "Number of Stockholders" on page A-64 and from "Dividends paid per common share" on page A-51 of Exhibit 13.

Non-U.S. Employee Stock Purchase Plans

We have 30 employee stock purchase plans administered outside the United States for our foreign employees. As of December 31, 2005, those plans had approximately 11,610 participants in the aggregate. During the fourth quarter of 2005, approximately 111,000 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 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.

Issuer Purchases of Equity Securities

| Period | Total number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased Under the Program | Maximum Number of Shares that May Yet Be Purchased Under the Program |
|---------------------|----------------------------------|------------------------------|--|--|
| October 1-31, 2005 | 7,632,000 | \$ 53.92 | 7,632,000 | 32,915,745 ¹ |
| November 1-30, 2005 | 3,370,000 | 54.48 | 3,370,000 | 30,515,565 ¹ |
| December 1-31, 2005 | 860,000 | 58.18 | 860,000 | 30,867,219 ¹ |
| Total | 11,862,000 | \$ 54.39 | 11,862,000 | |

¹ 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 was 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

| <u>Period</u> | <u>Total number of Shares Purchased¹</u> | <u>Average Price Paid per Share</u> | <u>Total Number of Shares Purchased Under the Program</u> | <u>Maximum Number of Shares that May Yet Be Purchased Under the Program</u> |
|---------------------|---|-------------------------------------|---|---|
| October 1-31, 2005 | -- | \$ -- | N/A | N/A |
| November 1-30, 2005 | 4,189 | 51.77 | N/A | N/A |
| December 1-31, 2005 | -- | -- | N/A | N/A |
| Total | 4,189 | \$ 51.77 | | |

¹ Represents shares delivered back to issuer for the payment of taxes resulting from the exercise of stock options.

Item 6. Selected Financial Data.

Information required by Item 6 is incorporated by reference from the "Five-year Financial Summary" on page A-37, "Contractual obligations" on page A-52 and "Supplemental consolidating data" on pages A-58 through A-60 of Exhibit 13.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Information required by Item 7 is incorporated by reference from pages A-38 through A-63 of Exhibit 13.

SAFE HARBOR STATEMENT UNDER THE SECURITIES LITIGATION REFORM ACT OF 1995

Certain statements contained in our Management's Discussion and Analysis 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 about 3.5 percent growth in the world economy in 2006 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 world economic growth and our Machinery and Engines sales likely would be weaker.

We expect the U. S. Federal Reserve will soon end its policy of raising interest rates and that the Federal Funds rate will end the year below five percent. Somewhat higher interest rates should cause a further slowing in economic growth to slightly over three percent in 2006. Other financial factors – long-term interest rates, corporate bond spreads – are expected to remain sufficiently favorable to support further growth in business investment. Should financial conditions tighten noticeably, causing economic growth to slow below three 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) in 2006 assumes that continued 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 Commonwealth of Independent States (CIS). Key risks are significant interest rate increases in the Eurozone that would slow the European economy or a worldwide collapse in commodity prices. Those developments would likely negatively impact our results.

Somewhat higher local interest rates in Latin America in 2006 and slower economic growth in the United States are expected to contribute to a further slowing in Latin American economic growth to slightly less than four percent. That rate of growth should support further increases in construction spending, and high metals prices should benefit investment in mining, both contributing to an increase in Machinery and Engines sales. This forecast is vulnerable to a significant weakening in commodity prices, widespread increases in interest rates or political disruptions.

In Asia/Pacific, we project economic growth will remain slightly below 6.5 percent in 2006, with faster growth in Australia and developing Asia offsetting a slight slowing in China. The projected increase in Machinery and Engines sales assumes that coal and metals prices will contribute to increased mine investment, growing populations and rising home prices will benefit housing construction, and rapid economic growth will prompt businesses to invest more in structures. 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 and Indonesia.

Commodity Prices

Commodities represent a significant sales opportunity, with prices and production as key drivers. Prices have improved sharply over the past three years and our outlook assumes that continued growth in world industrial production, low inventories and some difficulties in increasing production will cause metals prices to remain high enough in 2006 to encourage further mine investment. Any unexpected weakening in world industrial production, however, could cause prices to drop sharply to the detriment of our results.

Coal prices showed softness in some regions late in 2005 but remained well above prices that make mine investment attractive. We expect that the need to rebuild some coal stocks as well as increased electricity generation will support demand for coal in 2006 and prices will remain favorable. 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 three 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. 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 several developed countries have raised interest rates from the lowest rates in decades, with the U. S. Federal Reserve Bank being the most aggressive. Our outlook assumes that central banks will try to avoid increasing rates so much that economic recoveries stall. Should central banks raise interest rates more aggressively than anticipated, both economic growth and our sales could suffer.

Budget deficits in many countries remain higher than governments would like. 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 as enacted by the American Jobs Creation Act of 2004. 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 currency crises occur that could disrupt international trade or the competitiveness of our facilities. Should any crisis develop, 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/Original Equipment Manufacturers Inventory Practices

The company sells finished products through an independent dealer network or directly to Original Equipment Manufacturers (OEM). Both carry inventories of finished products as part of ongoing operations 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 no major changes in either dealer or OEM inventory practices. Should dealers or OEMs decide to 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 rates of infrastructure spending, housing starts, commercial construction and mining play 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 2006 sales outlook assumes that the company is successful in implementing worldwide machine price increases communicated to dealers with an effective date of January 2006. 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 realization.

Our sales and results are generally 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 sales and 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 7A. Quantitative and Qualitative Disclosures About Market Risk.

Information required by Item 7A appears in Note 1 under "Impairment of available-for-sale securities" on page A-11, Note 3 on pages A-14 and A-15, Note 20 on page A-28 and Note 21 on page A-28 of Exhibit 13. Other information required by Item 7A is incorporated by reference from pages A-56 and A-57 of Exhibit 13 under "Sensitivity."

Item 8. Financial Statements and Supplementary Data.

Information required by Item 8 is incorporated by reference from the Report of Independent Registered Public Accounting Firm on page A-4 and from the Financial Statements and Notes to Consolidated Financial Statements on pages A-5 through A-36 of Exhibit 13. Other information required by Item 8 is included in "Computation of Ratios of Earnings to Fixed Charges" filed as Exhibit 12 to this Form 10-K.

Item 9A. Controls and Procedures.

Under the supervision and with the participation of our management, including our chief executive officer and our chief financial officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Exchange Act Rule 13a-15(e). Based on this evaluation, our chief executive officer and our chief financial officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this annual report.

The management of Caterpillar Inc. is responsible for establishing and maintaining adequate internal control over financial reporting. Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Our internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. Management assessed the effectiveness of the company's internal control over financial reporting as of December 31, 2005. In making this assessment, we used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control — Integrated Framework*. Based on our assessment we concluded that, as of December 31, 2005, the company's internal control over financial reporting was effective based on those criteria.

Our management's assessment of the effectiveness of the company's internal control over financial reporting as of December 31, 2005 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm. The report appears on page A-4 of Exhibit 13.

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 III

Item 10. Directors and Executive Officers of the Registrant.

Identification of Directors and Business Experience

Information required by this Item is incorporated by reference from the 2006 Proxy Statement that will be filed within 120 days after the end of the calendar year.

Identification of Executive Officers and Business Experience

Information required by this Item appears in Item 1B of this Form 10-K.

Family Relationships

There are no family relationships between the officers and directors of the company. All officers serve at the pleasure of the board of directors and are elected annually at a meeting of the board.

Legal Proceedings Involving Officers and Directors

Information required by this Item is incorporated by reference from the 2006 Proxy Statement that will be filed within 120 days after the end of the calendar year.

Audit Committee Financial Expert

Information required by this Item is incorporated by reference from the 2006 Proxy Statement that will be filed within 120 days after the end of the calendar year.

Identification of Audit Committee

Information required by this Item is incorporated by reference from the 2006 Proxy Statement that will be filed within 120 days after the end of the calendar year.

Stockholder Recommendation of Board Nominees

Information required by this Item is incorporated by reference from the 2006 Proxy Statement that will be filed within 120 days after the end of the calendar year.

Compliance with Section 16(a) of the Exchange Act

Information required by this Item relating to compliance with Section 16(a) of the Securities Exchange Act of 1934 is incorporated by reference from the 2006 Proxy Statement that will be filed within 120 days after the end of the calendar year.

Code of Ethics

Our Worldwide Code of Conduct (Code), first published in 1974 and most recently amended in 2005, sets a high standard for honesty and ethical behavior by every employee, including the principal executive officer, principal financial officer and principal accounting officer/controller. The Code is posted on our website at www.CAT.com/governance and is incorporated by reference as Exhibit 14 to this Form 10-K. To obtain a copy of the Code at no charge, submit a written request to the Corporate Secretary at 100 NE Adams Street, Peoria, Illinois 61629-7310. We will post on our website any required amendments to or waivers granted under our Code pursuant to SEC or New York Stock Exchange disclosure rules.

Item 11. Executive Compensation.

Information required by this Item is incorporated by reference from the 2006 Proxy Statement that will be filed within 120 days after the end of the calendar year.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

Information required by this Item relating to security ownership of certain beneficial owners and management is incorporated by reference from the 2006 Proxy Statement that will be filed within 120 days after the end of the calendar year.

Information required by this item relating to securities authorized for issuance under equity compensation plans is included in the following table:

| Equity Compensation Plan Information (as of December 31, 2005) | | | |
|---|--|---|---|
| | (a) | (b) | (c) |
| Plan category | Number of securities to be issued upon exercise of outstanding options, warrants and rights ¹ | Weighted-average exercise price of outstanding options, warrants and rights | Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) |
| Equity compensation plans approved by security holders | 75,276,642 | 32.23 | 27,071,492 |
| Equity compensation plans not approved by security holders | n/a | n/a | n/a |
| Total | 75,276,642 | 32.23 | 27,071,492 |

¹ Column (a) excludes any cash payments in-lieu-of stock.

Item 13. Certain Relationships and Related Transactions.

Information required by this Item is incorporated by reference from the 2006 Proxy Statement that will be filed within 120 days after the end of the calendar year.

Item 14. Principal Accountant Fees and Services.

Information required by this Item is incorporated by reference from the 2006 Proxy Statement that will be filed within 120 days after the end of the calendar year.

PART IV

Item 15. Exhibits and Financial Statement Schedules.

- (a) The following documents are incorporated by reference from the indicated pages of Exhibit 13:
1. Financial Statements:
 - Report of Independent Registered Public Accounting Firm (A-4)
 - Statement 1 - Results of Operations (A- 5)
 - Statement 2 - Financial Position (A-6)
 - Statement 3 - Changes in Consolidated Stockholders' Equity (A-7)
 - Statement 4 - Statement of Cash Flow (A-8)
 - Notes to Consolidated Financial Statements (A-9 through A-36)
 2. Financial Statement Schedules:
 - All schedules are omitted because the required information is shown in the financial statements or the notes thereto incorporated by reference from Exhibit 13 or considered to be immaterial.

- (b) Exhibits:
- 3.1 Restated Certificate of Incorporation (incorporated by reference from Exhibit 3(i) to the Form 10-Q filed for the quarter ended March 31, 1998).
 - 3.2 Certificate of Designation, Preferences and Rights of the Terms of the Series A Junior Participating Preferred Stock (incorporated by reference from Exhibit 2 to Form 8-A filed December 11, 1996).
 - 3.3 Amendment to Certificate of Designation, Preferences and Rights of the Terms of the Series A Junior Participating Preferred Stock (incorporated by reference from Exhibit 3 to Form 10-Q filed for the quarter ended September 30, 2005).
 - 3.4 Bylaws, amended and restated as of February 11, 2004 (incorporated by reference from Exhibit 3.3 to the Form 10-Q filed for the quarter ended March 31, 2004).
 - 4 Fourth Amended and Restated Rights Agreement dated as of June 17, 2005, between Caterpillar Inc. and Mellon Investor Services LLC (incorporated by reference from Exhibit 4 to Form 8-K filed June 17, 2005).
 - 10.1 Caterpillar Inc. 1996 Stock Option and Long-Term Incentive Plan, amended and restated as of August 18, 2004 (incorporated by reference from Exhibit 10.1 to Form 10-K for 2004 filed February 24, 2005).**
 - 10.2 Caterpillar Inc. 1987 Stock Option Plan, as amended and restated and Long Term Incentive Supplement, amended and restated as of December 31, 2000 (incorporated by reference from Exhibit 10.2 to Form 10-K for 2002 filed March 31, 2003).**
 - 10.3 Supplemental Pension Benefit Plan, as amended and restated January 2003 (incorporated by reference from Exhibit 10.3 to Form 10-K for 2004 filed February 24, 2005).**
 - 10.4 Supplemental Employees' Investment Plan, as amended and restated through December 1, 2002 (incorporated by reference from Exhibit 10.4 to Form 10-K for 2002).**
 - 10.5 Caterpillar Inc. Executive Incentive Compensation Plan, effective as of January 1, 2002 (incorporated by reference from Exhibit 10.5 to the 2002 Form 10-K).**
 - 10.6 Directors' Deferred Compensation Plan, as amended and restated through April 12, 1999 (incorporated by reference from Exhibit 10.6 to the 1999 Form 10-K).**
 - 10.7 Directors' Charitable Award Program (incorporated by reference from Exhibit 10(h) to the 1993 Form 10-K).**
 - 10.8 Deferred Employees' Investment Plan, as amended and restated through February 16, 2005.**
 - 11 Computations of Earnings per Share.
 - 12 Computation of Ratios of Earnings to Fixed Charges.
 - 13 General and Financial Information for 2005 containing the information required by SEC Rule 14a-3 for an annual report to security holders.
 - 14 Caterpillar Worldwide Code of Conduct.
 - 21 Subsidiaries and Affiliates of the Registrant.
 - 23 Consent of Independent Registered Public Accounting Firm.
 - 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.
 - 99.1 Annual CEO certification to the New York Stock Exchange.
 - 99.2 Annual CEO certification for the Pacific Exchange.

** Compensatory plan or arrangement required to be filed as an exhibit pursuant to Item 15(c) of this Form 10-K.

Form 10-K
SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the company has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CATERPILLAR INC.
(Registrant)

February 22, 2006

By: /s/James B. Buda
James B. Buda, *Secretary*

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the company and in the capacities and on the dates indicated.

| | | |
|-------------------|--|--|
| February 22, 2006 | <u>/s/James W. Owens</u> (James W. Owens) | Chairman of the Board, Director and Chief Executive Officer |
| February 22, 2006 | <u>/s/Stuart L. Levenick</u> (Stuart L. Levenick) | Group President |
| February 22, 2006 | <u>/s/Douglas R. Oberhelman</u> (Douglas R. Oberhelman) | Group President |
| February 22, 2006 | <u>/s/Gerald L. Shaheen</u> (Gerald L. Shaheen) | Group President |
| February 22, 2006 | <u>/s/Gerard R. Vittecoq</u> (Gerard R. Vittecoq) | Group President |
| February 22, 2006 | <u>/s/Steven H. Wunning</u> (Steven H. Wunning) | Group President |
| February 22, 2006 | <u>/s/David B. Burritt</u> (David B. Burritt) | Vice President and Chief Financial Officer |
| February 22, 2006 | <u>/s/Bradley M. Halverson</u> (Bradley M. Halverson) | Controller and Chief Accounting Officer |

| | | |
|-------------------|--|----------|
| February 22, 2006 | <u>/s/W. Frank Blount</u> (W. Frank Blount) | Director |
| February 22, 2006 | <u>/s/John R. Brazil</u> (John R. Brazil) | Director |
| February 22, 2006 | <u>/s/John T. Dillon</u> (John T. Dillon) | Director |
| February 22, 2006 | <u>/s/Eugene V. Fife</u> (Eugene V. Fife) | Director |
| February 22, 2006 | <u>/s/Gail D. Fosler</u> (Gail D. Fosler) | Director |
| February 22, 2006 | <u>/s/Juan Gallardo</u> (Juan Gallardo) | Director |
| February 22, 2006 | <u>/s/David R. Goode</u> (David R. Goode) | Director |
| February 22, 2006 | <u>/s/Peter A. Magowan</u> (Peter A. Magowan) | Director |
| February 22, 2006 | <u>/s/William A. Osborn</u> (William A. Osborn) | Director |
| February 22, 2006 | <u>/s/Gordon R. Parker</u> (Gordon R. Parker) | Director |
| February 22, 2006 | <u>/s/Charles D. Powell</u> (Charles D. Powell) | Director |
| February 22, 2006 | <u>/s/Edward B. Rust, Jr.</u> (Edward B. Rust, Jr.) | Director |
| February 22, 2006 | <u>/s/Joshua I. Smith</u> (Joshua I. Smith) | Director |

CATERPILLAR INC.

DEFERRED EMPLOYEES'
INVESTMENT PLAN
(Amended and Restated through 2/2005)

1. Purpose

The purpose of the Caterpillar Inc. (Company) Deferred Employees' Investment Plan (DEIP), as set forth in the succeeding sections of this document, is to provide additional investment opportunities for those employees whose participation (through 2002) in the Employees' Investment Plan and (after 2002) in the Caterpillar 401(k) Plan (401(k) Plan) is restricted because of limitations imposed by the Internal Revenue Code of 1986, as amended. The DEIP was originally effective June 30, 1995.

2. Eligibility

An employee shall be eligible to participate in the DEIP if he [is in salary grade 28 or higher and] currently defers compensation into the 401(k) Plan.

3. Participant Deferrals

An employee must make a valid election (to become a "Participant") on or before the last Company business day in November of any year to participate in the DEIP during the following calendar year. Such election shall defer all or a portion of his compensation not to exceed the excess of (a) seventy percent (70%) of his base salary over (b) the total amount deferred by him into the 401(k) Plan; provided that his election to defer hereunder shall be contingent on his making the maximum deferral allowable under the 401(k) Plan. Any such election must be made (on a form provided by the Company) and delivered to the Director, Compensation and Benefits before the end of normal office hours on such last Company business day in November and shall remain in effect until it is revised as provided herein.

An employee may also elect to defer all or part of the incentive compensation payable to him for a calendar year; provided, however, that such Participant's election must be filed with such Director on or before the last Company business day in November of the year in which such compensation shall have been accruing. For this purpose, a Participant may elect to defer up to seventy percent (70%) of the base salary payable to him for a calendar year; provided, however, that such Participant's election must be filed with such Director on or before the last Company business day in November of the preceding calendar year.

For all purposes of the Plan, base salary shall include any lump sum base salary adjustment including any variable base pay and incentive compensation shall include any lump sum discretionary awards.

If a Participant wants to change or terminate the amount of compensation deferred, he shall deliver a revised election form to the Director, Compensation and Benefits; provided, however, that:

- (a) such revised election shall become effective (when and so long as the Participant is eligible) for each calendar year following the year in which such form is delivered, and shall remain effective until such election is further revised as provided herein, and
- (b) any such election must be filed before the end of normal office hours on the last Company business day in November.

When an employee first becomes eligible to participate in the DEIP (including those employees who first become eligible on the effective date), he may elect to defer compensation (or file a revised election) in accordance with the foregoing, except that any such election with respect to compensation payable to him during the calendar year in which he becomes eligible for the DEIP

- (a) must be filed within a 30-day period that begins on the date he becomes eligible, and
- (b) shall be applicable only to compensation paid for months that commence after the date of such election.

4. Employer Amounts

An employee will be credited with the same amount that would otherwise be contributed to his account as an employer contribution under the 401(k) Plan were it not for the limitations imposed by Section 401(a)(17) and 415(c)(1)(A) of the Internal Revenue Code of 1986, as amended, or any successor statute thereto.

5. Status of Accounts

All amounts in the DEIP shall be held in the general funds of the Company, but the Company will establish an individual bookkeeping account for each Participant. Amounts of compensation deferred by the Participant will be credited to the individual account of the Participant in accordance with his election(s).

Each Participant may elect to have all or a specified percentage of his deferred compensation allocated to:

- (a) interest bearing account;
- (b) share equivalency account and calculated as if invested in Company common stock (“Stock Election”);

- (c) mutual fund account or accounts and calculated as if invested in any of the following Preferred Group funds: Asset Allocation, International Value, Large Cap Growth, Large Cap Value, Small Cap Growth; or
- (d) U.S. Equity Broad Index account and calculated as if invested in the Russell 3000 Index Fund.

Amounts allocated to the stock account of a Participant who is an officer of the Company subject to Section 16 of the Securities Exchange Act of 1934 (“Officer”) may not be transferred to another of his accounts (nor may amounts allocated, respectively, to any such other account be transferred to his stock account) until at least six months after he ceases to be subject to such Section.

Under such a Stock Election, dividend equivalents will accrue to the account (when dividends are payable) and will be reinvested and a Participant’s account will in all other respects reflect share ownership for events such as a stock split but no voting rights will exist. The number of shares of stock equivalents shall be determined by dividing the amount of deferred compensation (or dividend equivalents credited) by the closing price of Company common stock on the New York Stock Exchange on the date of such deferral or dividend credit (or the next succeeding trading day if there is no trading on that date). Stock equivalents will be valued based on the closing price of Company common stock on the New York Stock Exchange as of the effective date of a transfer into or out of the stock account (“Transfer”), the date on which the Participant terminates employment, the date of distribution elected by the Participant hereunder or the date as of which he is considered totally and permanently disabled under the 401(k) Plan, whichever date applies (or the next succeeding trading day if there is no trading on that date).

The Company will credit interest accounts on a monthly basis. The interest rate will be equal to the base corporate lending rate (sometimes referred to as the "prime rate") applicable to commercial lending customers of Citibank, N.A., New York, New York (or any successor thereto) on the last business day of each calendar month. The monthly interest rate will be compounded daily and applied effective the last day of each month.

Participants who are not Officers may Transfer or make changes to the investment allocation of future deferred compensation which shall be effective as of the first day of a calendar quarter, provided that such Participant shall have filed an appropriate form with the Director, Compensation and Benefits, by the twentieth (20th) day of the preceding month.

All amounts in the DEIP and the establishment of individual bookkeeping accounts shall not be deemed to have created a trust, and no Participant shall have any ownership interest in any such account. A Participant's rights to any amounts credited to his account shall not be transferable or assignable. Each Participant will receive an annual report showing the status of his account at the close of each calendar year.

6. Disbursement

Following his termination of employment with the Company (or total and permanent disability), the value of the Participant's DEIP account will be payable to him as soon as practicable in cash, in a lump sum (including interest up to the date of payment) unless such Participant has elected a later payment date in writing that is acceptable to and approved by the Director, Compensation and Benefits; provided, however, that no such election shall be effective unless it shall have been filed on or before the last Company business day in November of the calendar year preceding the calendar year of such termination.

For Participants who are officers of the Company subject to Section 16 of the Securities Exchange Act of 1934, the payment date under DEIP, with respect to amounts in the stock account, must be at least six months after the date on which the Participant's final deferral into DEIP became irrevocable.

A Participant may elect, either before or after termination of employment, an installment distribution for a period of up to 15 years; provided, however, that an election of installment distribution shall be effective only if it shall have been filed with the Director, Compensation and Benefits, before November 30 of the second year that precedes the year in which the distribution would otherwise occur.

Notwithstanding the foregoing, effective for amounts deferred after December 31, 1996 (and any earnings thereon):

- (a) a Participant may elect one original scheduled withdrawal date as of which disbursement of elected amounts (and any earnings thereon) shall occur; provided that (i) such original date shall be the first day of any calendar quarter that is at least four years later than the year in which such an amount is deferred, and (ii) the Participant may change such original date to a later date, provided, however, that such change shall be effective only if it shall have been filed with the Director, Compensation and Benefits, before November 30 of the second year that precedes the year that includes such original date;
- (b) a Participant may elect unscheduled withdrawals of between 5% and 100% of account assets attributable to such amounts deferred after December 31, 1996 (and any earnings thereon); provided that (i) the amount withdrawn shall be subject to a forfeiture equal to 10%, and the Participant shall discontinue participation in the plan for the remainder of the year (in which such withdrawal occurs) and for the following year and (ii) the minimum withdrawal amount (before forfeiture) shall be \$10,000; and
- (c) such withdrawals under (a) or (b) shall be applied against the assets of the Deferred Employees' Investment Plan as well as this plan, and shall be subject to such other rules of convenience and administration as shall be determined by the Director, Compensation and Benefits.

7. Death of a Participant

Upon the death of a Participant prior to payment of his DEIP account, the balance in the Participant's account (including interest for the elapsed portion of the year of death) shall be determined as of the date of death. Such balance shall be paid as soon as reasonably possible thereafter in a lump sum payment to (i) the same beneficiary or beneficiaries and in the same proportionate amount as he shall have designated under the 401(k) Plan, in the absence of any designation to the contrary, or (ii) the beneficiary or beneficiaries for purposes of the DEIP as such Participant shall have designated in writing (in a form acceptable to, and filed with, the Director, Compensation and Benefits).

Notwithstanding the above, if the Participant has elected on a form that has been filed with and approved by the Director, Compensation and Benefits, amounts payable to the beneficiary may be paid at the payment date selected by the Participant and with an installment distribution for a period to 15 years, or under the remaining installment schedule in place for the Participant.

8. Amendment or Termination

The Compensation Committee of the Board of Directors or the Investment Plan Committee (for the 401(k) Plan) may at any time amend, merge, consolidate or terminate the DEIP, but no amendment, merger, consolidation or termination will have the effect of reducing the amount that any Participant is entitled to receive prior to such amendment, merger, consolidation or termination nor of changing the time of payment of any amount credited to a Participant's account.

9. Administration

Except as otherwise expressly provided herein, the DEIP shall be administered under the direction of the Director, Compensation and Benefits, of the Company.

**CATERPILLAR INC.
AND ITS SUBSIDIARIES**

COMPUTATIONS OF EARNINGS PER SHARE

FOR THE YEARS ENDED DECEMBER 31,

(Dollars in millions except per share data)

| | <u>2005</u> | <u>2004</u> | <u>2003</u> |
|--|-------------|-------------|-------------|
| Profit for the period (A): | \$ 2,854 | \$ 2,035 | \$ 1,099 |
| Determination of shares (millions): | | | |
| Weighted average number of common shares outstanding (B) | 678.4 | 684.5 | 690.4 |
| Shares issuable on exercise of stock options, net of shares assumed to be purchased out of proceeds at average market price | 27.4 | 22.9 | 12.3 |
| Average common shares outstanding for fully diluted computation (C) | 705.8 | 707.4 | 702.7 |
| Profit per share of common stock: | | | |
| Assuming no dilution (A/B) | \$ 4.21 | \$ 2.97 | \$ 1.59 |
| Assuming full dilution (A/C) | \$ 4.04 | \$ 2.88 | \$ 1.56 |
| Shares outstanding as of December 31 (in millions) | 670.9 | 685.9 | 687.5 |

CATERPILLAR INC.
AND CONSOLIDATED SUBSIDIARIES

COMPUTATION OF RATIOS OF EARNINGS TO FIXED CHARGES
(Millions of dollars)

YEARS ENDED DECEMBER 31,

| | <u>2005</u> | <u>2004</u> | <u>2003</u> | <u>2002</u> | <u>2001</u> |
|--|-----------------|---------------|---------------|---------------|-----------------|
| Earnings ⁽¹⁾ | \$ 3,910 | \$ 2,714 | \$ 1,488 | \$ 1,120 | \$ 1,170 |
| Plus: Interest expense | 1,028 | 754 | 720 | 806 | 945 |
| One-third of rental expense ⁽²⁾ | 85 | 74 | 65 | 67 | 71 |
| Adjusted Earnings | <u>5,023</u> | <u>3,542</u> | <u>2,273</u> | <u>1,993</u> | <u>2,186</u> |
| Fixed charges: | | | | | |
| Interest expense | 1,028 | 754 | 720 | 806 | 945 |
| Capitalized interest | 11 | 8 | 5 | 11 | 13 |
| One-third of rental expense ⁽²⁾ | 85 | 74 | 65 | 67 | 71 |
| Total fixed charges..... | <u>\$ 1,124</u> | <u>\$ 836</u> | <u>\$ 790</u> | <u>\$ 884</u> | <u>\$ 1,029</u> |
| Ratio of earnings to fixed charges | 4.5 | 4.2 | 2.9 | 2.3 | 2.1 |

⁽¹⁾ Pretax income from continuing operations before adjustment for minority interests and equity investments' profit

⁽²⁾ Considered to be representative of interest factor in rental expense

EXHIBIT 13

CATERPILLAR INC.

GENERAL AND FINANCIAL INFORMATION

2005

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MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

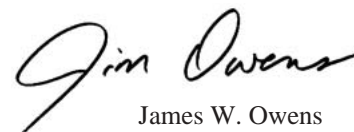
Caterpillar Inc.

The management of Caterpillar Inc. (company) is responsible for establishing and maintaining adequate internal control over financial reporting. Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Our internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of the company's internal control over financial reporting as of December 31, 2005. In making this assessment, we used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control — Integrated Framework*. Based on our assessment we concluded that, as of December 31, 2005, the company's internal control over financial reporting was effective based on those criteria.

Our management's assessment of the effectiveness of the company's internal control over financial reporting as of December 31, 2005 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm. The report appears on page A-4.



James W. Owens
Chairman of the Board



David B. Burritt
Chief Financial Officer

February 21, 2006

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM



TO THE BOARD OF DIRECTORS AND STOCKHOLDERS OF CATERPILLAR INC.:

We have completed integrated audits of Caterpillar Inc.'s 2005 and 2004 consolidated financial statements and of its internal control over financial reporting as of December 31, 2005, and an audit of its 2003 consolidated financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

Consolidated financial statements

In our opinion, the accompanying consolidated statement of financial position and the related statements of consolidated results of operations, changes in stockholders' equity, and cash flow, including pages A-5 through A-36, present fairly, in all material respects, the financial position of Caterpillar Inc. and its subsidiaries at December 31, 2005, 2004, and 2003, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2005 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

Internal control over financial reporting

Also, in our opinion, management's assessment, included in Management's Report on Internal Control Over Financial Reporting appearing on page A-3, that the Company maintained effective internal control over financial reporting as of December 31, 2005 based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on criteria established in *Internal Control — Integrated Framework* issued by the COSO. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed 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. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

PricewaterhouseCoopers LLP

Peoria, Illinois
February 21, 2006

STATEMENT 1**Caterpillar Inc.****Consolidated Results of Operations for the Years Ended December 31**

(Dollars in millions except per share data)

| | <u>2005</u> | 2004 | 2003 |
|--|-----------------|----------|----------|
| Sales and revenues: | | | |
| Sales of Machinery and Engines | \$34,006 | \$28,336 | \$21,048 |
| Revenues of Financial Products | 2,333 | 1,970 | 1,759 |
| Total sales and revenues | 36,339 | 30,306 | 22,807 |
| Operating costs: | | | |
| Cost of goods sold | 26,558 | 22,497 | 16,997 |
| Selling, general and administrative expenses | 3,190 | 2,926 | 2,322 |
| Research and development expenses | 1,084 | 928 | 669 |
| Interest expense of Financial Products | 768 | 524 | 474 |
| Other operating expenses | 955 | 747 | 675 |
| Total operating costs | 32,555 | 27,622 | 21,137 |
| Operating profit | 3,784 | 2,684 | 1,670 |
| Interest expense excluding Financial Products | 260 | 230 | 246 |
| Other income (expense) | 377 | 253 | 53 |
| Consolidated profit before taxes | 3,901 | 2,707 | 1,477 |
| Provision for income taxes | 1,120 | 731 | 398 |
| Profit of consolidated companies | 2,781 | 1,976 | 1,079 |
| Equity in profit (loss) of unconsolidated affiliated companies | 73 | 59 | 20 |
| Profit | \$ 2,854 | \$ 2,035 | \$ 1,099 |
| Profit per common share | \$ 4.21 | \$ 2.97 | \$ 1.59 |
| Profit per common share — diluted⁽¹⁾ | \$ 4.04 | \$ 2.88 | \$ 1.56 |
| Weighted-average common shares outstanding (millions) | | | |
| — Basic | 678.4 | 684.5 | 690.4 |
| — Diluted ⁽¹⁾ | 705.8 | 707.4 | 702.7 |
| Cash dividends declared per common share | \$.96 | \$.80 | \$.72 |

⁽¹⁾ Diluted by assumed exercise of stock options, using the treasury stock method.

See accompanying Notes to Consolidated Financial Statements.

STATEMENT 2

Consolidated Financial Position at December 31

(Dollars in millions)

| | 2005 | 2004 | 2003 |
|--|-----------------|-----------------|-----------------|
| Assets | | | |
| Current assets: | | | |
| Cash and short-term investments | \$ 1,108 | \$ 445 | \$ 342 |
| Receivables — trade and other | 7,526 | 7,463 | 4,030 |
| Receivables — finance | 6,442 | 5,182 | 5,167 |
| Retained interests in securitized trade receivables | — | — | 1,550 |
| Deferred and refundable income taxes | 344 | 398 | 707 |
| Prepaid expenses | 2,146 | 1,369 | 1,424 |
| Inventories | 5,224 | 4,675 | 3,047 |
| Total current assets | 22,790 | 19,532 | 16,267 |
| Property, plant and equipment — net | 7,988 | 7,682 | 7,251 |
| Long-term receivables — trade and other | 1,037 | 764 | 510 |
| Long-term receivables — finance | 10,301 | 9,903 | 7,735 |
| Investments in unconsolidated affiliated companies | 565 | 517 | 800 |
| Deferred income taxes | 768 | 674 | 616 |
| Intangible assets | 424 | 315 | 239 |
| Goodwill | 1,451 | 1,450 | 1,398 |
| Other assets | 1,745 | 2,258 | 1,895 |
| Total assets | \$47,069 | \$43,095 | \$36,711 |
| Liabilities | | | |
| Current liabilities: | | | |
| Short-term borrowings: | | | |
| — Machinery and Engines | \$ 871 | \$ 93 | \$ 72 |
| — Financial Products | 4,698 | 4,064 | 2,685 |
| Accounts payable | 3,471 | 3,580 | 2,259 |
| Accrued expenses | 2,617 | 2,261 | 1,952 |
| Accrued wages, salaries and employee benefits | 1,845 | 1,730 | 1,802 |
| Customer advances | 395 | 447 | 253 |
| Dividends payable | 168 | 141 | 127 |
| Deferred and current income taxes payable | 528 | 259 | 216 |
| Long-term debt due within one year: | | | |
| — Machinery and Engines | 340 | 6 | 32 |
| — Financial Products | 4,159 | 3,525 | 2,949 |
| Total current liabilities | 19,092 | 16,106 | 12,347 |
| Long-term debt due after one year: | | | |
| — Machinery and Engines | 2,717 | 3,663 | 3,603 |
| — Financial Products | 12,960 | 12,174 | 10,943 |
| Liability for postemployment benefits | 2,991 | 2,986 | 3,172 |
| Deferred income taxes and other liabilities | 877 | 699 | 568 |
| Total liabilities | 38,637 | 35,628 | 30,633 |
| Stockholders' equity | | | |
| Common stock of \$1.00 par value: | | | |
| Authorized shares: 900,000,000 | | | |
| Issued shares (2005, 2004 and 2003 — 814,894,624) at paid-in amount | 1,859 | 1,231 | 1,059 |
| Treasury stock (2005 — 144,027,405 shares; 2004 — 129,020,726 shares; and 2003 — 127,370,544 shares) at cost | (4,637) | (3,277) | (2,914) |
| Profit employed in the business | 11,808 | 9,937 | 8,450 |
| Accumulated other comprehensive income | (598) | (424) | (517) |
| Total stockholders' equity | 8,432 | 7,467 | 6,078 |
| Total liabilities and stockholders' equity | \$47,069 | \$43,095 | \$36,711 |

See accompanying Notes to Consolidated Financial Statements.

STATEMENT 3
Caterpillar Inc.
Changes in Consolidated Stockholders' Equity for the Years Ended December 31

(Dollars in millions)

| | 2005 | | 2004 | | 2003 |
|---|------------------------|----------------|-----------------|---------|-----------------|
| Common stock: | | | | | |
| Balance at beginning of year | \$ 1,231 | | \$ 1,059 | | \$ 1,034 |
| Common shares issued from treasury stock | 290 | | 172 | | 25 |
| Impact of 2-for-1 stock split | 338 | | — | | — |
| Balance at year-end | <u>1,859</u> | | <u>1,231</u> | | <u>1,059</u> |
| Treasury stock: | | | | | |
| Balance at beginning of year | (3,277) | | (2,914) | | (2,669) |
| Shares issued: 2005 — 18,912,521; 2004 — 12,216,618; 2003 — 9,913,946 | 324 | | 176 | | 160 |
| Shares repurchased: 2005 — 33,919,200; 2004 — 13,866,800; 2003 — 10,900,000 | (1,684) | | (539) | | (405) |
| Balance at year-end | <u>(4,637)</u> | | <u>(3,277)</u> | | <u>(2,914)</u> |
| Profit employed in the business: | | | | | |
| Balance at beginning of year | 9,937 | | 8,450 | | 7,849 |
| Profit | 2,854 | \$2,854 | 2,035 | \$2,035 | 1,099 |
| Dividends declared | (645) | | (548) | | (498) |
| Impact of 2-for-1 stock split | (338) | | — | | — |
| Balance at year-end | <u>11,808</u> | | <u>9,937</u> | | <u>8,450</u> |
| Accumulated other comprehensive income: | | | | | |
| Foreign currency translation adjustment: | | | | | |
| Balance at beginning of year | 489 | | 348 | | 86 |
| Aggregate adjustment for year | (187) | (187) | 141 | 141 | 262 |
| Balance at year-end | <u>302</u> | | <u>489</u> | | <u>348</u> |
| Minimum pension liability adjustment — consolidated companies: | | | | | |
| Balance at beginning of year (net of tax of: 2005 — \$485; 2004 — \$460; 2003 — \$383) | (993) | | (934) | | (771) |
| Aggregate adjustment for year (net of tax of: 2005 — \$36; 2004 — \$25; 2003 — \$77) | 96 | 96 | (59) | (59) | (163) |
| Balance at year-end (net of tax of: 2005 — \$449; 2004 — \$485; 2003 — \$460) | <u>(897)</u> | | <u>(993)</u> | | <u>(934)</u> |
| Minimum pension liability adjustment — unconsolidated companies: | | | | | |
| Balance at beginning of year | (48) | | (48) | | (37) |
| Aggregate adjustment for year | 11 | 11 | — | — | (11) |
| Balance at year-end | <u>(37)</u> | | <u>(48)</u> | | <u>(48)</u> |
| Derivative financial instruments: | | | | | |
| Balance at beginning of year (net of tax of: 2005 — \$58; 2004 — \$54; 2003 — \$5) | 110 | | 104 | | 11 |
| Gains/(losses) deferred during year (net of tax of: 2005 — \$0; 2004 — \$48; 2003 — \$29) | (5) | (5) | 90 | 90 | 53 |
| (Gains)/losses reclassified to earnings during year (net of tax of: 2005 — \$45; 2004 — \$44; 2003 — \$20) | (87) | (87) | (84) | (84) | 40 |
| Balance at year-end (net of tax of: 2005 — \$13; 2004 — \$58; 2003 — \$54) | <u>18</u> | | <u>110</u> | | <u>104</u> |
| Available-for-sale securities: | | | | | |
| Balance at beginning of year (net of tax of: 2005 — \$7; 2004 — \$5; 2003 — \$17) | 18 | | 13 | | (31) |
| Gains/(losses) deferred during year (net of tax of: 2005 — \$3; 2004 — \$3; 2003 — \$11) | 3 | 3 | 6 | 6 | 23 |
| (Gains)/losses reclassified to earnings during year (net of tax of: 2005 — \$1; 2004 — \$1; 2003 — \$11) | (5) | (5) | (1) | (1) | 21 |
| Balance at year-end (net of tax of: 2005 — \$9; 2004 — \$7; 2003 — \$5) | <u>16</u> | | <u>18</u> | | <u>13</u> |
| Total accumulated other comprehensive income | <u>(598)</u> | | <u>(424)</u> | | <u>(517)</u> |
| Comprehensive income | <u>\$2,680</u> | | <u>\$ 2,128</u> | | <u>\$ 1,324</u> |
| Stockholders' equity at year-end | <u>\$ 8,432</u> | | <u>\$ 7,467</u> | | <u>\$ 6,078</u> |

See accompanying Notes to Consolidated Financial Statements.

STATEMENT 4**Consolidated Statement of Cash Flow for the Years Ended December 31**

(Millions of dollars)

| | <u>2005</u> | <u>2004</u> | <u>2003</u> |
|---|------------------------|----------------|----------------|
| Cash flow from operating activities: | | | |
| Profit..... | \$ 2,854 | \$ 2,035 | \$ 1,099 |
| Adjustments for non-cash items: | | | |
| Depreciation and amortization | 1,477 | 1,397 | 1,347 |
| Other..... | (20) | (113) | (69) |
| Changes in assets and liabilities: | | | |
| Receivables — trade and other (see non-cash item below) | (908) | (7,616) | (8,115) |
| Inventories | (568) | (1,391) | (286) |
| Accounts payable and accrued expenses..... | 532 | 1,457 | 542 |
| Other assets — net..... | (866) | 337 | (277) |
| Other liabilities — net..... | 612 | (97) | 148 |
| Net cash provided by (used for) operating activities | <u>3,113</u> | <u>(3,991)</u> | <u>(5,611)</u> |
| Cash flow from investing activities: | | | |
| Capital expenditures — excluding equipment leased to others..... | (1,201) | (926) | (682) |
| Expenditures for equipment leased to others | (1,214) | (1,188) | (1,083) |
| Proceeds from disposals of property, plant and equipment | 637 | 486 | 761 |
| Additions to finance receivables | (10,334) | (8,930) | (6,868) |
| Collections of finance receivables | 7,057 | 6,216 | 5,251 |
| Proceeds from sale of finance receivables..... | 900 | 700 | 661 |
| Collections of retained interests in securitized trade receivables | — | 5,722 | 7,129 |
| Investments and acquisitions (net of cash acquired) | (13) | (290) | (268) |
| Proceeds from sale of partnership investment | — | 290 | — |
| Proceeds from release of security deposit..... | 530 | — | — |
| Proceeds from sale of available-for-sale securities | 257 | 408 | 329 |
| Investments in available-for-sale securities | (338) | (609) | (425) |
| Other — net..... | 194 | 198 | 79 |
| Net cash provided by (used for) investing activities..... | <u>(3,525)</u> | <u>2,077</u> | <u>4,884</u> |
| Cash flow from financing activities: | | | |
| Dividends paid | (618) | (534) | (491) |
| Common stock issued, including treasury shares reissued | 482 | 317 | 157 |
| Treasury shares purchased..... | (1,684) | (539) | (405) |
| Proceeds from debt issued (original maturities greater than three months): | | | |
| — Machinery and Engines | 574 | 55 | 164 |
| — Financial Products..... | 14,000 | 10,435 | 11,825 |
| Payments on debt (original maturities greater than three months): | | | |
| — Machinery and Engines | (654) | (78) | (499) |
| — Financial Products..... | (10,966) | (8,612) | (9,562) |
| Short-term borrowings (original maturities three months or less) — net..... | 19 | 830 | (444) |
| Net cash provided by financing activities..... | <u>1,153</u> | <u>1,874</u> | <u>745</u> |
| Effect of exchange rate changes on cash..... | (78) | 143 | 15 |
| Increase in cash and short-term investments..... | <u>663</u> | <u>103</u> | <u>33</u> |
| Cash and short-term investments at beginning of period..... | <u>445</u> | <u>342</u> | <u>309</u> |
| Cash and short-term investments at end of period..... | <u>\$ 1,108</u> | <u>\$ 445</u> | <u>\$ 342</u> |

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 activities:

Trade receivables of \$6,786 million and \$7,534 million were exchanged for retained interests in securitized trade receivables in 2004 and 2003, respectively. See Notes 2 and 6 on pages A-12 and A-16, respectively, for further discussion.

In 2005, \$116 million of 9.375% debentures due in 2021 and \$117 million of 8.00% debentures due in 2023 were exchanged for \$307 million of 5.300% debentures due in 2035 and \$23 million of cash. The \$23 million of cash is included in payments on debt.

See accompanying Notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Operations and summary of significant accounting policies

A. 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, telehandlers, 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 21,500 horsepower (4 to over 16 000 kilowatts). Turbines range from 1,600 to 20,500 horsepower (1 200 to 15 000 kilowatts).

(3) **Financial Products** — A principal line of business consisting primarily of Caterpillar Financial Services Corporation (Cat Financial), Caterpillar Insurance Holdings, Inc. (Cat Insurance), Caterpillar Power Ventures Corporation (Cat Power Ventures) and their 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.

Our products are sold primarily under the brands “Caterpillar,” “Cat,” “Solar Turbines,” “MaK,” “Perkins,” “FG Wilson” and “Olympian.”

We conduct operations in our Machinery and Engines lines of business under highly competitive conditions, including intense price competition. We place great emphasis on the high quality and performance of our products and our dealers’ service support. Although no one competitor is believed to produce all of the same types of machines and engines that we do, there are numerous companies, large and small, which compete with us in the sale of each of our products.

Machines are distributed principally through a worldwide organization of dealers (dealer network), 54 located in the United States and 128 located outside the United States. Worldwide, these dealers serve 182 countries and operate 3,510 places of business, including 1,587 dealer rental outlets. Reciprocating engines are sold principally through the dealer network and to other manufacturers for use in products manufactured by them. Some of the reciprocating engines manufactured by Perkins are also sold through a worldwide network of 140 distributors located in 170 countries along with 3,500 supporting dealers. Most of the electric power generation

systems manufactured by FG Wilson are sold through a worldwide network of 200 dealers located in 180 countries. Our dealers do not deal exclusively with our products; however, in most cases sales and servicing of our products are the dealers’ principal business. Turbines and large marine reciprocating engines are sold through sales forces employed by the company. At times, these employees are assisted by independent sales representatives.

Manufacturing activities of the Machinery and Engines lines of business are conducted in 41 plants in the United States; nine each in the United Kingdom and Italy; six in China; five in Mexico; three each in France, India and Northern Ireland; two each in Australia, Germany, Brazil, and Japan; and one each in Belgium, Hungary, Indonesia, The Netherlands, Poland, Russia, South Africa, Switzerland and Tunisia. Thirteen parts distribution centers are located in the United States and thirteen are located outside the United States.

The Financial Products line of business also conducts operations under highly competitive conditions. Financing for users of Caterpillar products is available through a variety of competitive sources, principally commercial banks and finance and leasing companies. We emphasize prompt and responsive service to meet customer requirements and offer various financing plans designed to increase the opportunity for sales of our products and generate financing income for our company. Financial Products activity is conducted primarily in the United States, with additional offices in Asia, Australia, Canada, Europe and Latin America.

See Note 2 for discussion of the reclassification of certain receivables and related cash flows.

B. Basis of consolidation

The financial statements include the accounts of Caterpillar Inc. and its subsidiaries. Investments in companies that are owned 20% to 50% or are less than 20% owned and for which we have significant influence are accounted for by the equity method (see Note 11). We consolidate all variable interest entities where Caterpillar Inc. is the primary beneficiary.

Certain amounts for prior years have been reclassified to conform with the current-year financial statement presentation.

Other operating expense primarily includes Cat Financial’s depreciation of equipment leased to others, Cat Insurance underwriting expenses, gains (losses) on disposal of long-lived assets and long-lived asset impairment charges.

C. Sales and revenue recognition

Sales of Machinery and Engines are recognized when title transfers and the risks and rewards of ownership have passed to customers or independently owned and operated dealers.

Our standard invoice terms are established by marketing region. When a sale is made to a dealer, the dealer is responsible for payment even if the product is not sold to an end customer and must make payment within the standard terms to avoid interest costs. Interest at or above prevailing market rates is charged on any past due balance. Our policy is to not forgive this interest. In 2005, 2004 and 2003, terms were extended to not more than one year for \$287 million, \$15 million and \$54 million of receivables, respectively. For 2005, 2004 and 2003, these amounts represent less than 1% of consolidated sales.

Sales with payment terms of two months or more were as follows:

| Payment Terms (months) | 2005 | | 2004 | | 2003 | |
|---------------------------|-----------------|---------------------|-----------------|---------------------|-----------------|---------------------|
| | Sales | Percent of Sales | Sales | Percent of Sales | Sales | Percent of Sales |
| 2 | \$ 261 | 0.8% | \$ 96 | 0.3% | \$ 116 | 0.6% |
| 3 | 548 | 1.6% | 175 | 0.6% | 27 | 0.1% |
| 4 | 262 | 0.8% | 117 | 0.4% | 28 | 0.1% |
| 5 | 916 | 2.7% | 750 | 2.6% | 594 | 2.8% |
| 6 | 8,147 | 23.9% | 6,172 | 21.9% | 4,104 | 19.5% |
| 7-12 | 345 | 1.0% | 831 | 2.9% | 671 | 3.2% |
| | <u>\$10,479</u> | <u>30.8%</u> | <u>\$ 8,141</u> | <u>28.7%</u> | <u>\$ 5,540</u> | <u>26.3%</u> |

We establish a bad debt allowance for Machinery and Engines receivables when it becomes probable that the receivable will not be collected. Our allowance for bad debts is not significant. No significant write-offs of Machinery and Engines receivables were made during 2005, 2004 or 2003.

Revenues of Financial Products represent primarily finance and lease revenues of Cat Financial. Finance revenues are recognized over the term of the contract at a constant rate of return on the scheduled uncollected principal balance. Lease revenues are recognized in the period earned. Recognition of income is suspended when collection of future income is not probable. Accrual is resumed, and previously suspended income is recognized, when the receivable becomes contractually current and/or collection doubts are removed. Cat Financial provides wholesale inventory financing to dealers. Please refer to Note 7 and Note 8 for more information.

D. Inventories

Inventories are stated at the lower of cost or market. Cost is principally determined using the last-in, first-out (LIFO) method. The value of inventories on the LIFO basis represented about 80% of total inventories at December 31, 2005, 2004 and 2003.

If the FIFO (first-in, first-out) method had been in use, inventories would have been \$2,345 million, \$2,124 million and \$1,863 million higher than reported at December 31, 2005, 2004 and 2003, respectively.

E. Securitized receivables

We periodically sell finance receivables in securitization transactions. When finance receivables are securitized, we retain interests in the receivables in the form of interest-only strips, servicing rights, cash reserve accounts and subordinated certificates. The retained interests are recorded in other assets at fair value. We estimate fair value based on the present value of future expected cash flows using key assumptions for credit losses, prepayment speeds and discount rates. Please refer to Note 8 for more information.

Prior to June 2005, we securitized trade receivables. We retained interests in the receivables in the form of certificates. The fair value of the certificated retained interests approximated carrying value due to their short-term nature. Please refer to Note 6 for more information.

F. Depreciation and amortization

Depreciation of plant and equipment is computed principally using accelerated methods. Depreciation on equipment leased to others, primarily for Financial Products, is computed using the straight-line method over the term of the lease. The depreciable

basis is the original cost of the equipment less the estimated residual value of the equipment at the end of the lease term. In 2005, 2004 and 2003, Cat Financial depreciation on equipment leased to others was \$615 million, \$575 million and \$527 million, respectively, and was included in "Other operating expenses" in Statement 1. In 2005, 2004 and 2003 consolidated depreciation expense was \$1,444 million, \$1,366 million and \$1,332 million, respectively. Amortization of purchased intangibles is computed using the straight-line method, generally not to exceed a period of 20 years. Accumulated amortization was \$107 million, \$91 million and \$44 million at December 31, 2005, 2004 and 2003, respectively.

G. Foreign currency translation

The functional currency for most of our Machinery and Engines consolidated companies is the U.S. dollar. The functional currency for most of our Financial Products and equity basis companies is the respective local currency. Gains and losses resulting from the translation of foreign currency amounts to the functional currency are included in "Other income (expense)" in Statement 1. Gains and losses resulting from translating assets and liabilities from the functional currency to U.S. dollars are included in "Accumulated other comprehensive income" in Statement 2.

H. Derivative financial instruments

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 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 Financial Position at their fair value. On the date the derivative contract is entered, we designate the derivative as (1) a hedge of the fair value of a recognized liability ("fair value" hedge), (2) a hedge of a forecasted transaction or the variability of cash flow to be paid ("cash flow" hedge), or (3) an "undesignated" instrument. Changes in the fair value of a derivative that is qualified, designated and highly effective as a fair value hedge, along with the gain or loss on the hedged 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 other comprehensive income until earnings are affected by the forecasted transaction or the variability of cash flow and are then reported in current 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 derivative financial instruments are classified within the same category as the item being hedged 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 liabilities on the Consolidated Financial Position and linking cash flow hedges to specific forecasted transactions or variability of cash flow.

We also formally assess, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flow of hedged items. When it is determined that a derivative is not highly effective as a hedge or that it has ceased to be a highly effective hedge, we discontinue hedge accounting prospectively, in accordance with Statement of Financial Accounting Standards No. 133 "Accounting for Derivative Instruments and Hedging Activities" (SFAS 133). Please refer to Note 3 for more information on derivatives.

I. Impairment of available-for-sale securities

Available-for-sale securities are reviewed monthly to identify market values below cost of 20% or more. If a decline for a debt security is in excess of 20% for six months, the investment is evaluated to determine if the decline is due to general declines in the marketplace or if the investment has been impaired and should be written down to market value pursuant to Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities" (SFAS 115). After the six-month period, debt securities with declines from cost in excess of 20% are evaluated monthly for impairment. For equity securities, if a decline from cost of 20% or more continues for a 12-month period, an other than temporary impairment is recognized without continued analysis.

J. Income taxes

The provision for income taxes is determined using the asset and liability approach for accounting for income taxes in accordance with Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" (SFAS 109). Tax laws require items to be included in tax filings at different times than the items are reflected in the financial statements. A current liability is recognized for the estimated taxes payable for the current year. Deferred taxes represent the future tax consequences expected to occur when the reported amounts of assets and liabilities are recovered or paid. Deferred taxes are adjusted for enacted changes in tax rates and tax laws. Valuation allowances are recorded to reduce deferred tax assets when it is more likely than not that a tax benefit will not be realized.

K. Estimates in financial statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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, postemployment benefits, post-sale discounts, credit losses and income taxes.

L. New accounting standards

SFAS 151 — 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.

SFAS 153 — 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 adopted this new accounting standard effective July 1, 2005. The adoption of SFAS 153 did not have a material impact on our financial statements.

SFAS 123R — 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 adopt the new guidance using the modified prospective method.

Our stock-based compensation plans allow for immediate vesting upon retirement for employees who are 55 years old or older with more than 10 years of service and who have fulfilled the requisite service period. Prior to the adoption of SFAS 123R, compensation expense for awards associated with these employees has been recognized in the pro forma net profit over the nominal vesting period. Upon adoption of SFAS 123R, compensation expense will be recognized over the period from the grant date to the end date of the requisite service period for employees who meet the immediate vesting upon retirement requirements. For those employees who become eligible for immediate vesting upon retirement subsequent to the requisite service period and prior to the completion of the vesting period, compensation expense will be recognized over the period from grant date to the date the eligibility is achieved. Application of the nominal vesting period for these employees did not have a significant impact on the 2005, 2004 and 2003 pro forma net profit.

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.

We expect the application of the expensing provisions of SFAS 123R will result in a pretax expense of approximately \$125 million in 2006. As a result of the vesting decisions discussed above, a full complement of expense related to stock-based compensation will not be recognized in our results of operations until 2009. Based on the same assumptions used to value our 2006 compensation expense, we estimate our pretax expense associated with our stock-based compensation plans will range from approximately \$160 million in 2007 to approximately \$210 million in 2009.

FIN 47 — In March 2005, the FASB Issued FIN 47, “Accounting for Conditional Asset Retirement Obligations, an interpretation of FASB Statement No. 143, Accounting for Asset Retirement Obligations.” FIN 47 clarifies that SFAS 143 requires accrual of the fair value of legally required asset retirement obligations if sufficient information exists to reasonably estimate the fair value. We adopted this new accounting standard during the fourth quarter of 2005. The adoption of FIN 47 did not have a material impact on our financial statements.

SFAS 154 — 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.

M. 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. Please refer to Note 18 for additional information on our stock-based compensation plans.

The following tables illustrate the effect on profit and profit per share if we had applied the fair value method of Statement of Financial Accounting Standards (SFAS 123), “Accounting for Stock-Based Compensation” for 2005 and 2004 grants using the binomial option-pricing model and 2003 using the Black-Scholes option-pricing model.

| | Years ended December 31, | | |
|--|--------------------------|-----------------|-----------------|
| | 2005 | 2004 | 2003 |
| (Dollars in millions except per share data) | | | |
| Profit, as reported | \$2,854 | \$ 2,035 | \$ 1,099 |
| Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects..... | (135) | (161) | (69) |
| Pro forma net profit | \$2,719 | <u>\$ 1,874</u> | <u>\$ 1,030</u> |
| Profit per share of common stock: | | | |
| As reported: | | | |
| Basic..... | \$ 4.21 | \$ 2.97 | \$ 1.59 |
| Diluted..... | \$ 4.04 | \$ 2.88 | \$ 1.56 |
| Pro forma: | | | |
| Basic..... | \$ 4.01 | \$ 2.74 | \$ 1.49 |
| Diluted..... | \$ 3.85 | \$ 2.65 | \$ 1.47 |

Pro forma net profit and profit per share in 2004 using the Black-Scholes option-pricing model would have been:

| | Year ended December 31, |
|---|----------------------------|
| | 2004 |
| (Dollars in millions except per share data) | |
| Profit, as reported | \$ 2,035 |
| Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects | (202) |
| Pro forma net profit | <u>\$ 1,833</u> |
| Profit per share of common stock: | |
| As reported: | |
| Basic..... | \$ 2.97 |
| Diluted..... | \$ 2.88 |
| Pro forma: | |
| Basic..... | \$ 2.68 |
| Diluted..... | \$ 2.59 |

2. Reclassification of certain receivables and related cash flows

A. Consolidated financial position

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 prior to June 2005, securitized a portion of the dealer receivables using a revolving securitization structure. Cat Financial’s portion of the securitized trade receivables was represented by certificated retained interests. Cat Financial also generates wholesale inventory receivables from its direct financing of inventory purchases by dealers. Previously, the certificated retained interests as well as the wholesale inventory receivables were classified as Finance Receivables in our Consolidated Financial Position. In the fourth quarter of 2004, we reclassified the certificated retained interests from Finance Receivables to Retained Interests in Securitized Trade Receivables and the wholesale inventory receivables from Finance Receivables to Trade and Other Receivables in our Consolidated Financial Position. These changes were made to align the financial position with the cash flow changes discussed below.

B. Consolidated statement of cash flow

During the fourth quarter of 2004, the staff of the Securities and Exchange Commission expressed concern regarding the classifications of certain cash flows by companies with captive finance

subsidiaries. As a result of this concern, management decided to make reclassifications to the 2003 Consolidated Statement of Cash Flow as described below.

Securitized trade receivables

Prior to the fourth quarter of 2004, we reported an increase in cash flow from operating activities in the Consolidated Statement of Cash Flow when Machinery and Engines sold receivables to Cat Financial that were subsequently securitized. Concurrently, Cat Financial's entire purchase of these receivables was included in Additions to Finance Receivables (investing activity) in the Consolidated Statement of Cash Flow. The receivables were immediately securitized and the portion sold to a third party was included in Proceeds from Sale of Finance Receivables (investing activity) in the Consolidated Statement of Cash Flow. Subsequently, collection of the certificated retained interests was included in Collection of Finance Receivables (investing activity) in the Consolidated Statement of Cash Flow. This cash flow treatment followed our principal lines of business reporting, however, when we reported an increase in cash flow from operating activities and a corresponding outflow from investing activities there was no increase in cash on a consolidated basis from the sale of inventory to our dealers and customers.

In the fourth quarter of 2004, we made a reclassification to eliminate the offsetting non-cash intercompany transactions in the Consolidated Statement of Cash Flow. In addition, we reclassified the proceeds from sale of trade receivables to operating activities. The reclassification properly classifies cash receipts from the sale of inventory as operating activities and reflects that these cash flows, although held and managed by Cat Financial, arise from our sale of Machinery and Engines inventory.

The securitization structure mentioned above involved a securitization trust. During 2003, the trust was a qualifying special purpose entity (QSPE) and thus, in accordance with Statement of Financial Accounting Standards No. 140 (SFAS 140), "Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities," was not consolidated. (See Note 6 for discussion of the 2004 QSPE status of the trust and termination of the trust in 2005.) When receivables were placed into the trust, we received cash for the portion sold to third party purchasers and the portion retained by Cat Financial was represented by certificated retained interests. Placing receivables into a securitization trust changes their nature and the receipt of certificated retained interests is considered a non-cash transaction. We have noted this non-cash transaction on the Consolidated Statement of Cash Flow and quantified the receivables decrease resulting from this transaction and thus excluded from operating activities. This reflects that certificated retained interests, not cash, were received for these sales. The certificated retained interests are considered held-to-maturity securities as defined by SFAS 115. SFAS 115 requires that collection of held-to-maturity securities be classified as an investing activity. We have therefore reclassified the collection of the certificated retained interests from Collection of Finance Receivables to Collections of Retained Interests in Securitized Trade Receivables within the investing activities section of the Consolidated Statement of Cash Flow. The impact of these changes is a significant reduction to cash flow from operating activities and a significant increase in cash flow from investing

activities. This reflects that although inventory was sold, the nature of the receivable was changed to a security. The subsequent collection of that security is shown as an investing activity.

Wholesale inventory receivables

Prior to the fourth quarter of 2004, we reported an increase in cash flow from operating activities when a dealer remitted payment for a trade receivable that was subsequently financed with the issuance of a wholesale inventory receivable by Cat Financial. The issuance of a wholesale inventory receivable by Cat Financial was reported as an Addition to Finance Receivables in the Consolidated Statement of Cash Flow and the subsequent collection was reported as a Collection of Finance Receivables. Similar to securitized receivables, this cash flow treatment followed our principal lines of business reporting, however, when we reported an increase in cash flow from operating activities and a corresponding outflow from investing activities there was no increase in cash on a consolidated basis from the sale of inventory to our dealers and customers. We therefore eliminated the offsetting non-cash transaction in the Consolidated Statement of Cash Flow. In addition, we reclassified the collection of wholesale inventory receivables to operating activities. The reclassification properly classifies cash receipts from the sale of inventory as operating activities and reflects that these cash flows, although held and managed by Cat Financial, arise from our sale of Machinery and Engines inventory.

These reclassifications had no impact on the "Increase in Cash and Short-term Investments" on the Statement of Consolidated Cash Flow.

Prior amounts reported have been reclassified to conform to this presentation as follows:

| (Millions of dollars) | 2003 | | |
|--|--|----------------|-----------------|
| | Previous classification ⁽¹⁾ | Change | As Reclassified |
| Consolidated Financial Position — Statement 2 | | | |
| Receivables — trade and other | \$ 3,671 | \$ 359 | \$ 4,030 |
| Receivables — finance | 7,076 | (1,909) | 5,167 |
| Retained interests in securitized trade receivables | — | 1,550 | 1,550 |
| Long-term receivables — trade and other | 82 | 428 | 510 |
| Long-term receivables — finance .. | 8,163 | (428) | 7,735 |
| Consolidated Statement of Cash Flow — Statement 4 | | | |
| Receivables — trade and other | \$ (438) | \$ (7,677) | \$ (8,115) |
| Net cash provided by (used for) operating activities | 2,066 | (7,677) | (5,611) |
| Additions to finance receivables..... | (17,146) | 10,278 | (6,868) |
| Collections of finance receivables... | 13,882 | (8,631) | 5,251 |
| Proceeds from sale of finance receivables..... | 1,760 | (1,099) | 661 |
| Collections of retained interests in securitized trade receivables.... | — | 7,129 | 7,129 |
| Net cash provided by (used for) investing activities | (2,793) | 7,677 | 4,884 |

⁽¹⁾ Certain amounts do not agree to prior period reported amounts due to unrelated reclassifications.

3. Derivative financial instruments and risk management

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

As of December 31, 2005, \$8 million of deferred net losses included in equity ("Accumulated other comprehensive income" in Statement 2), are expected to be reclassified to current earnings ["Other income (expense)"] over the next twelve months when earnings are positively affected by the hedged transactions. As of December 31, 2004 and 2003, the projected reclassification was a gain of \$102 million and \$70 million, respectively. The decrease from 2004 to 2005 is due to expiration of several Machinery and Engines long-term hedges. 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 2005, 2004 or 2003.

In managing foreign currency risk for our Financial Products operations, our objective is to minimize earnings volatility resulting from conversion and the remeasurement of net foreign currency balance sheet positions. Our policy allows the use of foreign currency forward and option contracts to offset the risk of currency mismatch between our receivables and debt. All such foreign currency forward and option contracts are undesignated.

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

| (Millions of dollars) | 2005 | 2004 | 2003 |
|---------------------------------|--------------|----------------|-----------------|
| Machinery and Engines: | | | |
| On undesignated contracts | \$ 25 | \$ (9) | \$ (1) |
| Financial Products: | | | |
| On undesignated contracts | \$ 58 | \$ (46) | \$ (121) |
| | <u>\$ 83</u> | <u>\$ (55)</u> | <u>\$ (122)</u> |

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

B. Interest rate risk

Interest rate movements create a degree of risk by affecting the amount of our interest payments and the value of our fixed rate debt. Our practice is to use interest rate swap agreements to manage our exposure to interest rate changes and, in some cases, lower the cost of borrowed funds.

Machinery and Engines operations generally use fixed rate debt as a source of funding. Our objective is to minimize the cost of borrowed funds. Our policy allows us to enter into fixed-to-floating interest rate swaps and forward rate agreements to meet that objective with the intent to designate as fair value hedges at inception of the contract all fixed-to-floating interest rate swaps. Designation as a hedge of the fair value of our fixed rate debt is performed to support hedge accounting. During 2001, our Machinery and Engines operations liquidated all fixed-to-floating interest rate swaps. The gain (\$11 million as of December 31, 2005) is being amortized to earnings ratably over the remaining life of the hedged debt.

Financial Products operations have a match funding policy that addresses interest rate risk by aligning the interest rate profile (fixed or floating rate) of their debt portfolio with the interest rate profile of their receivables portfolio within predetermined ranges on an on-going basis. In connection with that policy, we use interest rate derivative instruments to modify the debt structure to match assets within the receivables portfolio. This match funding reduces the volatility of margins between interest-bearing assets and interest-bearing liabilities, regardless of which direction interest rates move. 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 the inception of the swap contract. Designation as a hedge of the variability of cash flow is performed to support hedge accounting. Financial Products liquidated fixed-to-floating interest rate swaps during 2005, 2004 and 2002. The gains (\$14 million as of December 31, 2005) are being amortized to earnings ratably over the remaining life of the hedged debt.

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

| (Millions of dollars) | 2005 | 2004 | 2003 |
|---|--------------|-------------|-------------|
| Fixed-to-floating interest rate swaps | | | |
| Machinery and Engines: | | | |
| Gain on liquidated swaps | \$ 5 | \$ 5 | \$ 6 |
| Financial Products: | | | |
| Loss on designated interest rate derivatives | (71) | (28) | (20) |
| Gain on hedged debt | 71 | 28 | 20 |
| Gain on liquidated swaps — included in interest expense | 5 | 2 | 2 |
| | <u>\$ 10</u> | <u>\$ 7</u> | <u>\$ 8</u> |

As of December 31, 2005, \$12 million of deferred net gains included in equity ("Accumulated other comprehensive income" in Statement 2), 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

twelve months. As of December 31, 2004, this projected reclassification was a net loss of \$3 million. As of December 31, 2003, this projected reclassification was a net loss of \$16 million. There were no circumstances where hedge treatment was discontinued during 2005, 2004 or 2003.

C. Commodity price risk

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

Our Machinery and Engines operations purchase aluminum, copper and nickel embedded in the components we purchase from suppliers. Our suppliers pass on to us price changes in the commodity portion of the component cost. In addition, we are also 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. Gains on the undesignated contracts of \$7 million, \$15 million and \$27 million were recorded in current earnings ["Other income (expense)"] in 2005, 2004 and 2003, respectively.

4. Other income (expense)

| (Millions of dollars) | Years ended December 31, | | |
|-------------------------------------|--------------------------|---------------|--------------|
| | 2005 | 2004 | 2003 |
| Investment and interest income | \$ 97 | \$ 77 | \$ 31 |
| Foreign exchange gains | 148 | 96 | 3 |
| Charge for early retirement of debt | — | — | (55) |
| License fees | 59 | 54 | 40 |
| Miscellaneous income (loss) | 73 | 26 | 34 |
| | <u>\$ 377</u> | <u>\$ 253</u> | <u>\$ 53</u> |

5. Income taxes

The components of profit before taxes were:

| (Millions of dollars) | Years ended December 31, | | |
|-----------------------|--------------------------|-----------------|-----------------|
| | 2005 | 2004 | 2003 |
| U.S. | \$2,254 | \$ 1,106 | \$ 489 |
| Non-U.S. | 1,647 | 1,601 | 988 |
| | <u>\$3,901</u> | <u>\$ 2,707</u> | <u>\$ 1,477</u> |

Profit before taxes, as shown above, is based on the location of the entity to which such earnings are attributable. However, since such earnings are subject to taxation in more than one country, the income tax provision shown below as U.S. or non-U.S. may not correspond to the earnings shown above.

The components of the provision for income taxes were:

| (Millions of dollars) | Years ended December 31, | | |
|----------------------------------|--------------------------|---------------|---------------|
| | 2005 | 2004 | 2003 |
| Current tax provision (credit): | | | |
| U.S. Federal | \$ 683 | \$ 136 | \$ 24 |
| Non-U.S. | 365 | 308 | 196 |
| State (U.S.) | 31 | 13 | 10 |
| | <u>1,079</u> | <u>457</u> | <u>230</u> |
| Deferred tax provision (credit): | | | |
| U.S. Federal | (5) | 301 | 182 |
| Non-U.S. | 31 | (24) | (21) |
| State (U.S.) | 15 | (3) | 7 |
| | <u>41</u> | <u>274</u> | <u>168</u> |
| Total provision for income taxes | <u>\$1,120</u> | <u>\$ 731</u> | <u>\$ 398</u> |

Reconciliation of the U.S. federal statutory rate to effective rate:

| | Years ended December 31, | | |
|--|--------------------------|---------------|---------------|
| | 2005 | 2004 | 2003 |
| U.S. statutory rate | 35.0 % | 35.0 % | 35.0 % |
| (Decreases) increases in taxes resulting from: | | | |
| Benefit of extraterritorial income exclusion | (2.7)% | (4.9)% | (4.9)% |
| Non-U.S. subsidiaries taxed at other than 35% | (3.2)% | (3.7)% | (4.0)% |
| Other — net | 0.4 % | 0.6 % | 0.9 % |
| | <u>29.5%</u> | <u>27.0%</u> | <u>27.0%</u> |
| Discrete items | (0.8)% | — | — |
| Provision for income taxes | <u>28.7 %</u> | <u>27.0 %</u> | <u>27.0 %</u> |

We paid income taxes of \$731 million, \$326 million and \$55 million in 2005, 2004 and 2003, respectively.

We have recorded income tax expense at U.S. tax rates on all profits, except for undistributed profits of non-U.S. companies which are considered indefinitely reinvested. Determination of the amount of unrecognized deferred tax liability related to indefinitely reinvested profits is not feasible.

Deferred income tax assets and liabilities:

| (Millions of dollars) | December 31, | | |
|---|--------------|--------------|--------------|
| | 2005 | 2004 | 2003 |
| Deferred income tax assets: | | | |
| Postemployment benefits other than pensions | \$1,034 | \$ 1,092 | \$ 1,147 |
| Warranty reserves | 216 | 212 | 163 |
| Unrealized profit excluded from inventories | 176 | 153 | 136 |
| Tax carryforwards | 523 | 498 | 395 |
| Deferred compensation | 70 | 57 | 48 |
| Allowance for credit losses | 86 | 73 | 66 |
| Unremitted earnings of non-U.S. subs | — | — | 25 |
| Post sale discounts | 62 | 51 | 39 |
| Other — net | 106 | 184 | 156 |
| | <u>2,273</u> | <u>2,320</u> | <u>2,175</u> |

Deferred income tax liabilities:

| | | | |
|---|----------------|-----------------|-----------------|
| Capital assets | (787) | (903) | (731) |
| Pension | (359) | (216) | (102) |
| Unremitted earnings of non-U.S. subs | (52) | (131) | — |
| | <u>(1,198)</u> | <u>(1,250)</u> | <u>(833)</u> |
| Valuation allowance for deferred tax assets | (79) | (42) | (62) |
| Deferred income taxes — net | <u>\$ 996</u> | <u>\$ 1,028</u> | <u>\$ 1,280</u> |

SFAS 109 requires that individual tax-paying entities of the company offset all current deferred tax liabilities and assets within each particular tax jurisdiction and present them as a single amount in the Consolidated Financial Position. A similar procedure is followed for all noncurrent deferred tax liabilities and assets. Amounts in different tax jurisdictions cannot be offset against each other. The amount of deferred income taxes at December 31, included on the following lines in Statement 2, are as follows:

| (Millions of dollars) | 2005 | | | 2004 | | | 2003 | | |
|---|----------------|-----------------|-----------------|------|------|------|------|------|------|
| | 2005 | 2004 | 2003 | 2005 | 2004 | 2003 | 2005 | 2004 | 2003 |
| Assets: | | | | | | | | | |
| Deferred and refundable income taxes | \$ 344 | \$ 397 | \$ 702 | | | | | | |
| Deferred income taxes | 768 | 674 | 616 | | | | | | |
| | <u>\$1,112</u> | <u>\$ 1,071</u> | <u>\$ 1,318</u> | | | | | | |
| Liabilities: | | | | | | | | | |
| Deferred and current income taxes payable | \$ 89 | \$ 20 | \$ 18 | | | | | | |
| Deferred income taxes and other liabilities | 27 | 23 | 20 | | | | | | |
| Deferred income taxes — net | <u>\$ 996</u> | <u>\$ 1,028</u> | <u>\$ 1,280</u> | | | | | | |

As of December 31, 2005, amounts and expiration dates of U.S. foreign tax credits available to carry forward were:

| (Millions of dollars) | | | | | |
|-----------------------|------|-------|------|------|-------|
| 2006-2011 | 2012 | 2013 | 2014 | 2015 | Total |
| \$0 | \$36 | \$109 | \$74 | \$18 | \$237 |

As of December 31, 2005, amounts and expiration dates of net operating loss carryforwards in various non-U.S. taxing jurisdictions were:

| (Millions of dollars) | | | | | | |
|-----------------------|------|------|------|-----------|-----------|-------|
| 2006 | 2007 | 2008 | 2009 | 2010-2015 | Unlimited | Total |
| \$7 | \$3 | \$0 | \$5 | \$137 | \$569 | \$721 |

A valuation allowance has been recorded at certain non-U.S. subsidiaries that have not yet demonstrated consistent and/or sustainable profitability to support the recognition of net deferred tax assets.

As of December 31, 2005, approximately \$890 million of state tax net operating losses (NOLs) and \$36 million of state tax credit carryforwards were available. Of the NOLs, 67% expire after 2015. The state tax credit carryforwards expire over the next ten years. We established a valuation allowance for those NOLs and credit carryforwards likely to expire prior to utilization.

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 of 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. We completed our evaluation in the second quarter and recognized a provision for income taxes of \$33 million in 2005 under the provisions of the Act. We repatriated earnings of \$1.4 billion in 2005, which includes approximately \$500 million subject to the preferential treatment allowed by the Act. In connection with our 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 2005 provision for income taxes also includes the impact of favorable tax settlements of \$26 million primarily related to non-U.S. tax jurisdictions. The net impact of repatriation planning and these favorable tax settlements was a \$31 million decrease to our 2005 provision for income taxes. Excluding these discrete items, the effective tax rate for 2005 was 29.5%.

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 are vigorously disputing 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.

6. Sales and servicing of 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.

A. Prior to June 2005, Cat Financial periodically securitized a portion of the dealer receivables using a revolving securitization structure. We used a trust which issued a collateralized trust obligation (CTO) certificate to third party purchasers for their portion of these receivables. The trust also issued a transferor certificate (certificated retained interests) to Cat Financial for the portion not represented by the CTO.

For 2003 and through August of 2004, the trust was a qualifying special purpose entity (QSPE) and thus, in accordance with SFAS 140, was not consolidated. The outstanding principal balance of the CTO was not included in our Consolidated Financial Position during these periods. As of December 31, 2003, the certificated retained interests of \$1,550 million were included in "Retained Interests in Securitized Trade Receivables" in Statement 2.

From September 2004 through May 2005, because of a significant increase in Machinery and Engines' sales and subsequent sale of the receivables to Cat Financial, 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. As of December 31, 2004, assets of the trust of \$2,587 million were included in "Receivables — trade and other" in Statement 2 and the CTO of \$240 million was included in "Short-term Borrowings." Please refer to Note 15.

Cat Financial serviced the dealer receivables and received an annual servicing fee of approximately 1% of the average outstanding principal balance of the securitized trade receivables transferred to third party purchasers. Consolidated expenses of \$7 million and \$6 million related to the securitized receivables were recognized during 2004 and 2003, respectively, and are included in "Other income (expense)" on Statement 1. Expected credit losses were assumed to be 0% because dealer receivables have historically had no losses and none were expected. The carrying value of the certificated retained interests approximated fair value due to their short-term nature. Other than the certificated retained interests (assets of the trust when consolidated), the investors and the securitization facilities had no recourse to Cat Financial's assets for failure of debtors to pay when due.

| (Millions of dollars) | 2004 | 2003 |
|---|----------|----------|
| Cash flow from securitizations: | | |
| Proceeds from collections reinvested in revolving securitization ⁽¹⁾ | \$ 663 | \$ 1,099 |
| Servicing fees received ⁽¹⁾ | 2 | 2 |
| Characteristics of securitized receivables: | | |
| Principal balance at December 31: | | |
| Certificated retained interests | \$ — | \$ 1,550 |
| Collateralized trust obligation | — | 240 |
| Average balance for the year ended December 31 ⁽¹⁾ : | | |
| Certificated retained interests | \$ 1,936 | \$ 1,350 |
| Collateralized trust obligation | 240 | 240 |

⁽¹⁾ For 2004, proceeds, servicing fees received and average balances include only the periods the trust was a QSP.

In June 2005, Cat Financial terminated the trade receivable securitization trust and no longer securitizes trade receivables. Upon termination, receivables held by the trust were transferred back to Cat Financial.

B. In June 2005, Cat Financial transferred an undivided interest of \$240 million in trade receivables to third party purchasers. In accordance with SFAS 140, the transfer to third party purchasers is accounted for as a sale. Cat Financial services the transferred trade receivables and receives an annual servicing fee of approximately 1% of the average outstanding principal balance. Consolidated expense of \$8 million related to the sale of trade receivables was recognized during 2005 and is included in "Other income (expense)" on Statement 1.

The remaining interest as of December 31, 2005 of \$3,028 million is included in "Receivables — trade and other" in Statement 2. The cash collections from these receivables held by Cat Financial, including those attributable to the third party purchasers, are first applied to satisfy any obligations of Cat Financial to those purchasers. The third party purchasers have no recourse to Cat Financial's assets, other than the remaining interest, for failure of debtors to pay when due. For Cat Financial's remaining interest in trade receivables, carrying amount approximated fair value due to the short-term nature of these receivables.

7. Wholesale inventory receivables

Wholesale inventory receivables are receivables of Cat Financial that arise when Cat Financial provides financing for a dealer's purchase of inventory. These receivables are included in "Receivables — trade and other" and "Long-term receivables — trade and other" in Statement 2 and were \$1,282 million, \$991 million and \$764 million at December 31, 2005, 2004 and 2003, respectively. Please refer to Note 20 on page A-28 and Table III on page A-29 for fair value information.

Contractual maturities of outstanding wholesale inventory receivables:

| (Millions of dollars) | December 31, 2005 | | | |
|---------------------------|---------------------------------|--------------------------|-----------------|----------|
| | Wholesale Installment Contracts | Wholesale Finance Leases | Wholesale Notes | Total |
| Amounts Due In | | | | |
| 2006 | \$ 37 | \$ 73 | \$ 441 | \$ 551 |
| 2007 | 13 | 52 | 254 | 319 |
| 2008 | 14 | 36 | 250 | 300 |
| 2009 | 10 | 19 | 18 | 47 |
| 2010 | 7 | 7 | 14 | 28 |
| Thereafter | — | — | 3 | 3 |
| | 81 | 187 | 980 | 1,248 |
| Guaranteed residual value | — | 85 | — | 85 |
| Less: Unearned income | 4 | 18 | 29 | 51 |
| Total | \$ 77 | \$ 254 | \$ 951 | \$ 1,282 |

8. Finance receivables

Finance receivables are receivables of Cat Financial, which generally can be repaid or refinanced without penalty prior to contractual maturity. Total finance receivables reported in Statement 2 are net of an allowance for credit losses.

During 2005, 2004 and 2003, Cat Financial securitized retail installment sale contracts and finance leases into public asset-backed securitization facilities. The securitization facilities are qualifying special purpose entities and thus, in accordance with SFAS 140, are not consolidated. These finance receivables, which are being held in securitization trusts, are secured by new and used equipment. Cat Financial retained servicing responsibilities and subordinated interests related to these securitizations. For 2005, subordinated interests included subordinated certificates with an initial fair value of \$8 million, an interest in certain future cash flow (excess) with an initial fair value of \$1 million and a reserve account with an initial fair value of \$12 million. For 2004, subordinated interests included subordinated certificates with an initial fair value of \$8 million, an interest in certain future cash flow (excess) with an initial fair value of \$2 million and a reserve account with an initial fair value of \$10 million. For 2003, subordinated interests included subordinated certificates with an initial fair value of \$9 million, an interest in certain future cash flow (excess) with an initial fair value of \$14 million and a reserve account with an initial fair value of \$10 million. The company's retained interests generally are subordinate to the investors' interests. Net gains of \$12 million, \$13 million and \$22 million were recognized on these transactions in 2005, 2004 and 2003, respectively.

Significant assumptions used to estimate the fair value of the retained interests and subordinated certificates at the time of the transaction were:

| | 2005 | 2004 | 2003 |
|----------------------------------|-------|-------|-------|
| Discount rate | 10.8% | 10.7% | 11.0% |
| Weighted-average prepayment rate | 14.0% | 14.0% | 14.0% |
| Expected credit losses | 1.0% | 1.0% | 1.0% |

These assumptions are based on our historical experience, market trends and anticipated performance relative to the particular assets securitized.

The company receives annual servicing fees of approximately 1% of the unpaid note value.

As of December 31, 2005, 2004 and 2003, the subordinated retained interests in the public securitizations totaled \$72 million, \$73 million and \$73 million, respectively. Key assumptions used to determine the fair value of the retained interests were:

| | 2005 | 2004 | 2003 |
|--|-----------|-----------|-----------|
| Cash flow discount rates on retained interests and subordinated tranches | 10.7% | 10.7% | 9.1-10.8% |
| Weighted-average maturity | 30 months | 28 months | 27 months |
| Average prepayment rate | 14.0% | 14.0% | 14.0% |
| Expected credit losses | 1.0% | 1.0% | 1.0% |

The investors and the securitization trusts have no recourse to Cat Financial's other assets for failure of debtors to pay when due.

We estimated the impact of individual 10% and 20% changes to the key economic assumptions used to determine the fair value of residual cash flow in retained interests on our income. An

TABLE I — Finance Receivables Information (Millions of dollars)

Contractual maturities of outstanding finance receivables:

| Amounts Due In | December 31, 2005 | | | | | Total |
|--------------------------|------------------------------------|-----------------------------|-----------------|--------------------|--|------------------|
| | Retail Installment Contracts | Retail Finance Leases | Retail Notes | Wholesale Notes | | |
| 2006 | \$ 2,760 | \$ 2,085 | \$ 1,896 | \$ 137 | | \$ 6,878 |
| 2007 | 1,988 | 1,465 | 850 | 15 | | 4,318 |
| 2008 | 1,312 | 951 | 626 | 7 | | 2,896 |
| 2009 | 657 | 516 | 439 | — | | 1,612 |
| 2010 | 214 | 218 | 374 | — | | 806 |
| Thereafter | 39 | 205 | 731 | — | | 975 |
| | <u>6,970</u> | <u>5,440</u> | <u>4,916</u> | <u>159</u> | | <u>17,485</u> |
| Residual value | — | 938 | — | — | | 938 |
| Less: Unearned income | 681 | 623 | 74 | — | | 1,378 |
| Total | <u>\$ 6,289</u> | <u>\$ 5,755</u> | <u>\$ 4,842</u> | <u>\$ 159</u> | | <u>\$ 17,045</u> |

Impaired loans and leases:

| | 2005 | 2004 | 2003 |
|--|---------------|---------------|---------------|
| Average recorded investment | <u>\$ 143</u> | <u>\$ 265</u> | <u>\$ 321</u> |
| At December 31: | | | |
| Recorded investment | \$ 106 | \$ 181 | \$ 275 |
| Impaired loans/finance leases for which there is a related allowance for credit losses | \$ 33 | \$ 51 | \$ 98 |
| Impaired loans/finance leases for which there is no related allowance for credit losses | \$ 73 | \$ 130 | \$ 177 |

Cash flow from securitizations:

| | 2005 | 2004 | 2003 |
|--|--------|--------|--------|
| Proceeds from initial sales of receivables | \$ 829 | \$ 639 | \$ 661 |
| Servicing fees received | 11 | 9 | 8 |
| Cash flows received on retained interests | 38 | 34 | 15 |

Characteristics of securitized receivables:

| | 2005 | 2004 | 2003 |
|---------------------------------------|----------|--------|--------|
| At December 31: | | | |
| Total securitized principal balance | \$ 980 | \$ 815 | \$ 813 |
| Loans more than 30 days past due | 23 | 26 | 34 |
| Weighted average maturity (in months) | 30 | 28 | 27 |
| For the year ended December 31: | | | |
| Average securitized principal balance | \$ 1,085 | \$ 873 | \$ 884 |
| Net credit losses | 3 | 4 | 6 |

independent, adverse change to each key assumption had an immaterial impact on the fair value of residual cash flow.

We consider an account past due if any portion of an installment is due and unpaid for more than 30 days. Recognition of income is suspended when management determines that collection of future income is not probable (generally after 120 days past due). Accrual is resumed, and previously suspended income is recognized, when the receivable becomes contractually current and/or collection doubts are removed. Cash receipts on impaired loans or finance leases are recorded against the receivable and then to any unrecognized income. Investment in loans/finance leases on non-accrual status were \$175 million, \$176 million and \$233 million and past due over 90 days and still accruing were \$31 million, \$11 million and \$25 million as of December 31, 2005, 2004 and 2003, respectively.

Cat Financial provides financing only when acceptable criteria are met. Credit decisions are based on, among other things, the customer's credit history, financial strength and intended use

Allowance for credit loss activity:

| | 2005 | 2004 | 2003 |
|--|---------------|---------------|---------------|
| Balance at beginning of year | \$ 278 | \$ 241 | \$ 207 |
| Provision for credit losses | 92 | 105 | 101 |
| Receivables written off | (62) | (88) | (104) |
| Recoveries on receivables previously written off | 17 | 16 | 22 |
| Other — net | (23) | 4 | 15 |
| Balance at end of year | <u>\$ 302</u> | <u>\$ 278</u> | <u>\$ 241</u> |

In estimating the allowance for credit losses, we review accounts that are past due, non-performing or in bankruptcy.

Cat Financial's net retail finance leases:

| | December 31, | | |
|--|-----------------|-----------------|-----------------|
| | 2005 | 2004 | 2003 |
| Total minimum lease payments receivable | <u>\$ 5,440</u> | <u>\$ 4,876</u> | <u>\$ 4,096</u> |
| Estimated residual value of leased assets: | | | |
| Guaranteed | 384 | 379 | 323 |
| Unguaranteed | 554 | 540 | 558 |
| | <u>6,378</u> | <u>5,795</u> | <u>4,977</u> |
| Less: Unearned income | 623 | 550 | 498 |
| Net retail finance leases | <u>\$ 5,755</u> | <u>\$ 5,245</u> | <u>\$ 4,479</u> |

| | 2005 | 2004 | 2003 |
|--|----------|--------|--------|
| Proceeds from initial sales of receivables | \$ 829 | \$ 639 | \$ 661 |
| Servicing fees received | 11 | 9 | 8 |
| Cash flows received on retained interests | 38 | 34 | 15 |
| Total securitized principal balance | \$ 980 | \$ 815 | \$ 813 |
| Loans more than 30 days past due | 23 | 26 | 34 |
| Weighted average maturity (in months) | 30 | 28 | 27 |
| Average securitized principal balance | \$ 1,085 | \$ 873 | \$ 884 |
| Net credit losses | 3 | 4 | 6 |

of equipment. Cat Financial typically maintains a security interest in retail financed equipment and requires physical damage insurance coverage on financed equipment.

Please refer to Table I above for additional finance receivables information and Note 20 on page A-28 and Table III on page A-29 for fair value information.

9. Inventories

| | December 31, | | |
|-----------------------|-----------------|-----------------|-----------------|
| (Millions of dollars) | 2005 | 2004 | 2003 |
| Raw materials | \$ 1,689 | \$ 1,592 | \$ 1,105 |
| Work-in-process | 814 | 664 | 377 |
| Finished goods | 2,493 | 2,209 | 1,381 |
| Supplies | 228 | 210 | 184 |
| Total inventories | <u>\$ 5,224</u> | <u>\$ 4,675</u> | <u>\$ 3,047</u> |

We had long-term material purchase obligations of approximately \$890 million at December 31, 2005.

10. Property, plant and equipment

| (Dollars in millions) | Useful Lives (Years) | December 31, | | |
|---|----------------------------|--------------|---------|---------|
| | | 2005 | 2004 | 2003 |
| Land | — | \$ 154 | \$ 152 | \$ 149 |
| Buildings and land improvements | 20-45 | 3,195 | 3,089 | 3,006 |
| Machinery, equipment and other | 3-10 | 7,829 | 7,361 | 7,039 |
| Equipment leased to others | 1-10 | 3,988 | 3,975 | 3,609 |
| Construction-in-process | — | 696 | 587 | 487 |
| Total property, plant and equipment, at cost | | 15,862 | 15,164 | 14,290 |
| Less: Accumulated depreciation | | 7,874 | 7,482 | 7,039 |
| Property, plant and equipment — net | | \$7,988 | \$7,682 | \$7,251 |

We had commitments for the purchase or construction of capital assets of approximately \$461 million at December 31, 2005. Software assets totaling \$50 million, primarily related to our dealer distribution support system, were abandoned in 2005. The write-off of these assets is included in "Other Operating Expense" on Statement 1.

Assets recorded under capital leases⁽¹⁾:

| (Millions of dollars) | December 31, | | |
|---|--------------|--------|--------|
| | 2005 | 2004 | 2003 |
| Gross capital leases ⁽²⁾ | \$ 91 | \$ 326 | \$ 321 |
| Less: Accumulated depreciation | 55 | 220 | 213 |
| Net capital leases | \$ 36 | \$ 106 | \$ 108 |

⁽¹⁾ Included in Property, plant and equipment table above.

⁽²⁾ Consists primarily of machinery and equipment.

The decrease in capital leases was due to termination of certain leases in the fourth quarter of 2005. See Note 16 for additional information.

Equipment leased to others (primarily by Financial Products):

| (Millions of dollars) | December 31, | | |
|--|--------------|---------|---------|
| | 2005 | 2004 | 2003 |
| Equipment leased to others — at original cost | \$3,988 | \$3,975 | \$3,609 |
| Less: Accumulated depreciation | 1,201 | 1,196 | 1,074 |
| Equipment leased to others — net | \$2,787 | \$2,779 | \$2,535 |

At December 31, 2005, scheduled minimum rental payments to be received for equipment leased to others were:

| (Millions of dollars) | | | | | |
|-----------------------|-------|-------|-------|------|---------------|
| 2006 | 2007 | 2008 | 2009 | 2010 | After 2010 |
| \$636 | \$473 | \$281 | \$136 | \$66 | \$20 |

11. Investment in unconsolidated affiliated companies

Our investment in affiliated companies accounted for by the equity method consists 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 September 30) was as follows:

| (Millions of dollars) | Years ended December 31, | | |
|-----------------------------------|--------------------------|---------|---------|
| | 2005 | 2004 | 2003 |
| Results of Operations: | | | |
| Sales | \$4,140 | \$3,628 | \$2,946 |
| Cost of sales | 3,257 | 2,788 | 2,283 |
| Gross profit | 883 | 840 | 663 |
| Profit (loss) | \$ 161 | \$ 129 | \$ 48 |
| Caterpillar's profit (loss) | \$ 73 | \$ 59 | \$ 20 |

| (Millions of dollars) | December 31, | | |
|---|--------------|--------------|--------------|
| | 2005 | 2004 | 2003 |
| Financial Position: | | | |
| Assets: | | | |
| Current assets | \$1,714 | \$1,540 | \$1,494 |
| Property, plant and equipment — net | 1,121 | 1,097 | 961 |
| Other assets | 193 | 145 | 202 |
| | <u>3,028</u> | <u>2,782</u> | <u>2,657</u> |
| Liabilities: | | | |
| Current liabilities | \$1,351 | \$1,345 | \$1,247 |
| Long-term debt due after one year | 336 | 276 | 343 |
| Other liabilities | 188 | 214 | 257 |
| | <u>1,875</u> | <u>1,835</u> | <u>1,847</u> |
| Ownership | \$1,153 | \$ 947 | \$ 810 |

Caterpillar's investment in unconsolidated affiliated companies:

| (Millions of dollars) | 2005 | 2004 | 2003 |
|---|--------|--------|--------|
| Investment in equity method companies | \$ 540 | \$ 487 | \$ 432 |
| Plus: Investment in cost method companies | 25 | 30 | 368 |
| Total investments in unconsolidated affiliated companies | \$ 565 | \$ 517 | \$ 800 |

At December 31, 2005, consolidated "Profit employed in the business" in Statement 2 included \$202 million representing undistributed profit of the unconsolidated affiliated companies.

Certain investments in unconsolidated affiliated companies are accounted for using the cost method. During first quarter 2001, Cat Financial invested for a limited partnership interest in a venture financing structure associated with Caterpillar's rental strategy in the United Kingdom. In the fourth quarter 2004, we sold our investment in this limited partnership. This sale had no impact on earnings.

12. Intangible assets and goodwill

A. Intangible assets

Intangible assets are comprised of the following:

| (Millions of dollars) | Weighted Amortizable Life (Years) | December 31, | | |
|---|--|--------------|------------|-----------|
| | | 2005 | 2004 | 2003 |
| Intellectual property | 10 | \$ 206 | \$ 213 | \$ 126 |
| Other | 16 | 73 | 73 | 0 |
| Total finite-lived intangible assets — gross | | 279 | 286 | 126 |
| Less: Accumulated amortization | | 107 | 91 | 44 |
| | | <u>172</u> | <u>195</u> | <u>82</u> |
| Pension-related | | 252 | 120 | 157 |
| Intangible assets — net | | \$ 424 | \$ 315 | \$ 239 |

During 2004 we acquired finite lived intangible assets of \$130 million. (See Note 26 for details on the acquisition of these assets.) Amortization expense related to intangible assets was \$22 million, \$18 million and \$15 million for 2005, 2004 and 2003, respectively.

Amortization expense related to intangible assets is expected to be:

| (Millions of dollars) | | | | | |
|-----------------------|------|------|------|------|------------|
| 2006 | 2007 | 2008 | 2009 | 2010 | Thereafter |
| \$21 | \$18 | \$16 | \$16 | \$18 | \$83 |

B. Goodwill

During 2004 we acquired assets with related goodwill of \$55 million. (See Note 26 for details on the acquisition of these assets.) No goodwill was acquired during the years ended December 31,

2005 and 2003. During 2003 we disposed of assets reported in the Electric Power segment with related goodwill of \$3 million. No goodwill was disposed of during the years ended December 31, 2005 and 2004. On an annual basis, we test goodwill for impairment in accordance with Statement of Financial Accounting Standards No. 142 "Goodwill and Other Intangible Assets." No goodwill was impaired during the years ended December 31, 2005, 2004 and 2003.

13. Available-for-sale securities

Financial Products, primarily Cat Insurance, has investments in certain debt and equity securities at December 31, 2005, 2004 and 2003, that have been classified as available-for-sale in accordance with SFAS 115 and recorded at fair value based upon quoted market prices. These fair values are included in "Other assets" in Statement 2. 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 Statement 2). 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 Statement 1.

| (Millions of dollars) | December 31, 2005 | | |
|-------------------------|-------------------|---------------------------------------|---------------|
| | Cost Basis | Unrealized Pre-Tax Net Gains (Losses) | Fair Value |
| Government debt | \$ 305 | \$ (6) | \$ 299 |
| Corporate bonds | 422 | (7) | 415 |
| Equity securities | 146 | 38 | 184 |
| | <u>\$ 873</u> | <u>\$ 25</u> | <u>\$ 898</u> |

| (Millions of dollars) | December 31, 2004 | | |
|-------------------------|-------------------|---------------------------------------|---------------|
| | Cost Basis | Unrealized Pre-Tax Net Gains (Losses) | Fair Value |
| Government debt | \$ 239 | \$ (1) | \$ 238 |
| Corporate bonds | 342 | — | 342 |
| Equity securities | 204 | 26 | 230 |
| | <u>\$ 785</u> | <u>\$ 25</u> | <u>\$ 810</u> |

| (Millions of dollars) | December 31, 2003 | | |
|-------------------------|-------------------|------------------------------|---------------|
| | Cost Basis | Unrealized Pre-Tax Net Gains | Fair Value |
| Government debt | \$ 102 | \$ — | \$ 102 |
| Corporate bonds | 288 | 3 | 291 |
| Equity securities | 191 | 15 | 206 |
| | <u>\$ 581</u> | <u>\$ 18</u> | <u>\$ 599</u> |

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

| (Millions of dollars) | December 31, 2005 | | | | | |
|-----------------------|------------------------------------|-------------------|------------------------------------|-------------------|---------------|-------------------|
| | Less than 12 months ⁽¹⁾ | | More than 12 months ⁽¹⁾ | | Total | |
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Government debt ... | 155 | 2 | 113 | 3 | 268 | 5 |
| Corporate bonds ... | 220 | 3 | 136 | 4 | 356 | 7 |
| Equity securities.... | 31 | 2 | — | — | 31 | 2 |
| Total | <u>\$ 406</u> | <u>\$ 7</u> | <u>\$ 249</u> | <u>\$ 7</u> | <u>\$ 655</u> | <u>\$ 14</u> |

| (Millions of dollars) | December 31, 2004 | | | | | |
|-----------------------|------------------------------------|-------------------|------------------------------------|-------------------|---------------|-------------------|
| | Less than 12 months ⁽¹⁾ | | More than 12 months ⁽¹⁾ | | Total | |
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Government debt ... | 166 | 1 | 9 | — | 175 | 1 |
| Corporate bonds ... | 156 | 2 | 35 | 1 | 191 | 3 |
| Equity securities.... | 46 | 1 | 2 | — | 48 | 1 |
| Total | <u>\$ 368</u> | <u>\$ 4</u> | <u>\$ 46</u> | <u>\$ 1</u> | <u>\$ 414</u> | <u>\$ 5</u> |

| (Millions of dollars) | December 31, 2003 | | | | | |
|-----------------------|------------------------------------|-------------------|------------------------------------|-------------------|---------------|-------------------|
| | Less than 12 months ⁽¹⁾ | | More than 12 months ⁽¹⁾ | | Total | |
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Corporate bonds ... | 93 | 2 | 13 | 1 | 106 | 3 |
| Equity securities.... | — | — | 25 | 1 | 25 | 1 |
| Total | <u>\$ 93</u> | <u>\$ 2</u> | <u>\$ 38</u> | <u>\$ 2</u> | <u>\$ 131</u> | <u>\$ 4</u> |

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

Government Debt. The unrealized losses on our investments in U.S. Treasury obligations, direct obligations of U.S. governmental agencies and federal agency mortgage-backed securities were caused by an increase in interest rates. There are no credit related events on any of these securities. We intend to and have the ability to hold these investments that are less than book value until recovery to fair value or maturity. We do not consider these investments to be other-than-temporarily impaired as of December 31, 2005.

Corporate Bonds. The unrealized losses on our investments in corporate bonds relate primarily to an increase in interest rates. Much of the corporate debt securities market has also been affected by an increase in risk and volatility due to the aggressiveness of private equity funds. This has caused yield spreads in general to widen which has increased the size of the unrealized losses in the portfolio. We currently believe it is probable that we will be able to collect all amounts due according to the contractual terms of our investments in corporate debt securities. We intend to and have the ability to hold these investments that are less than book value, for the aforementioned reasons, until recovery to fair value or maturity. We do not consider these investments to be other-than-temporarily impaired as of December 31, 2005.

Equity Securities. We maintain a well-diversified portfolio consisting of a separately managed account of individual stocks and four mutual funds. The individual securities and mutual fund investments support cash flow, asset allocation and investment objectives. In each case where unrealized losses occur in the individual stocks, company management is taking corrective action to increase shareholder value. None of the mutual funds are in a position where their market value is less than their cost. We currently believe it is probable that we will be able to recover all amounts due and do not consider these investments to be other than temporarily impaired as of December 31, 2005.

The fair value of available-for-sale debt securities at December 31, 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 | \$ 43 |
| Due after one year through five years | \$308 |
| Due after five years through ten years | \$ 92 |
| Due after ten years | \$271 |

Proceeds from sales of investments in debt and equity securities during 2005, 2004 and 2003 were \$257 million, \$408 million and \$329 million, respectively. Gross gains of \$14 million, \$8 million and \$3 million and gross losses of \$6 million, \$6 million and \$2 million have been included in current earnings as a result of these sales for 2005, 2004 and 2003, respectively.

During 2003, we recognized pretax charges in accordance with the application of SFAS 115 for "other than temporary" declines in the market value of securities in the Cat Insurance and Caterpillar Investment Management Ltd. investment portfolios of \$33 million. During 2005 and 2004, there were no charges for "other than temporary" declines in the market value of securities.

14. Postemployment benefit plans

We have both U.S. and non-U.S. pension plans covering substantially all of our U.S. employees and a portion of our non-U.S. employees, primarily in our European facilities. Our defined benefit plans provide a benefit based on years of service and/or the employee's average earnings near retirement. Our defined contribution plans allow employees to contribute a portion of

their salary to help save for retirement, and in certain cases, we provide a matching contribution. We also have defined-benefit retirement health care and life insurance plans covering substantially all of our U.S. employees.

In January 2005, amendments were made to both U.S. hourly 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 10, 2005 to account for the benefit changes. The result was a \$29 million increase in pension cost, and a \$69 million increase in other postretirement benefit cost for 2005. 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 \$18 million in other postretirement benefit cost for 2005.

We use a November 30th measurement date for our U.S. pension and other postretirement benefit plans and a September 30th measurement date for our non-U.S. pension plans. Year-end asset and obligation amounts are disclosed as of the plan measurement dates.

A. Benefit obligations

| (Millions of dollars) | U.S. Pension Benefits | | | Non-U.S. Pension Benefits | | | Other Postretirement Benefits | | |
|---|-----------------------|----------|----------|---------------------------|----------|----------|-------------------------------|----------|----------|
| | 2005 | 2004 | 2003 | 2005 | 2004 | 2003 | 2005 | 2004 | 2003 |
| Change in benefit obligation: | | | | | | | | | |
| Benefit obligation, beginning of year | \$ 9,593 | \$ 8,993 | \$ 7,844 | \$ 2,097 | \$ 1,836 | \$ 1,517 | \$ 4,926 | \$ 5,004 | \$ 4,465 |
| Service cost | 150 | 143 | 122 | 58 | 53 | 43 | 86 | 66 | 70 |
| Interest cost | 555 | 548 | 554 | 109 | 97 | 83 | 294 | 265 | 298 |
| Plan amendments | 204 | — | (27) | (8) | — | — | 412 | — | (6) |
| Actuarial losses (gains) | 863 | 584 | 1,148 | 254 | 54 | 118 | 458 | (64) | 474 |
| Foreign currency exchange rates | — | — | — | (65) | 135 | 137 | (2) | 2 | 4 |
| Participant contributions | — | — | — | 12 | 11 | 10 | 28 | 58 | 25 |
| Benefits paid | (686) | (675) | (648) | (96) | (89) | (72) | (384) | (405) | (326) |
| Benefit obligation, end of year | \$10,679 | \$ 9,593 | \$ 8,993 | \$ 2,361 | \$ 2,097 | \$ 1,836 | \$ 5,818 | \$ 4,926 | \$ 5,004 |
| Accumulated benefit obligation, end of year ... | \$10,213 | \$ 9,040 | \$ 8,379 | \$ 2,069 | \$ 1,844 | \$ 1,660 | | | |
| Weighted-average assumptions used to determine benefit obligations, end of year: | | | | | | | | | |
| Discount rate ⁽¹⁾ | 5.6% | 5.9% | 6.2% | 4.6% | 5.2% | 5.1% | 5.6% | 5.9% | 6.1% |
| Rate of compensation increase ⁽¹⁾ | 4.0% | 4.0% | 4.0% | 3.7% | 3.5% | 3.2% | 4.0% | 4.0% | 4.0% |

⁽¹⁾ End of year rates are used to determine net periodic cost for the subsequent year. See Note 14E.

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one-percentage-point change in assumed health care cost trend rates would have the following effects:

| (Millions of dollars) | One-percentage-point increase | One-percentage-point decrease |
|--|-------------------------------|-------------------------------|
| Effect on 2005 service and interest cost components of other postretirement benefit cost | \$ 34 | \$ (29) |
| Effect on accumulated postretirement benefit obligation | \$432 | \$(376) |

NOTES *continued*

B. Plan assets

| (Millions of dollars) | U.S. Pension Benefits | | | Non-U.S. Pension Benefits | | | Other Postretirement Benefits | | |
|--|-----------------------|----------|----------|---------------------------|----------|----------|-------------------------------|--------|--------|
| | 2005 | 2004 | 2003 | 2005 | 2004 | 2003 | 2005 | 2004 | 2003 |
| Change in plan assets: | | | | | | | | | |
| Fair value of plan assets, beginning of year.... | \$ 8,725 | \$ 7,728 | \$ 6,443 | \$ 1,503 | \$ 1,262 | \$ 1,024 | \$ 994 | \$ 867 | \$ 849 |
| Actual return on plan assets..... | 860 | 1,106 | 1,290 | 272 | 124 | 120 | 100 | 118 | 140 |
| Foreign currency exchange rates..... | — | — | — | (47) | 91 | 96 | — | — | — |
| Company contributions..... | 542 | 566 | 643 | 390 | 104 | 84 | 573 | 356 | 179 |
| Participant contributions..... | — | — | — | 12 | 11 | 10 | 28 | 58 | 25 |
| Benefits paid..... | (686) | (675) | (648) | (96) | (89) | (72) | (384) | (405) | (326) |
| Settlements..... | — | — | — | (10) | — | — | — | — | — |
| Fair value of plan assets, end of year..... | \$ 9,441 | \$ 8,725 | \$ 7,728 | \$ 2,024 | \$ 1,503 | \$ 1,262 | \$ 1,311 | \$ 994 | \$ 867 |

The asset allocation for our pension and other postretirement benefit plans at the end of 2005, 2004 and 2003, and the target allocation for 2006, by asset category, are as follows:

| | Target Allocation | Percentage of Plan Assets at Year End | | |
|---------------------------------------|-------------------|---------------------------------------|------|------|
| | 2006 | 2005 | 2004 | 2003 |
| U.S. pension: | | | | |
| Equity securities..... | 70% | 72% | 74% | 75% |
| Debt securities..... | 30% | 28% | 26% | 25% |
| Total..... | 100% | 100% | 100% | 100% |
| Non-U.S. pension: | | | | |
| Equity securities..... | 64% | 63% | 54% | 56% |
| Debt securities..... | 29% | 30% | 38% | 39% |
| Real estate..... | 6% | 5% | 6% | 4% |
| Other..... | 1% | 2% | 2% | 1% |
| Total..... | 100% | 100% | 100% | 100% |
| Other postretirement benefits: | | | | |
| Equity securities..... | 80% | 84% | 84% | 84% |
| Debt securities..... | 20% | 16% | 16% | 16% |
| Total..... | 100% | 100% | 100% | 100% |

Our target asset allocations reflect our investment strategy of maximizing the long-term rate of return on plan assets and the resulting funded status, within an appropriate level of risk. The U.S. plans are rebalanced to plus or minus five percentage points of the target asset allocation ranges on a monthly basis. The frequency of rebalancing for the non-U.S. plans varies depending on the plan.

Equity securities within plan assets include Caterpillar Inc. common stock in the amounts of:

| (Millions of dollars) | U.S. Pension Benefits ⁽¹⁾ | | | Non-U.S. Pension Benefits | | | Other Postretirement Benefits | | |
|------------------------------------|--------------------------------------|--------|--------|---------------------------|------|------|-------------------------------|------|------|
| | 2005 | 2004 | 2003 | 2005 | 2004 | 2003 | 2005 | 2004 | 2003 |
| Caterpillar Inc. common stock..... | \$ 371 | \$ 299 | \$ 245 | \$ 2 | \$ — | \$ — | \$ 5 | \$ 1 | \$ 2 |

⁽¹⁾ Amounts represent 4% of total plan assets for 2005 and 3% for 2004 and 2003.

C. Funded status

The funded status of the plans, reconciled to the amount reported on the Consolidated Financial Position, is as follows:

| (Millions of dollars) | U.S. Pension Benefits | | | Non-U.S. Pension Benefits | | | Other Postretirement Benefits | | |
|--|-----------------------|----------|----------|---------------------------|----------|----------|-------------------------------|------------|------------|
| | 2005 | 2004 | 2003 | 2005 | 2004 | 2003 | 2005 | 2004 | 2003 |
| End of Year | | | | | | | | | |
| Fair value of plan assets | \$ 9,441 | \$ 8,725 | \$ 7,728 | \$ 2,024 | \$ 1,503 | \$ 1,262 | \$ 1,311 | \$ 994 | \$ 867 |
| Benefit obligations | 10,679 | 9,593 | 8,993 | 2,361 | 2,097 | 1,836 | 5,818 | 4,926 | 5,004 |
| Over (under) funded status | (1,238) | (868) | (1,265) | (337) | (594) | (574) | (4,507) | (3,932) | (4,137) |
| Amounts not yet recognized: | | | | | | | | | |
| Unrecognized prior service cost (benefit) | 303 | 158 | 202 | 22 | 27 | 31 | 208 | (232) | (280) |
| Unrecognized net actuarial loss | 3,070 | 2,552 | 2,518 | 746 | 726 | 677 | 1,595 | 1,232 | 1,364 |
| Unrecognized net obligation existing at adoption of SFAS 87/106 | — | — | — | 2 | 3 | 6 | 14 | 16 | 17 |
| Contributions made after measurement date | 1 | — | 1 | 1 | 22 | 14 | 28 | 27 | 57 |
| Net amount recognized in financial position | \$ 2,136 | \$ 1,842 | \$ 1,456 | \$ 434 | \$ 184 | \$ 154 | \$ (2,662) | \$ (2,889) | \$ (2,979) |
| Components of net amount recognized in financial position: | | | | | | | | | |
| Prepaid benefit costs | \$ 1,487 | \$ 1,099 | \$ 1,136 | \$ 466 | \$ 28 | \$ 61 | \$ — | \$ — | \$ — |
| Accrued benefit liabilities | (71) | (97) | (548) | (59) | (173) | (127) | (599) | (402) | (341) |
| Intangible assets | 237 | 95 | 127 | 16 | 25 | 30 | — | — | — |
| Liability for postemployment benefits | (760) | (248) | (136) | (92) | (181) | (327) | (2,063) | (2,487) | (2,638) |
| Accumulated other comprehensive income (pretax) | 1,243 | 993 | 877 | 103 | 485 | 517 | — | — | — |
| Net asset (liability) recognized | \$ 2,136 | \$ 1,842 | \$ 1,456 | \$ 434 | \$ 184 | \$ 154 | \$ (2,662) | \$ (2,889) | \$ (2,979) |

The following amounts relate to our pension plans with projected benefit obligations in excess of plan assets:

| (Millions of dollars) | U.S. Pension Benefits | | | Non-U.S. Pension Benefits | | |
|--------------------------------------|-----------------------|------------|------------|---------------------------|------------|------------|
| | at Year-end | | | at Year-end | | |
| | 2005 | 2004 | 2003 | 2005 | 2004 | 2003 |
| Projected benefit obligation | \$ (10,679) | \$ (9,593) | \$ (8,993) | \$ (2,319) | \$ (2,059) | \$ (1,800) |
| Accumulated benefit obligation | \$ (10,213) | \$ (9,040) | \$ (8,379) | \$ (2,034) | \$ (1,813) | \$ (1,633) |
| Fair value of plan assets | \$ 9,441 | \$ 8,725 | \$ 7,728 | \$ 1,973 | \$ 1,455 | \$ 1,216 |

The following amounts relate to our pension plans with accumulated benefit obligations in excess of plan assets:

| (Millions of dollars) | U.S. Pension Benefits | | | Non-U.S. Pension Benefits | | |
|--------------------------------------|-----------------------|------------|------------|---------------------------|------------|------------|
| | at Year-end | | | at Year-end | | |
| | 2005 | 2004 | 2003 | 2005 | 2004 | 2003 |
| Projected benefit obligation | \$ (4,594) | \$ (3,975) | \$ (3,785) | \$ (556) | \$ (2,003) | \$ (1,761) |
| Accumulated benefit obligation | \$ (4,564) | \$ (3,959) | \$ (3,751) | \$ (506) | \$ (1,767) | \$ (1,601) |
| Fair value of plan assets | \$ 3,733 | \$ 3,614 | \$ 3,083 | \$ 382 | \$ 1,406 | \$ 1,181 |

The accumulated postretirement benefit obligation exceeds plan assets for all of our other postretirement benefit plans.

NOTES *continued*

D. Expected cash flow

Information about the expected cash flow for the pension and other postretirement benefit plans follows:

| (Millions of dollars) | U.S. Pension Benefits | Non-U.S. Pension Benefits | Other Postretirement Benefits |
|-----------------------------------|--------------------------|------------------------------|----------------------------------|
| Employer contributions: | | | |
| 2006 (expected)..... | \$ 10 | \$ 30 | \$ 550 |
| Expected benefit payments: | | | |
| 2006 | 700 | 70 | 350 |
| 2007 | 710 | 70 | 370 |
| 2008 | 710 | 80 | 380 |
| 2009 | 720 | 80 | 390 |
| 2010 | 730 | 90 | 400 |
| 2011-2015 | <u>3,700</u> | <u>490</u> | <u>2,120</u> |
| Total | <u>\$ 7,270</u> | <u>\$ 880</u> | <u>\$ 4,010</u> |

The above table reflects the total benefits expected to be paid from the plan or from company assets and does not include the participants' share of the cost. The expected benefit payments for our other postretirement benefits include payments for prescription drug benefits. Expected Medicare Part D subsidy amounts expected to be received by the company which will offset other postretirement benefit payments are as follows:

| (Millions of dollars) | 2006 | 2007 | 2008 | 2009 | 2010 | 2011- 2015 | Total |
|-------------------------------------|-------|-------|-------|-------|-------|---------------|--------|
| Other postretirement benefits | \$ 20 | \$ 20 | \$ 20 | \$ 30 | \$ 30 | \$ 170 | \$ 290 |

E. Net periodic cost

| (Millions of dollars) | U.S. Pension Benefits | | | Non-U.S. Pension Benefits | | | Other Postretirement Benefits | | |
|---|-----------------------|---------------|--------------|---------------------------|--------------|--------------|-------------------------------|---------------|---------------|
| | <u>2005</u> | 2004 | 2003 | <u>2005</u> | 2004 | 2003 | <u>2005</u> | 2004 | 2003 |
| Components of net periodic benefit cost: | | | | | | | | | |
| Service cost | \$ 150 | \$ 143 | \$ 122 | \$ 58 | \$ 53 | \$ 43 | \$ 86 | \$ 66 | \$ 70 |
| Interest cost | 555 | 548 | 554 | 109 | 97 | 83 | 294 | 265 | 298 |
| Expected return on plan assets..... | (712) | (697) | (680) | (111) | (103) | (94) | (91) | (74) | (88) |
| Settlement loss..... | — | — | — | 3 | — | — | — | — | — |
| Amortization of: | | | | | | | | | |
| Net asset existing at adoption | | | | | | | | | |
| of SFAS 87/106..... | — | — | — | 1 | 3 | 3 | 2 | 2 | — |
| Prior service cost ⁽¹⁾ | 59 | 44 | 49 | 7 | 6 | 5 | (29) | (48) | (47) |
| Net actuarial loss | 197 | 142 | 27 | 50 | 38 | 14 | 85 | 45 | 36 |
| Total cost included in operating profit..... | \$ 249 | <u>\$ 180</u> | <u>\$ 72</u> | \$ 117 | <u>\$ 94</u> | <u>\$ 54</u> | \$ 347 | <u>\$ 256</u> | <u>\$ 269</u> |
| Weighted-average assumptions used to determine net cost: | | | | | | | | | |
| Discount rate ⁽²⁾ | 5.9% | 6.2% | 7.0% | 5.2% | 5.1% | 5.4% | 5.8% | 6.1% | 7.0% |
| Expected return on plan assets ⁽³⁾ | 9.0% | 9.0% | 9.0% | 7.1% | 7.4% | 7.1% | 9.0% | 9.0% | 9.0% |
| Rate of compensation increase..... | 4.0% | 4.0% | 4.0% | 3.5% | 3.2% | 3.3% | 4.0% | 4.0% | 4.0% |

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

⁽²⁾ 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 other postretirement benefit plan amendment, a 5.7% discount rate was utilized for valuing the plan re-measurement.

⁽³⁾ The weighted-average rates for 2006 are 9.0% and 7.5% for U.S. and non-U.S. plans, respectively.

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. To validate the discount rate, a detailed analysis of the individual plans' expected cash flows is made annually. This involves analyzing Caterpillar's projected cash flows against a high quality bond yield curve, calculated

using a wide population of corporate Aa bonds. The modeled discount rate that results from matching the aggregate expected future cash flows from the Caterpillar benefit plans to the yield curve of high quality corporate bonds is consistent with the annualized Moody's Aa rate. 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.

Our 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 pension assets. Based on historical performance, we increase the passive returns due to our active management of the plan assets. To arrive at our expected long-term return, the amount added for active management was 1% for 2005, 2004 and 2003. A similar process is used to determine this rate for our non-U.S. plans.

The assumed health care trend rate represents the rate at which health care costs are assumed to increase. To calculate the 2005 benefit expense, we assumed an increase of 8.4% for 2005. This rate was assumed to decrease gradually to the ultimate health care trend rate of 5.0% in 2012. This rate represents 3.0% general inflation plus 2.0% additional health care inflation. Based on our recent expenses and our forecast of changes, we expect an increase of 8.5% during 2006 with a gradual decrease to the ultimate health care trend rate of 5.0% in 2013. The revised ultimate rate also represents 3.0% general inflation plus 2.0% additional health care inflation.

Our U.S. postretirement health care plans provide for prescription drug benefits. On December 8, 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act) was signed into law. The Act introduces a prescription drug benefit under Medicare (Medicare part D) as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare part D. In January 2004, the FASB issued FASB Staff Position No. 106-1 (FSP 106-1), "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003." As permitted by FSP 106-1, we made a one-time election to defer accounting for the effects of the Act pending further guidance from the FASB.

In May 2004, the FASB issued FASB Staff Position No. 106-2 (FSP 106-2), which superseded FSP 106-1. FSP 106-2 provides accounting guidance to employers that have determined that prescription drug benefits available under their retiree health care benefit plans are at least actuarially equivalent to Medicare Part D. The FSP requires that the benefit attributable to past service be accounted for as an actuarial gain and the benefit related to current service be reported as a reduction in service cost.

We determined that most of our U.S. retiree health care plans are at least actuarially equivalent to Medicare Part D and will qualify for the federal subsidy. In the third quarter of 2004, we adopted FSP 106-2 retroactive to December 31, 2003 (the period end that includes the date of the Act's enactment) as permitted by the FSP. The impact was a reduction in our accumulated postretirement benefit obligation of \$284 million related to benefits attributed to past service. The reduction in the components of 2005 and 2004 net periodic postretirement benefits expense was as follows:

| (Millions of dollars) | 2005 | 2004 |
|--|--------------|--------------|
| Service cost..... | \$ 7 | \$ 4 |
| Interest cost..... | 24 | 18 |
| Prior service cost..... | 4 | — |
| Amortization of actuarial gain..... | 33 | 29 |
| Total reduction in net periodic postretirement benefit cost..... | <u>\$ 68</u> | <u>\$ 51</u> |

F. Other postemployment benefit plans

We offer long-term disability benefits, continued health care for disabled employees, survivor income benefit insurance and supplemental unemployment benefits to substantially all eligible U.S. employees.

G. Summary of long-term liability:

| (Millions of dollars) | December 31, | | |
|--|----------------|----------------|----------------|
| | 2005 | 2004 | 2003 |
| Pensions: | | | |
| U.S. pensions..... | \$ 760 | \$ 248 | \$ 136 |
| Non-U.S. pensions..... | 92 | 181 | 327 |
| Total pensions..... | 852 | 429 | 463 |
| Postretirement benefits other than pensions..... | 2,063 | 2,487 | 2,638 |
| Other postemployment benefits..... | 76 | 70 | 71 |
| | <u>\$2,991</u> | <u>\$2,986</u> | <u>\$3,172</u> |

H. Defined contribution plans

We have both U.S. and non-U.S. employee defined contribution plans to help employees save for retirement. In January 2003, we introduced a company match to our U.S. 401(k) plan. This plan allows eligible employees to contribute a portion of their salary to the plan on a tax-deferred basis, and we provide a matching contribution equal to 100% of employee contributions to the plan up to 6% of their compensation. Various other U.S. and non-U.S. defined contribution plans allow eligible employees to contribute a portion of their salary to the plans, and in some cases, we provide a matching contribution to the funds.

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

| (Millions of dollars) | 2005 | 2004 | 2003 |
|-----------------------|---------------|---------------|---------------|
| U.S. plans..... | \$ 135 | \$ 110 | \$ 106 |
| Non-U.S. plans..... | 18 | 11 | 11 |
| | <u>\$ 153</u> | <u>\$ 121</u> | <u>\$ 117</u> |

15. Short-term borrowings

| (Millions of dollars) | December 31, | | |
|--------------------------------------|----------------|----------------|----------------|
| | 2005 | 2004 | 2003 |
| Machinery and Engines: | | | |
| Notes payable to banks..... | \$ 543 | \$ 93 | \$ 72 |
| Commercial paper..... | 328 | — | — |
| | 871 | 93 | 72 |
| Financial Products: | | | |
| Notes payable to banks..... | 257 | 370 | 183 |
| Commercial paper..... | 3,936 | 2,972 | 2,087 |
| Collateralized trust obligation..... | — | 240 | — |
| Demand notes..... | 505 | 482 | 415 |
| | 4,698 | 4,064 | 2,685 |
| Total short-term borrowings..... | <u>\$5,569</u> | <u>\$4,157</u> | <u>\$2,757</u> |

See Note 6 for further discussion of the collateralized trust obligation.

The weighted average interest rates on external short-term borrowings outstanding were:

| | December 31, | | |
|--------------------------------------|--------------|------|------|
| | 2005 | 2004 | 2003 |
| Notes payable to banks..... | 5.4% | 5.9% | 6.5% |
| Commercial paper..... | 3.4% | 2.5% | 2.1% |
| Collateralized trust obligation..... | — | 2.3% | — |
| Demand notes..... | 4.2% | 2.3% | 2.3% |

Please refer to Note 20 on page A-28 and Table III on page A-29 for fair value information on short-term borrowings.

16. Long-term debt

| (Millions of dollars) | December 31, | | |
|--|-----------------|------------------|-----------------|
| | 2005 | 2004 | 2003 |
| Machinery and Engines: | | | |
| Notes — 6.550% due 2011 | \$ 250 | \$ 250 | \$ 250 |
| Debentures — 9.000% due 2006 | — | 206 | 208 |
| Debentures — 7.250% due 2009 | 310 | 313 | 315 |
| Debentures — 9.375% due 2011 | 123 | 123 | 123 |
| Debentures — 9.375% due 2021 | 120 | 236 | 236 |
| Debentures — 8.000% due 2023 | 82 | 199 | 199 |
| Debentures — 6.625% due 2028 | 299 | 299 | 299 |
| Debentures — 7.300% due 2031 | 348 | 348 | 348 |
| Debentures — 5.300% due 2035 | 200 | — | — |
| Debentures — 6.950% due 2042 | 249 | 249 | 249 |
| Debentures — 7.375% due 2097 | 297 | 297 | 297 |
| Capital lease obligations | 66 | 665 | 611 |
| Commercial paper | — | 40 | 45 |
| Deposit obligations | 231 | 245 | 236 |
| Other | 142 | 193 | 187 |
| Total Machinery and Engines | 2,717 | 3,663 | 3,603 |
| Financial Products: | | | |
| Commercial paper | \$ 299 | \$ 1,400 | \$ 1,825 |
| Medium-term notes | 12,187 | 10,468 | 8,775 |
| Deposit obligations | 232 | 232 | 232 |
| Other | 242 | 74 | 111 |
| Total Financial Products | 12,960 | 12,174 | 10,943 |
| Total long-term debt due after one year | \$15,677 | \$ 15,837 | \$14,546 |

All outstanding notes and debentures are unsecured. The capital lease obligations which were collateralized by leased manufacturing equipment and/or security deposits, were terminated in the fourth quarter of 2005. This resulted in the fulfillment of the capital lease obligation and conversion of the associated security deposits into cash. The deposit obligations have corresponding security deposits, which are included in "Other assets" in Statement 2. These deposit obligations and corresponding security deposits relate to two finance arrangements which provide us a return. These finance arrangements require that we commit to certain long-term obligations and provide security deposits which will fulfill these obligations when they become due.

On September 13, 2005, \$116 million of 9.375% debentures due in 2021 and \$117 million of 8.00% debentures due in 2023 were exchanged for \$307 million of 5.30% debentures due in 2035 and \$23 million of cash. The book value of the 5.30% debentures due in 2035 was \$200 million at December 31, 2005, which results in an effective yield of 8.55%.

We may redeem the 6.55% notes and the 5.30%, 7.25%, 6.625%, 7.3%, 6.95% and 7.375% debentures in whole or in part at our option at any time at a redemption price equal to the greater of 100% of the principal amount of the debentures to be redeemed or the sum of the present value of the remaining scheduled payments.

The terms of other notes and debentures do not specify a redemption option prior to maturity.

Based on long-term credit agreements, \$299 million, \$1,440 million and \$1,870 million of commercial paper outstanding at December 31, 2005, 2004 and 2003, respectively, was classified as long-term debt due after one year.

Medium-term notes are offered by prospectus and are issued through agents at fixed and floating rates. Financial Products medium-term notes have a weighted average interest rate of 4.1% with remaining maturities up to 20 years at December 31, 2005.

The aggregate amounts of maturities of long-term debt during each of the years 2006 through 2010, including amounts due within one year and classified as current, are:

| (Millions of dollars) | December 31, | | | | |
|-----------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| | 2006 | 2007 | 2008 | 2009 | 2010 |
| Machinery and Engines | \$ 340 | \$ 88 | \$ 25 | \$ 550 | \$ 1 |
| Financial Products | 4,159 | 3,882 | 2,731 | 1,994 | 2,333 |
| | <u>\$ 4,499</u> | <u>\$ 3,970</u> | <u>\$ 2,756</u> | <u>\$ 2,544</u> | <u>\$ 2,334</u> |

The above table includes \$708 million of medium-term notes that can be called at par.

Interest paid on short-term and long-term borrowings for 2005, 2004 and 2003 was \$1,030 million, \$766 million and \$718 million, respectively.

Please refer to Note 20 on page A-28 and Table III on page A-29 for fair value information on long-term debt.

17. Credit commitments

| (Millions of dollars) | December 31, 2005 | | |
|--|------------------------|-----------------------|------------------------|
| | Consolidated | Machinery and Engines | Financial Products |
| Credit lines available: | | | |
| Global credit facilities | \$5,750 ⁽¹⁾ | \$ 600 ⁽¹⁾ | \$5,150 ⁽¹⁾ |
| Other external | 2,177 | 911 | 1,266 |
| Total credit lines available | 7,927 | 1,511 | 6,416 |
| Less: Global credit facilities supporting commercial paper ... | 4,563 | 328 | 4,235 |
| Less: Utilized credit | 531 | 143 | 388 |
| Available credit | \$2,833 | \$1,040 | \$1,793 |

⁽¹⁾ We have three global credit facilities with a syndicate of banks totaling \$5,750 million 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 during the year, the portion of the facility available to Cat Financial at December 31, 2005 was \$5,150 million. The five-year facility of \$2,500 million expires in September 2009. The five-year facility of \$1,625 million expires in September 2010. The 364-day facility of \$1,625 million expires in September 2006. The facility expiring in September 2006 has a provision that allows Caterpillar or Cat Financial to obtain a one-year loan in September 2006 that would mature in September 2007.

As part of Cat Financial's 2005 global credit facilities renewal, the year-end leverage covenant (debt-to-equity ratio) has been increased to 8.5:1, from previous level of 8:1 which aligns it with the 8.5:1 six-month moving average leverage covenant. At December 31, 2005, there were no borrowings under these lines and Cat Financial was in compliance with all debt covenants.

18. Capital stock**A. Stock options**

In 1996, stockholders approved the Stock Option and Long-Term Incentive Plan (the Plan) providing for the granting of options to purchase common stock to officers and other key employees, as well as non-employee directors. The Plan reserves 144 million shares of common stock for issuance (128 million under the Plan and 16 million under prior stock option plans). Options granted prior to 2004 vest at the rate of one-third per year over the three year period following the date of grant. In anticipation of delaying vesting until three years after the grant date for future grants, the 2004 grant 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. All grants continue to have a maximum term of 10 years. Common

shares issued under stock options, including treasury shares reissued, totaled 18,912,521 for 2005, 12,207,420 for 2004 and 9,850,992 for 2003. We recognized income tax benefits related to employees' exercise of stock options of \$134 million, \$80 million, and \$45 million in 2005, 2004 and 2003, respectively.

The Plan grants options which have exercise prices equal to the average market price on the date of grant. A summary of the pro forma net profit and profit per share amounts is shown in Item M of Note 1. 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 using the Black-Scholes option-pricing model. Grants made prior to 2004 continue to be valued using the Black-Scholes model.

Please refer to Table II below for additional financial information on our stock options.

B. 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 called 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.

19. Profit per share

Computations of profit per share:

| (Dollars in millions except per share data) | 2005 | 2004 | 2003 |
|---|----------------|----------|----------|
| Profit for the period (A) | \$2,854 | \$ 2,035 | \$ 1,099 |
| Determination of shares (millions): | | | |
| Weighted average number of common shares outstanding (B)..... | 678.4 | 684.5 | 690.4 |
| Shares issuable on exercise of stock options, net of shares assumed to be purchased out of proceeds at average market price | 27.4 | 22.9 | 12.3 |
| Average common shares outstanding for fully diluted computation (C) | 705.8 | 707.4 | 702.7 |
| Profit per share of common stock: | | | |
| Assuming no dilution (A/B) | \$ 4.21 | \$ 2.97 | \$ 1.59 |
| Assuming full dilution (A/C) | \$ 4.04 | \$ 2.88 | \$ 1.56 |
| Shares outstanding as of December 31 (in millions) | 670.9 | 685.9 | 687.5 |

TABLE II — Financial Information Related to Capital Stock

Changes in the status of common shares subject to issuance under options:

| | 2005 | | 2004 | | 2003 | |
|--|---------------------|---------------------------------|-------------------|---------------------------------|-------------------|---------------------------------|
| | Shares | Weighted-Average Exercise Price | Shares | Weighted-Average Exercise Price | Shares | Weighted-Average Exercise Price |
| Fixed Options: | | | | | | |
| Outstanding at beginning of year | 82,448,348 | \$ 28.80 | 78,999,344 | \$ 25.69 | 77,442,728 | \$ 24.46 |
| Granted to officers and key employees | 12,565,872 | \$ 45.64 | 17,781,466 | \$ 38.63 | 16,836,200 | \$ 27.15 |
| Granted to outside directors | 104,000 | \$ 44.90 | 104,000 | \$ 40.64 | 112,000 | \$ 26.03 |
| Exercised | (20,086,770) | \$ 26.68 | (13,651,840) | \$ 23.86 | (15,258,040) | \$ 21.02 |
| Lapsed | (170,868) | \$ 24.31 | (784,622) | \$ 25.60 | (133,544) | \$ 25.09 |
| Outstanding at end of year | 74,860,582 | \$ 32.23 | <u>82,448,348</u> | \$ 28.80 | <u>78,999,344</u> | \$ 25.69 |
| Options exercisable at year-end | 69,848,250 | \$ 32.58 | 67,241,232 | \$ 29.28 | 47,301,974 | \$ 25.14 |
| Weighted-average fair value of options granted during the year | \$ 11.95 | | \$ 9.03 | | \$ 6.41 | |

Stock options outstanding and exercisable:

| Exercise Prices | Options Outstanding | | | Options Exercisable | |
|-----------------|---------------------------|---|---------------------------------|---------------------------|---------------------------------|
| | # Outstanding at 12/31/05 | Weighted-Average Remaining Contractual Life (Years) | Weighted-Average Exercise Price | # Outstanding at 12/31/05 | Weighted-Average Exercise Price |
| \$16.45-\$22.76 | 4,600,935 | 4.0 | \$19.06 | 4,600,935 | \$19.06 |
| \$25.36-\$31.17 | 41,480,829 | 5.8 | \$27.16 | 36,537,813 | \$27.16 |
| \$38.63-\$45.64 | 28,778,818 | 8.7 | \$41.65 | 28,709,502 | \$41.65 |
| | <u>74,860,582</u> | | <u>\$32.23</u> | <u>69,848,250</u> | <u>\$32.58</u> |

Weighted-average assumptions used in determining fair value of option grants:

| | Grant Year | | |
|--------------------------------|---------------------|---------------------|---------------------|
| | 2005 ⁽¹⁾ | 2004 ⁽¹⁾ | 2003 ⁽²⁾ |
| Dividend yield | 2.11% | 1.89% | 2.75% |
| Expected volatility | 26.48% | 25.98% | 29.6% |
| Risk-free interest rates | 3.98% | 5.13% | 2.52% |
| Expected lives | 7 years | 6 years | 6 years |

⁽¹⁾ Assumptions used in the binomial option-pricing model valuation.

⁽²⁾ Assumptions used in Black-Scholes valuation.

Stock options to purchase 104,000 and 8,535,088 shares of common stock at a weighted-average price of \$40.64 and \$31.17 were outstanding at December 31, 2004 and 2003, respectively, but were not included in the computation of diluted profit per share because the options' exercise price was greater than the average market price of the common shares; no such options were outstanding at December 31, 2005.

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. Capital accounts, share data and profit per share data reflect the stock split, applied retroactively, to all periods presented.

20. Fair values of financial instruments

We used the following methods and assumptions to estimate the fair value of our financial instruments:

Cash and short-term investments — carrying amount approximated fair value.

Long-term investments (other than investments in unconsolidated affiliated companies) — fair value for available-for-sale securities was estimated based on quoted market prices. Fair value for security deposits approximated carrying value.

Foreign currency forward and option contracts — fair value of forward contracts was determined by discounting the future cash flow resulting from the differential between the contract price and the forward rate. Fair value of option contracts was determined by using the Black-Scholes model.

Finance receivables — fair value was estimated by discounting the future cash flow using current rates, representative of receivables with similar remaining maturities. Historical bad-debt experience also was considered.

Wholesale inventory receivables — fair value was estimated by discounting the future cash flow using current rates, representative of receivables with similar remaining maturities.

Short-term borrowings — carrying amount approximated fair value.

Long-term debt — for Machinery and Engines notes and debentures, fair value was estimated based on quoted market prices. For Financial Products, fair value was estimated by discounting the future cash flow using our current borrowing rates for similar types and maturities of debt, except for floating rate notes and commercial paper supported by long-term credit agreements for which the carrying amounts were considered a reasonable estimate of fair value. For deposit obligations carrying value approximated fair value.

Interest rate swaps — fair value was estimated based on the amount that we would receive or pay to terminate our agreements as of year-end.

Guarantees — fair value is estimated based on the premium we would require to issue the same guarantee in a stand alone arm's-length transaction with an unrelated party.

Please refer to Table III on page A-29 for the fair values of our financial instruments.

21. Concentration of credit risk

Financial instruments with potential credit risk consist primarily of trade and finance receivables and short-term and long-term investments. Additionally, to a lesser extent, we have a potential credit risk associated with counterparties to derivative contracts.

Trade receivables are primarily short-term receivables from independently owned and operated dealers and customers which arise in the normal course of business. We perform regular credit evaluations of our dealers and customers. Collateral generally is not required, and the majority of our trade receivables are unsecured. We do, however, when deemed necessary, make use of various devices such as security agreements and letters of credit to protect our interests. No single dealer or customer represents a significant concentration of credit risk.

Finance receivables and wholesale inventory receivables primarily represent receivables under installment sales contracts, receivables arising from leasing transactions and notes receivable. We generally maintain a secured interest in the equipment financed. No single customer or region represents a significant concentration of credit risk.

Short-term and long-term investments are held with high quality institutions and, by policy, the amount of credit exposure to any one institution is limited. Long-term investments, included in "Other assets" in Statement 2, are comprised primarily of investments which collateralize deposit obligations and investments of Cat Insurance supporting insurance reserve requirements. At December 31, 2004 and 2003, long-term investments also included investments which collateralized capital lease obligations (see Note 16).

For derivatives contracts, collateral is generally not required of the counterparties or of our company. We do not anticipate nonperformance by any of the counterparties. Our exposure to credit loss in the event of nonperformance by the counterparties is limited to only those gains that we have recorded, but have not yet received cash payment. At December 31, 2005, 2004 and 2003, the exposure to credit loss was \$141 million, \$312 million and \$336 million, respectively.

Please refer to Note 20 above and Table III on page A-29 for fair value information.

22. Operating leases

We lease certain computer and communications equipment, transportation equipment and other property through operating leases. Total rental expense for operating leases was \$257 million, \$224 million and \$198 million for 2005, 2004 and 2003, respectively.

Minimum payments for operating leases having initial or remaining non-cancelable terms in excess of one year are:

| Years ended December 31, (Millions of dollars) | | | | | | |
|---|-------|-------|-------|------|---------------|---------|
| 2006 | 2007 | 2008 | 2009 | 2010 | After 2010 | Total |
| \$213 | \$167 | \$146 | \$113 | \$97 | \$365 | \$1,101 |

23. 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

TABLE III — Fair Values of Financial Instruments

| | 2005 | | 2004 | | 2003 | | Reference |
|--|-----------------|------------|-----------------|------------|-----------------|------------|-----------------|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value | Carrying Amount | Fair Value | |
| (Millions of dollars) | | | | | | | |
| Asset (Liability) at December 31 | | | | | | | |
| Cash and short-term investments | \$ 1,108 | \$ 1,108 | \$ 445 | \$ 445 | \$ 342 | \$ 342 | Statement 2 |
| Long-term investments | 1,356 | 1,356 | 1,852 | 1,852 | 1,574 | 1,574 | Notes 13 and 21 |
| Foreign currency contracts | (1) | (1) | 176 | 176 | 167 | 167 | Note 3 |
| Finance receivables — net (excluding tax leases ⁽¹⁾) | 15,214 | 15,210 | 13,457 | 13,445 | 11,439 | 11,489 | Note 8 |
| Wholesale inventory receivables — net (excluding finance type leases ⁽¹⁾) | 1,089 | 1,085 | 882 | 857 | 681 | 666 | Note 7 |
| Short-term borrowings | (5,569) | (5,569) | (4,157) | (4,157) | (2,757) | (2,757) | Note 15 |
| Long-term debt (including amounts due within one year) | | | | | | | |
| Machinery and Engines | (3,057) | (3,465) | (3,669) | (4,186) | (3,635) | (4,109) | Note 16 |
| Financial Products | (17,119) | (17,176) | (15,699) | (15,843) | (13,892) | (14,078) | Note 16 |
| Interest rate swaps | | | | | | | |
| Financial Products — | | | | | | | |
| in a net receivable position | 94 | 94 | 75 | 75 | 87 | 87 | Note 3 |
| in a net payable position | (114) | (114) | (69) | (69) | (59) | (59) | Note 3 |
| Guarantees ⁽²⁾ | (9) | (10) | (10) | (10) | (5) | (9) | Note 23 |

⁽¹⁾ Total excluded items have a net carrying value at December 31, 2005, 2004 and 2003 of \$1,719 million, \$1,737 million and \$1,546 million, respectively.

⁽²⁾ The carrying amount provisions of FASB Interpretation No. 45 related to guarantees are effective for guarantees issued or modified subsequent to December 31, 2002 only, whereas the fair value amount is for all guarantees.

guarantees generally have one-year terms and are secured, primarily by dealer assets.

We provide loan guarantees to a third party lender for financing associated with machinery purchased by customers. The loan guarantees are for the remote chance that the customers will become insolvent. These guarantees have an average three-year term and are secured by the machinery.

Cat Financial has provided a limited indemnity to a third party bank for \$40 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 December 31, 2005, 2004 and 2003, the related book value was \$9 million, \$10 million and \$5 million, respectively. The maximum potential amount of future payments (undiscounted and without reduction for any amounts that may possibly be recovered under recourse or collateralized provisions) we could be required to make under the guarantees at December 31 are as follows:

| (Millions of dollars) | 2005 | 2004 | 2003 |
|---|--------|--------|--------|
| Guarantees with Caterpillar Dealers | \$ 434 | \$ 364 | \$ 380 |
| Guarantees with Customers | 27 | 29 | — |
| Limited Indemnity | 40 | 45 | — |
| Guarantees — other | 53 | 17 | 37 |
| Total guarantees | \$ 554 | \$ 455 | \$ 417 |

We are party to agreements in the normal course of business with selected customers and Caterpillar dealers in which we commit to provide a set dollar amount of financing on a pre-approved

basis. We also provide lines of credit to selected customers and Caterpillar dealers, of which a portion remains unused as of the end of the period. Commitments and lines of credit generally have fixed expiration dates or other termination clauses. It has been our experience that not all commitments and lines of credit will be used. Management applies the same credit policies when making commitments and granting lines of credit as it does for any other financing. We do not require collateral for these commitments/lines, but if credit is extended, collateral may be required upon funding. The amount of the unused commitments and lines of credit for dealers as of December 31, 2005 was \$4,729 million compared to \$5,019 million at December 31, 2004 and \$4,784 million at December 31, 2003. The amount of the unused commitments and lines of credit for customers as of December 31, 2005 was \$1,972 million compared to \$1,499 million at December 31, 2004 and \$1,336 million at December 31, 2003.

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. 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.

| (Millions of dollars) | 2005 | 2004 | 2003 |
|--|--------|--------|--------|
| Warranty liability, January 1 | \$ 785 | \$ 624 | \$ 693 |
| Reduction in liability (payments) | (712) | (571) | (503) |
| Increase in liability (new warranties) | 806 | 732 | 434 |
| Warranty liability, December 31 | \$ 879 | \$ 785 | \$ 624 |

24. 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 addition to governing our manufacturing and other operations, these laws often impact the development of our products, including through required compliance with air emissions standards applicable to internal combustion engines. Compliance with these existing laws has not had a material impact on our capital expenditures, earnings, or competitive position.

We are cleaning up contamination at a number of locations, often with other companies, pursuant to federal and state laws. When it is probable we will pay cleanup 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 or others.

The amount recorded for environmental cleanup is not material and is included in "Accrued expenses" in Statement 2.

We cannot estimate costs on sites in the very early stages of cleanup. Currently, we have several sites in the very early stages of cleanup, and there is no more than a remote chance that a material amount for cleanup at any individual site or at all sites in the aggregate will be required.

Pursuant to a consent decree Caterpillar entered with the United States Environmental Protection Agency (EPA), the company was required to meet certain emission standards by October 2002. The decree provides that if engine manufacturers were unable to meet the standards at that time, they would be required to pay a Non-Conformance Penalty (NCP) on each engine sold that did not meet the standard. The amount of the NCP would be based on how close to meeting the standard the engine came — the more out of compliance the higher the penalty. The company began introduction of fully compliant ACERT engines in 2003 and by the end of 2003 Caterpillar was only producing fully compliant engine models. As a result, NCPs were not payable for any engines built in 2004. NCPs of \$153 million were paid in 2003.

In addition, the consent decree required Caterpillar to pay a fine of \$25 million, which was expensed in 1998, and to make investments totaling \$35 million in environmental-related products by July 7, 2007. During the first quarter of 2005, Caterpillar made qualifying investments of \$3 million surpassing its investment requirement in environmental-related products with an accumulated investment of \$38 million. A future benefit is expected to be realized from these environmental projects related to Caterpillar's ability to capitalize on the technologies it developed in complying with its environmental project obligations. In short, Caterpillar expects to receive a positive net return on the environmental projects by being able to market the technology it developed.

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 of these unresolved actions 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, among other things, 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 December 31, 2005, the net past due receivable from Navistar regarding the foregoing and included in "Long-term receivables — trade and other" in Statement 2 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. As of December 31, 2005, the net past due receivables for the foregoing, included in "Long-term receivables — trade and other" in Statement 2 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 September 30, 2005, International Truck and Engine Corporation (International) commenced an action against Caterpillar in the Circuit Court of the Tenth Judicial Circuit of Illinois in Peoria, Illinois. The lawsuit states that it arises out of the May 31, 1988 Purchase Agreement described above. The Complaint alleges, among other things, that Caterpillar procured the May 31, 1988 Purchase Agreement by fraudulently misrepresenting or concealing information related to the business of selling fuel injectors to International, and that Caterpillar breached the Purchase Agreement. International's Complaint does not specify the amount of damages being sought. Caterpillar intends to defend itself vigorously in this case.

On May 7, 2002, 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 has filed a counterclaim seeking a declaration that the term sheet has 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 contained allegations similar to the allegations contained in the first lawsuit. International also alleged in the second lawsuit that Caterpillar materially breached the subsequent agreement. On June 15, 2005 International voluntarily dismissed its complaint in the first lawsuit. The second lawsuit has been consolidated with Caterpillar's counterclaims from the first lawsuit. Trial is currently scheduled to begin during the third quarter of 2006. This case is not 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, 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.

25. Segment information

A. Basis for 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 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, one of these profit centers also has 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 for our external readers.

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 A-38.

B. Description of segments

The profit center divisions meet the SFAS 131 definition of "operating segments;" however, the service center divisions do not. Several of the profit centers have similar characteristics and have been aggregated. The following is a brief description of our nine reportable segments and the business activities included in the *All Other* category.

Asia/Pacific Marketing: Primarily responsible for marketing machinery through dealers in Australia, Asia (excluding Japan) and the Pacific Rim.

Construction & Mining Products: Primarily responsible for the design, manufacture and ongoing support of medium and large machinery used in a variety of construction and mining applications.

EAME Marketing: Primarily responsible for marketing machinery through dealers in Europe, Africa, the Middle East and the Commonwealth of Independent States.

Electric Power: Primarily responsible for the design, manufacture and ongoing support of natural gas and diesel powered generator sets as well as integrated systems used in the electric power generation industry. Also includes marketing through dealers worldwide.

Financing & Insurance Services: Provides financing to customers and dealers for the purchase and lease of Caterpillar and other equipment, as well as some financing for Caterpillar sales to dealers. Financing plans include operating and finance leases, installment sale contracts, working capital loans and wholesale financing plans. The division also provides various forms of insurance to customers and dealers to help support the purchase and lease of our equipment.

Large Power Products: Primarily responsible for the design, manufacture and ongoing support of C7 and larger reciprocating engines. These engines are used in various industries and applications including on-highway truck, electric power, industrial/rail, marine, petroleum and Caterpillar machinery.

Latin America: Primarily responsible for marketing machinery and engines through dealers in Latin America. Also includes the manufacturing of machinery and components used in a variety of construction and mining applications.

North America Marketing: Primarily responsible for marketing machinery through dealers in the United States and Canada.

Power Systems Marketing: Primarily responsible for marketing and ongoing support of reciprocating engines sold into on-highway truck, marine and petroleum industry applications.

All Other: Primarily includes activities such as: service support and parts distribution to Caterpillar dealers worldwide; logistics services for Caterpillar and other companies; remanufacturing of Caterpillar engines and components and remanufacturing services for other companies; design, manufacture and ongoing support for reciprocating engines used in industrial applications; design, manufacture, marketing and ongoing support of turbines; regional manufacturing of construction and mining machinery and components in Europe, Asia, and Australia; design, manufacture and ongoing support of building construction, paving and forestry machinery and related components and control systems.

C. Segment measurement and reconciliations

Please refer to Table IV on pages A-33 to A-35 for financial information regarding our segments. There are several accounting differences between our segment reporting and our external reporting. Our segments are measured on an accountable basis; therefore, only those items for which divisional management is directly responsible are included in the determination of segment profit/(loss) and assets. We changed the composition of our reportable segments and made several organizational changes that impacted our segment reporting in 2005. The information for 2003 and 2004 has been restated to conform to the 2005 presentation. We made several changes to our segment reporting methodologies in 2004. Most notable are a change in the current cost methodology used to value inventory and cost of sales for segment reporting purposes, as well as a change in the manner that interest expense is charged to segments. Amounts for 2003 have been restated to conform to this methodology.

The following is a list of the more significant accounting differences:

- Generally, liabilities are managed at the corporate level and are not included in segment operations. Segment accountable assets generally include inventories, receivables, property, plant and equipment.
- We account for intersegment transfers using a system of market-based prices. With minor exceptions, each of the profit centers either sells or purchases virtually all of its products to or from other profit centers within the company. Our high level of integration results in our internally reported sales being approximately double that of our consolidated, externally reported sales.
- Segment inventories and cost of sales are valued using a current cost methodology.
- Postretirement benefit expenses are split; segments are generally responsible for service and prior services costs, with the remaining elements of net periodic benefit cost included as a methodology difference.
- Interest expense is imputed (i.e., charged) to profit centers based on their level of accountable assets.
- Accountable profit is determined on a pretax basis.

Reconciling items are created based on accounting differences between segment reporting and our consolidated, external reporting. Please refer to Table IV on pages A-33 to A-35 for financial information regarding significant reconciling items. Most of our reconciling items are self-explanatory given the above explanations of accounting differences. However, for the reconciliation of profit, we have grouped the reconciling items as follows:

- **Corporate costs:** Certain corporate costs are not charged to our segments. These costs are related to corporate requirements and strategies that are considered to be for the benefit of the entire organization.
- **Timing:** Timing differences in the recognition of costs between segment reporting and consolidated external reporting.
- **Methodology differences:** See previous discussion of significant accounting differences between segment reporting and consolidated external reporting.

TABLE IV — Segment Information (Millions of dollars)

Business Segments:

| | Machinery and Engines | | | | | | | | | Financing & Insurance Services | Consoli- dated Total | |
|--------------------------------------|-------------------------------|--------------------------------------|-------------------|-------------------|----------------------------|------------------|-------------------------------|-------------------------------|--------------|--------------------------------------|----------------------------|-----------|
| | Asia/ Pacific Marketing | Construction & Mining Products | EAME Marketing | Electric Power | Large Power Products | Latin America | North America Marketing | Power Systems Marketing | All Other | | | Total |
| 2005 | | | | | | | | | | | | |
| External sales and revenues | \$ 2,462 | 5 | 4,441 | 2,119 | (260) | 2,275 | 10,988 | 4,669 | 7,110 | \$ 33,809 | 2,867 | \$ 36,676 |
| Intersegment sales and revenues..... | \$ 3 | 9,925 | 5 | 187 | 7,303 | 1,703 | 385 | 87 | 14,388 | \$ 33,986 | 35 | \$ 34,021 |
| Total sales and revenues..... | \$ 2,465 | 9,930 | 4,446 | 2,306 | 7,043 | 3,978 | 11,373 | 4,756 | 21,498 | \$ 67,795 | 2,902 | \$ 70,697 |
| Depreciation and amortization..... | \$ 2 | 89 | 1 | 18 | 154 | 44 | 2 | 8 | 373 | \$ 691 | 646 | \$ 1,337 |
| Imputed interest expense | \$ 7 | 42 | 4 | 18 | 48 | 26 | 4 | 3 | 247 | \$ 399 | 798 | \$ 1,197 |
| Accountable profit (loss)..... | \$ 91 | 1,473 | 75 | 110 | 490 | 200 | 276 | 112 | 1,884 | \$ 4,711 | 566 | \$ 5,277 |
| Accountable assets at Dec. 31..... | \$ 257 | 1,559 | 103 | 592 | 1,657 | 878 | 31 | 40 | 8,583 | \$ 13,700 | 26,815 | \$ 40,515 |
| Capital expenditures | \$ 2 | 177 | 1 | 27 | 186 | 51 | 5 | 5 | 517 | \$ 971 | 1,232 | \$ 2,203 |
| 2004 | | | | | | | | | | | | |
| External sales and revenues | \$ 2,110 | (47) | 3,878 | 1,757 | (176) | 1,730 | 8,882 | 3,930 | 6,059 | \$ 28,123 | 2,439 | \$ 30,562 |
| Intersegment sales and revenues..... | \$ — | 7,565 | 6 | 141 | 6,242 | 1,236 | 323 | 75 | 11,806 | \$ 27,394 | 1 | \$ 27,395 |
| Total sales and revenues..... | \$ 2,110 | 7,518 | 3,884 | 1,898 | 6,066 | 2,966 | 9,205 | 4,005 | 17,865 | \$ 55,517 | 2,440 | \$ 57,957 |
| Depreciation and amortization..... | \$ 1 | 82 | 1 | 35 | 158 | 46 | 1 | (6) | 359 | \$ 677 | 604 | \$ 1,281 |
| Imputed interest expense | \$ 9 | 34 | 4 | 17 | 50 | 20 | 1 | 4 | 211 | \$ 350 | 543 | \$ 893 |
| Accountable profit (loss)..... | \$ 134 | 900 | 82 | (37) | 243 | 228 | 392 | 9 | 1,320 | \$ 3,271 | 460 | \$ 3,731 |
| Accountable assets at Dec. 31..... | \$ 240 | 1,348 | 107 | 618 | 1,578 | 775 | (61) | 124 | 8,064 | \$ 12,793 | 24,450 | \$ 37,243 |
| Capital expenditures | \$ — | 109 | — | 19 | 108 | 41 | 6 | — | 436 | \$ 719 | 1,327 | \$ 2,046 |
| 2003 | | | | | | | | | | | | |
| External sales and revenues | \$ 1,569 | (31) | 3,131 | 1,226 | (110) | 1,153 | 6,437 | 2,971 | 4,521 | \$ 20,867 | 2,076 | \$ 22,943 |
| Intersegment sales and revenues..... | \$ — | 5,655 | 5 | 154 | 4,637 | 719 | 209 | 47 | 9,048 | \$ 20,474 | 2 | \$ 20,476 |
| Total sales and revenues..... | \$ 1,569 | 5,624 | 3,136 | 1,380 | 4,527 | 1,872 | 6,646 | 3,018 | 13,569 | \$ 41,341 | 2,078 | \$ 43,419 |
| Depreciation and amortization..... | \$ 1 | 86 | 1 | 19 | 167 | 43 | 1 | 2 | 367 | \$ 687 | 551 | \$ 1,238 |
| Imputed interest expense | \$ 7 | 31 | 4 | 13 | 47 | 22 | 8 | 7 | 189 | \$ 328 | 477 | \$ 805 |
| Accountable profit (loss)..... | \$ 109 | 450 | 48 | (47) | 32 | 107 | 269 | (114) | 772 | \$ 1,626 | 337 | \$ 1,963 |
| Accountable assets at Dec. 31..... | \$ 266 | 1,096 | 88 | 489 | 1,656 | 640 | 251 | 164 | 6,369 | \$ 11,019 | 20,467 | \$ 31,486 |
| Capital expenditures | \$ — | 68 | — | 13 | 102 | 35 | 8 | 4 | 355 | \$ 585 | 1,220 | \$ 1,805 |

Reconciliations:

| | Machinery and Engines | Financing & Insurance Services | Consolidating Adjustments | Consolidated Total |
|--|--------------------------|-----------------------------------|------------------------------|-----------------------|
| Sales & Revenues | | | | |
| 2005 | | | | |
| Total external sales and revenues from business segments | \$ 33,809 | \$ 2,867 | \$ — | \$ 36,676 |
| Other | 197 | (217) | (317) ⁽¹⁾ | (337) |
| Total sales and revenues..... | \$ 34,006 | \$ 2,650 | \$ (317) | \$ 36,339 |
| 2004 | | | | |
| Total external sales and revenues from business segments | \$ 28,123 | \$ 2,439 | \$ — | \$ 30,562 |
| Other | 213 | (270) | (199) ⁽¹⁾ | (256) |
| Total sales and revenues..... | \$ 28,336 | \$ 2,169 | \$ (199) | \$ 30,306 |
| 2003 | | | | |
| Total external sales and revenues from business segments | \$ 20,867 | \$ 2,076 | \$ — | \$ 22,943 |
| Other | 181 | (123) | (194) ⁽¹⁾ | (136) |
| Total sales and revenues..... | \$ 21,048 | \$ 1,953 | \$ (194) | \$ 22,807 |

⁽¹⁾ Elimination of Financial Products revenues from Machinery and Engines.

Continued on Page A-34

TABLE IV Continued — Segment Information (Millions of dollars)

Reconciliations:

| | Machinery and Engines | Financing & Insurance Services | Consolidated Total | |
|---|--------------------------|-----------------------------------|------------------------------|-----------------------|
| Profit before taxes | | | | |
| 2005 | | | | |
| Total accountable profit from business segments | \$ 4,711 | \$ 566 | \$ 5,277 | |
| Corporate costs | (728) | — | (728) | |
| Timing | (133) | — | (133) | |
| Methodology differences: | | | | |
| Inventory/cost of sales | 14 | — | 14 | |
| Postretirement benefit expense | (386) | — | (386) | |
| Financing costs | (14) | — | (14) | |
| Equity in profit of unconsolidated affiliated companies | (64) | (9) | (73) | |
| Currency | (21) | — | (21) | |
| Other methodology differences | (33) | 23 | (10) | |
| Other | (25) | — | (25) | |
| Total profit before taxes | <u>\$ 3,321</u> | <u>\$ 580</u> | <u>\$ 3,901</u> | |
| 2004 | | | | |
| Total accountable profit from business segments | \$ 3,271 | \$ 460 | \$ 3,731 | |
| Corporate costs | (601) | — | (601) | |
| Timing | (94) | — | (94) | |
| Methodology differences: | | | | |
| Inventory/cost of sales | (62) | — | (62) | |
| Postretirement benefit expense | (270) | — | (270) | |
| Financing costs | 52 | — | 52 | |
| Equity in profit of unconsolidated affiliated companies | (56) | (3) | (59) | |
| Currency | 35 | — | 35 | |
| Other methodology differences | (89) | 48 | (41) | |
| Other | 16 | — | 16 | |
| Total profit before taxes | <u>\$ 2,202</u> | <u>\$ 505</u> | <u>\$ 2,707</u> | |
| 2003 | | | | |
| Total accountable profit from business segments | \$ 1,626 | \$ 337 | \$ 1,963 | |
| Corporate costs | (512) | — | (512) | |
| Timing | 54 | — | 54 | |
| Methodology differences: | | | | |
| Inventory/cost of sales | (30) | — | (30) | |
| Postretirement benefit expense | (162) | — | (162) | |
| Financing costs | 84 | — | 84 | |
| Equity in profit of unconsolidated affiliated companies | (16) | (4) | (20) | |
| Currency | 48 | — | 48 | |
| Other methodology differences | (32) | 38 | 6 | |
| Other | 46 | — | 46 | |
| Total profit before taxes | <u>\$ 1,106</u> | <u>\$ 371</u> | <u>\$ 1,477</u> | |
| | Machinery and Engines | Financing & Insurance Services | Consolidating Adjustments | Consolidated Total |
| Assets | | | | |
| 2005 | | | | |
| Total accountable assets from business segments | \$ 13,700 | \$ 26,815 | \$ — | \$ 40,515 |
| Items not included in segment assets: | | | | |
| Cash and short-term investments | 951 | 157 | — | 1,108 |
| Intercompany receivables | 310 | 67 | (377) | — |
| Trade and other receivables | 332 | — | — | 332 |
| Investments in unconsolidated affiliated companies | 407 | — | — | 407 |
| Investment in Financial Products | 3,253 | — | (3,253) | — |
| Deferred income taxes and prepaids | 3,282 | 100 | (340) | 3,042 |
| Intangible assets and other assets | 1,692 | — | — | 1,692 |
| Service center assets | 1,030 | — | — | 1,030 |
| Liabilities included in segment assets | 1,242 | 14 | — | 1,256 |
| Inventory methodology differences | (2,300) | — | — | (2,300) |
| Other | 88 | (101) | — | (13) |
| Total assets | <u>\$ 23,987</u> | <u>\$ 27,052</u> | <u>\$ (3,970)</u> | <u>\$ 47,069</u> |

Continued on Page A-35

TABLE IV Continued — Segment Information (Millions of dollars)

Reconciliations:

| | Machinery and Engines | Financing & Insurance Services | Consolidating Adjustments | Consolidated Total |
|---|--------------------------|-----------------------------------|------------------------------|-----------------------|
| Assets | | | | |
| 2004 | | | | |
| 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 |
| Investments 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> |
| 2003 | | | | |
| Total accountable assets from business segments..... | \$ 11,019 | \$ 20,467 | \$ — | \$ 31,486 |
| Items not included in segment assets: | | | | |
| Cash and short-term investments..... | 220 | 122 | — | 342 |
| Intercompany receivables..... | 572 | 397 | (969) | — |
| Trade and other receivables..... | 232 | — | — | 232 |
| Investments in unconsolidated affiliated companies..... | 325 | — | — | 325 |
| Investment in Financial Products..... | 2,547 | — | (2,547) | — |
| Deferred income taxes and prepaids..... | 2,736 | 77 | (228) | 2,585 |
| Intangible assets and other assets..... | 2,110 | — | — | 2,110 |
| Service center assets..... | 943 | — | — | 943 |
| Liabilities included in segment assets..... | 925 | — | — | 925 |
| Inventory methodology differences..... | (2,035) | — | — | (2,035) |
| Other..... | (143) | (91) | 32 | (202) |
| Total assets..... | <u>\$ 19,451</u> | <u>\$ 20,972</u> | <u>\$ (3,712)</u> | <u>\$ 36,711</u> |

Enterprise-wide Disclosures:

External sales and revenues from products and services:

| | 2005 | 2004 | 2003 |
|-------------------------|-----------------|-----------------|-----------------|
| Machinery..... | \$22,931 | \$18,844 | \$13,678 |
| Engines..... | 11,075 | 9,492 | 7,370 |
| Financial Products..... | 2,333 | 1,970 | 1,759 |
| Total consolidated..... | <u>\$36,339</u> | <u>\$30,306</u> | <u>\$22,807</u> |

Information about Geographic Areas:

| | External Sales & Revenues ⁽¹⁾ | | | Net property, plant and equipment | | |
|----------------------------|--|------------------|------------------|-----------------------------------|----------------------|----------------------|
| | 2005 | 2004 | 2003 | December 31, | | |
| | 2005 | 2004 | 2003 | 2005 | 2004 | 2003 |
| Inside United States..... | \$ 17,348 | \$ 14,198 | \$ 10,064 | \$ 4,725 | \$ 4,424 | \$ 4,276 |
| Outside United States..... | 18,991 | 16,108 | 12,743 | 3,263 ⁽²⁾ | 3,258 ⁽²⁾ | 2,975 ⁽²⁾ |
| Total..... | <u>\$ 36,339</u> | <u>\$ 30,306</u> | <u>\$ 22,807</u> | <u>\$ 7,988</u> | <u>\$ 7,682</u> | <u>\$ 7,251</u> |

⁽¹⁾ Sales of machinery and engines are based on dealer location. Revenues from services provided are based on where service is rendered.

⁽²⁾ Amount includes \$692 million, \$681 million and \$675 million of net property, plant and equipment located in the United Kingdom as of December 31, 2005, 2004 and 2003, respectively.

26. Alliances and Acquisitions**Global Alliance with JLG Industries, Inc.**

In November 2005, we entered into a global alliance agreement with JLG Industries, Inc. (“JLG”) to produce a full line of Caterpillar branded telehandlers. The alliance is a strategic fit for both companies and will give Caterpillar dealers and customers greater access to a quality range of Caterpillar branded telehandler products. Caterpillar will supply components to JLG and JLG will benefit by distributing through the Caterpillar dealer network and utilizing our parts distribution capabilities. Under the 20 year alliance agreement, telehandler production will shift from Caterpillar’s manufacturing facility in Leicester, United Kingdom to JLG’s manufacturing facilities during 2006. The terms of the alliance agreement were for JLG to pay Caterpillar \$51 million, with \$46 million paid at closing and \$5 million to be paid upon transition in 2006. The book value of assets acquired by JLG was \$10 million. The resulting \$41 million gain will be deferred and recognized over the alliance agreement.

As part of the telehandler production shift, Caterpillar’s Building Construction Products Division, part of Caterpillar’s “All Other” segment, began a strategic restructuring to better position its European manufacturing operations. This restructuring resulted in approximately \$11 million in severance costs, charged to “Other Operating Expenses” in the fourth quarter of 2005, related to approximately 500 voluntary and probable involuntary employee separations. As of year-end 2005, approximately \$7 million of the severance costs had been paid.

Turbomach S.A.

In June 2004, we acquired Turbomach S.A. from Borsig Energy GmbH for \$41 million. Turbomach S.A. is a Swiss corporation that has packaged, distributed and provided aftermarket services for Solar brand gas turbine engines since 1985 for the industrial power generation market. Turbomach also provides integrated systems for power projects, including balance of plant design, procurement and site construction. The acquisition expands our participation within the global power generation market, particularly in the expanding markets of Europe, Africa and Asia.

The transaction, which was financed with available cash and commercial paper borrowings, was accounted for by the purchase method of accounting and, accordingly, the results of the acquired business for the period from the acquisition date are included in the accompanying consolidated financial statements and reported in the “All Other” segment. Net tangible assets acquired and liabilities assumed of \$41 million were recorded at their fair values. No significant intangible assets were acquired. Assuming this transaction had been made at January 1, 2004, the consolidated pro forma results for the year would not be materially different from reported results.

Parts and Accessories Distribution Business of MG Rover Ltd.

In August 2004, we acquired the global parts and accessories business of U.K. auto manufacturer MG Rover, a wholly owned subsidiary of Phoenix Venture Holdings Limited, for \$178 million, including \$169 million at closing (subject to certain post-closing adjustments) and a \$9 million promissory note to be paid in 2006. The business acquired includes the sourcing, marketing, distribution and sale of automotive service parts and accessories to MG Rover dealers, distributors, importers and other related customers worldwide.

The transaction, which was financed with available cash and commercial paper borrowings, was accounted for by the purchase method of accounting and, accordingly, the results of the acquired business for the period from the acquisition date are included in the accompanying consolidated financial statements and reported in the “All Other” segment. Net tangible assets acquired and liabilities assumed of \$73 million were recorded at their fair values. Finite-lived intangible assets acquired of \$87 million relate primarily to technology and trademark rights, which are being amortized on a straight-line basis over 10 years. Goodwill of \$18 million represents the excess of cost over the fair value of net tangible and finite-lived intangible assets acquired. Assuming this transaction had been made at January 1, 2004, the consolidated pro forma results for the year would not be materially different from reported results.

Williams Technologies, Inc.

In September 2004, we acquired Williams Technologies, Inc., a wholly owned subsidiary of Remy International, Inc., for \$105 million. Williams Technologies, Inc. is a leading remanufacturer of automatic transmissions, torque converters and engines for automotive and medium and heavy-duty truck applications. This acquisition represents an expansion of our remanufacturing operations into the automotive powertrain remanufacturing business.

The transaction, which was financed with available cash and commercial paper borrowings, was accounted for by the purchase method of accounting and, accordingly, the results of the acquired business for the period from the acquisition date are included in the accompanying consolidated financial statements and reported in the “All Other” segment. Net tangible assets acquired and liabilities assumed of \$25 million were recorded at their fair values. Finite-lived intangible assets acquired of \$43 million relate primarily to customer relationships, and are being amortized on a straight-line basis over 20 years. Goodwill of \$37 million represents the excess of cost over the fair value of net tangible and finite-lived intangible assets acquired. Assuming this transaction had been made at January 1, 2004, the consolidated pro forma results for the year would not be materially different from reported results.

27. Selected quarterly financial results (unaudited)

| (Dollars in millions except per share data) | 2005 Quarter | | | |
|---|--------------|----------|----------|----------|
| | 1st | 2nd | 3rd | 4th |
| Sales and revenues..... | \$ 8,339 | \$ 9,360 | \$ 8,977 | \$ 9,663 |
| Less: Revenues | 550 | 576 | 585 | 622 |
| Sales | 7,789 | 8,784 | 8,392 | 9,041 |
| Cost of goods sold | 6,215 | 6,890 | 6,547 | 6,906 |
| Gross margin | 1,574 | 1,894 | 1,845 | 2,135 |
| Profit | 581 | 760 | 667 | 846 |
| Profit per common share..... | \$ 0.85 | \$ 1.12 | \$ 0.98 | \$ 1.26 |
| Profit per common share — diluted .. | \$ 0.81 | \$ 1.08 | \$ 0.94 | \$ 1.20 |

| (Dollars in millions except per share data) | 2004 Quarter | | | |
|---|--------------|----------|----------|----------|
| | 1st | 2nd | 3rd | 4th |
| Sales and revenues..... | \$ 6,480 | \$ 7,583 | \$ 7,659 | \$ 8,584 |
| Less: Revenues | 478 | 483 | 484 | 525 |
| Sales | 6,002 | 7,100 | 7,175 | 8,059 |
| Cost of goods sold | 4,701 | 5,563 | 5,745 | 6,488 |
| Gross margin | 1,301 | 1,537 | 1,430 | 1,571 |
| Profit | 420 | 566 | 498 | 551 |
| Profit per common share..... | \$ 0.62 | \$ 0.83 | \$ 0.73 | \$ 0.81 |
| Profit per common share — diluted .. | \$ 0.59 | \$ 0.80 | \$ 0.70 | \$ 0.77 |

Five-year Financial Summary
(Dollars in millions except per share data)

Caterpillar Inc.

| Years ended December 31, | 2005 | 2004 ⁽⁵⁾ | 2003 ⁽⁵⁾ | 2002 ⁽⁵⁾ | 2001 ⁽⁵⁾ |
|--|------------------|---------------------|---------------------|---------------------|---------------------|
| Sales and revenues | \$ 36,339 | 30,306 | 22,807 | 20,185 | 20,510 |
| Sales | \$ 34,006 | 28,336 | 21,048 | 18,648 | 19,027 |
| Percent inside the United States | 47% | 46% | 44% | 45% | 49% |
| Percent outside the United States | 53% | 54% | 56% | 55% | 51% |
| Revenues | \$ 2,333 | 1,970 | 1,759 | 1,537 | 1,483 |
| Profit ⁽¹⁾ | \$ 2,854 | 2,035 | 1,099 | 798 | 805 |
| Profit per common share ⁽¹⁾⁽²⁾ | \$ 4.21 | 2.97 | 1.59 | 1.16 | 1.17 |
| Profit per common share — diluted ⁽¹⁾⁽³⁾ | \$ 4.04 | 2.88 | 1.56 | 1.15 | 1.16 |
| Dividends declared per share of common stock | \$ 0.955 | 0.800 | 0.720 | 0.700 | 0.695 |
| Return on average common stockholders' equity ⁽⁴⁾ | 35.9% | 30.0% | 19.0% | 14.4% | 14.4% |
| Capital expenditures: | | | | | |
| Property, plant and equipment | \$ 1,201 | 926 | 682 | 728 | 1,100 |
| Equipment leased to others | \$ 1,214 | 1,188 | 1,083 | 1,045 | 868 |
| Depreciation and amortization | \$ 1,477 | 1,397 | 1,347 | 1,220 | 1,169 |
| Research and development expenses | \$ 1,084 | 928 | 669 | 656 | 696 |
| As a percent of sales and revenues | 3.0% | 3.1% | 2.9% | 3.3% | 3.4% |
| Wages, salaries and employee benefits | \$ 6,928 | 6,025 | 4,980 | 4,360 | 4,272 |
| Average number of employees | 81,673 | 73,033 | 67,828 | 70,973 | 70,678 |
| December 31, | | | | | |
| Total assets | \$ 47,069 | 43,095 | 36,711 | 32,705 | 30,489 |
| Long-term debt due after one year: | | | | | |
| Consolidated | \$ 15,677 | 15,837 | 14,546 | 11,774 | 11,452 |
| Machinery and Engines | \$ 2,717 | 3,663 | 3,603 | 3,581 | 3,653 |
| Financial Products | \$ 12,960 | 12,174 | 10,943 | 8,193 | 7,799 |
| Total debt: | | | | | |
| Consolidated | \$ 25,745 | 23,525 | 20,284 | 17,861 | 16,763 |
| Machinery and Engines | \$ 3,928 | 3,762 | 3,707 | 3,903 | 3,945 |
| Financial Products | \$ 21,817 | 19,763 | 16,577 | 13,958 | 12,818 |

⁽¹⁾ In 2002, we adopted Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" and therefore no longer amortize goodwill.

⁽²⁾ Computed on weighted-average number of shares outstanding.

⁽³⁾ Computed on weighted-average number of shares outstanding diluted by assumed exercise of stock options, using the treasury stock method.

⁽⁴⁾ Represents profit divided by average stockholders' equity (beginning of year stockholders' equity plus end of year stockholders' equity divided by two).

⁽⁵⁾ The per share data reflects the 2005 2-for-1 stock split, applied retroactively, to all periods presented.

MANAGEMENT'S DISCUSSION AND ANALYSIS

OVERVIEW

We effectively responded to unprecedented customer demand in 2005 and reported full-year sales and revenues of \$36.339 billion and profit per share of \$4.04. Sales and revenues rose 20 percent from 2004, and profit per share was up 40 percent—both were records. Fourth-quarter sales and revenues of \$9.663 billion and profit per share of \$1.20 were both all-time records for any quarter in Caterpillar history.

2005 was an incredibly strong year for us. With the surge in customer demand and production, our employees, suppliers and dealers have responded in spectacular fashion to help us realize the opportunity. We should celebrate our 2005 accomplishments knowing Caterpillar is extremely well-positioned going forward.

2005 sales and revenues of \$36.339 billion were up \$6.033 billion, or 20 percent, from 2004. The increase was a result of \$3.715 billion of higher *sales volume*, \$1.827 billion of improved *price realization* and a \$363 million increase in *Financial Products* revenues.

Profit of \$2.854 billion, or \$4.04 a share, was up 40 percent. The improvement was primarily the result of higher price realization and sales volume, partially offset by an increase in *core operating costs*. The increase was a result of higher material costs, primarily steel, and costs to support higher volume and ongoing investment in new products and technology.

Our focus this year has been on meeting customer delivery expectations while creating stockholder value. Over the past two years we've more than doubled production at several of our man-

ufacturing facilities, particularly those manufacturing large machines. We've done this without additional bricks and mortar and with a focus on managing our *period cost* structure.

In 2006, we expect sales and revenues of about \$40 billion and profit per share between \$4.65 and \$5.00.

2006 should be another year of excellent growth for Caterpillar. Most of the industries we serve are strong, and the fundamental economic picture remains positive. Our emphasis is on execution with *6 Sigma* as we implement our new strategy to achieve our *2010 goals*, with even greater focus on improving employee safety, product quality and product availability.

It is our objective to provide the most meaningful disclosures in our Management's Discussion and Analysis in order to explain significant changes in our company's results of operations and liquidity and capital resources. As discussed in Note 25, our segment financial information is not based on generally accepted accounting principles and it is not intended to measure contributions to enterprise results. Therefore, it is impractical for us to try to discuss our company's results of operations and liquidity and capital resources solely based on segment information. Where practical, we have linked our discussions to segment information provided in Note 25 and Table IV on pages A-31 to A-35 (see "Reconciliation of Machinery and Engines Sales by Geographic Region to External Sales by Marketing Segment" on page A-39). Our discussions will focus on consolidated results and our three principal lines of business, *Machinery, Engines* and *Financial Products*.

*Glossary of terms included on pages A-49 to A-50; first occurrence of terms shown in bold italics.

2005 COMPARED WITH 2004

Sales and Revenues by Geographic Region

| (Millions of dollars) | Total | % Change | North America | % Change | EAME | % Change | Latin America | % Change | Asia/ Pacific | % Change |
|---------------------------------------|-----------------|-------------|------------------|-------------|-----------------|-------------|------------------|-------------|------------------|-------------|
| 2005 | | | | | | | | | | |
| Machinery..... | \$22,931 | 22% | \$12,822 | 24% | \$ 5,222 | 16% | \$ 1,982 | 31% | \$ 2,905 | 17% |
| Engines ⁽¹⁾ | 11,075 | 17% | 4,887 | 17% | 3,638 | 22% | 1,042 | 21% | 1,508 | 4% |
| Financial Products ⁽²⁾ ... | 2,333 | 18% | 1,659 | 20% | 341 | 1% | 148 | 25% | 185 | 42% |
| | <u>\$36,339</u> | <u>20%</u> | <u>\$19,368</u> | <u>22%</u> | <u>\$ 9,201</u> | <u>17%</u> | <u>\$ 3,172</u> | <u>27%</u> | <u>\$ 4,598</u> | <u>13%</u> |
| 2004 | | | | | | | | | | |
| Machinery..... | \$18,844 | | \$10,337 | | \$ 4,511 | | \$ 1,510 | | \$ 2,486 | |
| Engines ⁽¹⁾ | 9,492 | | 4,184 | | 2,994 | | 862 | | 1,452 | |
| Financial Products ⁽²⁾ ... | 1,970 | | 1,384 | | 338 | | 118 | | 130 | |
| | <u>\$30,306</u> | | <u>\$15,905</u> | | <u>\$ 7,843</u> | | <u>\$ 2,490</u> | | <u>\$ 4,068</u> | |

⁽¹⁾ Does not include internal engine transfers of \$2,065 million and \$1,738 million in 2005 and 2004, respectively. Internal engines transfers are valued at prices comparable to those for unrelated parties.

⁽²⁾ Does not include revenues earned from Machinery and Engines of \$317 million and \$199 million in 2005 and 2004, respectively.

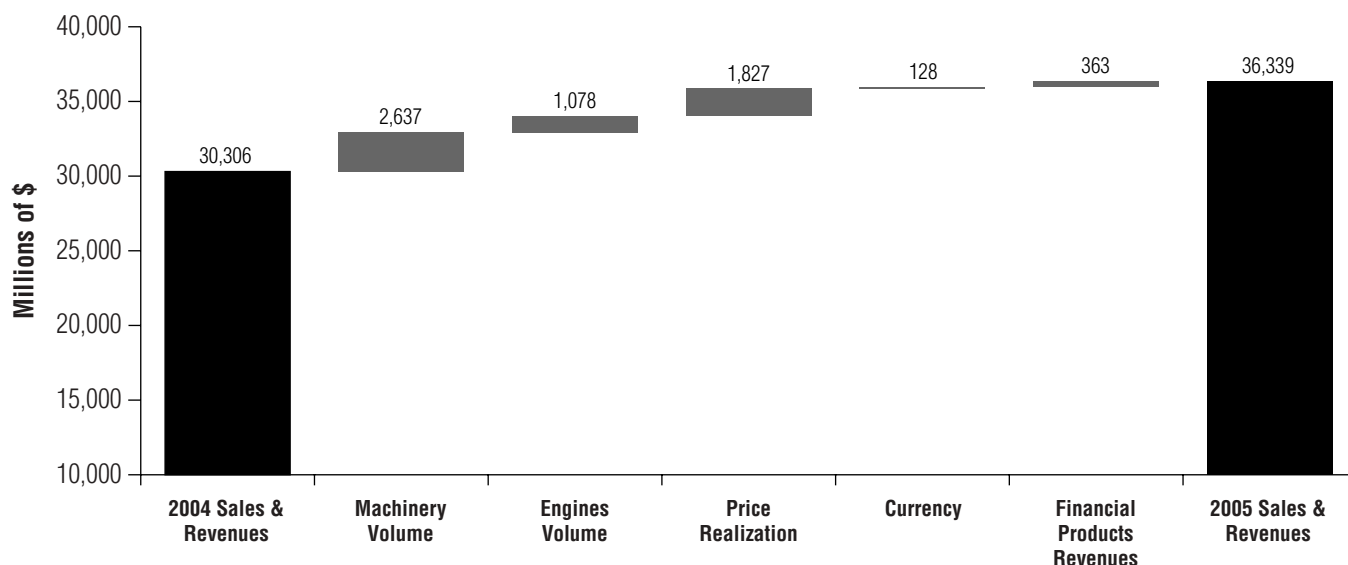
Reconciliation of Machinery and Engine Sales by Geographic Region to External Sales by Marketing Segment

| (Millions of dollars) | 2005 | 2004 | 2003 |
|--|------------------|-----------------|-----------------|
| North America Geographic Region | \$ 17,709 | \$ 14,521 | \$ 10,532 |
| Sales included in the Power Systems Marketing segment | (3,431) | (2,896) | (2,166) |
| Sales included in the Electric Power segment | (603) | (499) | (316) |
| Company owned dealer sales included in the All Other segment | (878) | (766) | (388) |
| Other* | (1,809) | (1,478) | (1,225) |
| North America Marketing external sales | <u>\$ 10,988</u> | <u>\$ 8,882</u> | <u>\$ 6,437</u> |
| EAME Geographic Region | \$ 8,860 | \$ 7,505 | \$ 5,952 |
| Sales included in the Power Systems Marketing segment | (625) | (515) | (419) |
| Sales included in the Electric Power segment | (1,087) | (903) | (610) |
| Other* | (2,707) | (2,209) | (1,792) |
| EAME Marketing external sales | <u>\$ 4,441</u> | <u>\$ 3,878</u> | <u>\$ 3,131</u> |
| Latin America Geographic Region | \$ 3,024 | \$ 2,372 | \$ 1,721 |
| Sales included in the Power Systems Marketing segment | (145) | (153) | (62) |
| Sales included in the Electric Power segment | (25) | (19) | (6) |
| Other* | (579) | (470) | (500) |
| Latin America external sales | <u>\$ 2,275</u> | <u>\$ 1,730</u> | <u>\$ 1,153</u> |
| Asia/Pacific Geographic Region | \$ 4,413 | \$ 3,938 | \$ 2,843 |
| Sales included in the Power Systems Marketing segment | (468) | (366) | (324) |
| Sales included in the Electric Power segment | (404) | (336) | (294) |
| Other* | (1,079) | (1,126) | (656) |
| Asia/Pacific Marketing external sales | <u>\$ 2,462</u> | <u>\$ 2,110</u> | <u>\$ 1,569</u> |

*Mostly represents external sales of the All Other segment.

SALES AND REVENUES**Consolidated Sales and Revenues Comparison**

2005 vs. 2004



The chart above graphically illustrates reasons for the change in Consolidated Sales and Revenues between 2004 (at left) and 2005 (at right). Items favorably impacting sales and revenues appear as upward stair steps with the corresponding dollar amounts above each bar. Caterpillar management utilizes these charts internally to visually communicate with its Board and employees.

Sales and revenues for 2005 were \$36.339 billion, up \$6.033 billion, or 20 percent, from 2004. Machinery volume was up \$2.637 billion, Engines volume was up \$1.078 billion, price realization improved \$1.827 billion and *currency* had a positive impact on sales of \$128 million. In addition, Financial Products revenues increased \$363 million.

Machinery sales in 2005 were \$22.931 billion, an increase of \$4.087 billion, or 22 percent, from 2004. Sales were an all-time record for a year. Sales volume accounted for \$2.637 billion of the increase, price realization added \$1.343 billion and the remaining \$107 million was due to currency.

Growth in sales volume resulted from increased shipments to dealers in response to broad-based gains in reported dealer deliveries to end users. All regions and most industries participated in this growth, which showed little sign of abating as the year ended. Worldwide, dealers reported increases to machine inventory in both 2004 and 2005. At the end of 2005, dealers reported lower machine inventory, as measured by months of supply, than at the end of 2004.

- **North America** sales were up \$2.485 billion, or 24 percent, from 2004; sales volume increased \$1.653 billion and price realization added \$832 million. Growth in sales volume resulted largely from increased sales through our dealer network, the result of favorable metals and energy prices and increased construction spending. Dealers built machine inventories in line with deliveries so that inventories in months of deliveries were the same as at the end of 2004.
- **EAME** sales increased 16 percent, or \$711 million, compared to 2004. Sales volume accounted for \$421 million, improved price realization added \$253 million and the remaining \$37 million came from the favorable impact of currency. Volume growth occurred as a result of increased sales through our dealer network. Low interest rates benefited housing construction in Europe, and higher metals and energy prices supported both construction and mining in Africa/Middle East (AME). Mining and energy investment in the Commonwealth of Independent States (CIS) increased and had a positive effect on Caterpillar sales.
- **Latin America** sales rose \$472 million, or 31 percent, from the same period a year ago — \$304 million from increased volume, \$120 million from improved price realization and the remaining \$48 million due to currency, primarily related to a stronger Brazilian real. Increased sales through our dealer network into both construction and mining sectors accounted for all the sales volume growth; dealer machine inventories declined in both absolute amount and months of deliveries.
- **Asia/Pacific** sales were up 17 percent, or \$419 million, higher than last year — \$259 million from higher volume, \$138 million from improved price realization and the remaining \$22 million due to currency. Sales volume in most of the larger countries increased, a result of very strong mining activity and continued growth in construction. In China, sales were down modestly for the year. Sales in China have been rising since early in 2005 following a steep downturn in the second half of 2004. Dealers in the Asia/Pacific region added less to their inventories than in 2004. Dealer machine inventories at December 2005, in months of deliveries, were below 2004.

Engine sales were \$11.075 billion in 2005, up \$1.583 billion, or 17 percent, from 2004. Volume accounted for \$1.078 billion, price realization added \$484 million and currency added \$21 million.

Dealer engine inventory increased during both full-year 2005 and full-year 2004. The 2005 inventory increase was less than the 2004 increase, which slightly reduced the company's year-over-year sales growth. Months of inventory relative to deliveries declined in most regions and sectors compared to 2004.

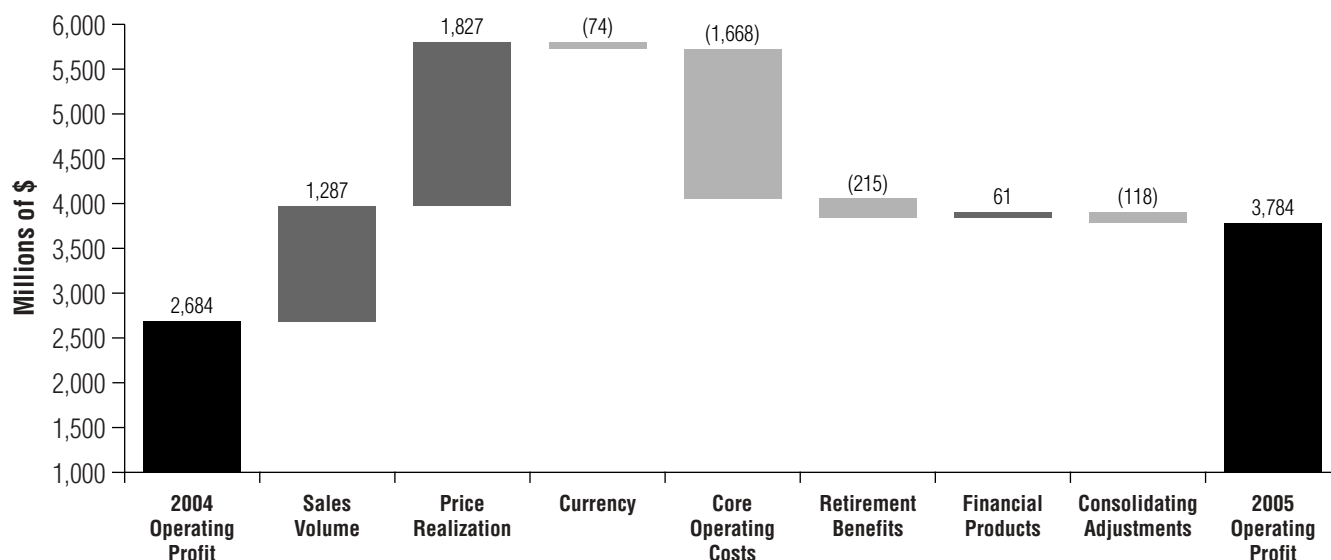
- **North America** sales were up 17 percent. Sales of petroleum engines increased 50 percent, primarily from increased sales of reciprocating engines for drilling and gas compression and turbines and related services for gas production and transmission. High oil and gas prices were a significant factor behind the increase in sales. Sales of on-highway truck engines were up 5 percent, primarily due to expansion and replacement of truck fleets. Sales of electric power engines were up 21 percent, with widespread demand for generator sets for communications, data center and standby applications. Marine engine sales were up 33 percent, primarily from increased demand for workboats and petroleum support vessels.
- **EAME** sales increased 22 percent. Sales into the electric power sector were up 35 percent, with widespread growth in demand for reciprocating generator sets, support from Middle East reconstruction efforts and incremental revenue from the acquisition of Turbomach, a turbine generator set packager and service provider. Marine engine sales increased 20 percent, with strong demand for oceangoing and inland waterway vessels. Sales of industrial engines were up 8 percent — a result of increases in demand from a broad range of industrial equipment customers, partially offset by lower demand from agricultural equipment manufacturers. Petroleum engine sales dropped 4 percent for the year, primarily from reduced shipments for turbines and turbine-related services for offshore oil platforms and gas transmission projects.
- **Latin America** sales were up 21 percent. Sales of petroleum engines increased 49 percent, with nearly all of the increase from sales of turbines and turbine-related services to support increased investment in oil production. Sales of electric power engines increased 44 percent, benefiting from investments in generator sets for electricity reliability and disaster preparedness as well as demand for rental fleets. Sales of industrial engines decreased 34 percent, with reduced demand for engines for agricultural equipment. Sales of marine engines declined 37 percent, impacted by limited shipyard capacity and comparison with a high 2004 base.
- **Asia/Pacific** sales were up 4 percent. Sales of marine engines were up 26 percent, with increased demand for oceangoing and petroleum support vessels due to strong freight and petroleum demand. Petroleum engine sales increased 12 percent, with widespread demand for reciprocating engines for petroleum site power, drilling and well support as well as demand for turbines and related services to support production. Electric power engine sales declined 19 percent, with most of the decline due to centralized electrical demand management actions and improved electricity reliability in China that drove reduced demand for generator sets.

Financial Products revenues were \$2.333 billion, up \$363 million, or 18 percent, from 2004. The increase was due primarily to a \$211 million favorable impact from continued growth of *Earning Assets* and an \$89 million impact of higher interest rates on new and existing finance receivables at Cat Financial. Also, there was a \$47 million increase in revenues at Cat Insurance, primarily due to an increase in earned premiums.

OPERATING PROFIT

Consolidated Operating Profit Comparison

2005 vs. 2004



The chart above graphically illustrates reasons for the change in Consolidated Operating Profit between 2004 (at left) and 2005 (at right). Items favorably impacting operating profit appear as upward stair steps with the corresponding dollar amounts above each bar, while items negatively impacting operating profit appear as downward stair steps with dollar amounts reflected in parentheses above each bar. Caterpillar management utilizes these charts internally to visually communicate with its Board and employees.

Operating profit in 2005 improved \$1.100 billion, or 41 percent, from last year, driven by higher price realization and sales volume, partially offset by higher core operating costs and *retirement benefits*.

Core operating costs rose \$1.668 billion from 2004, primarily due to a \$1.296 billion increase in *manufacturing costs*. Approximately two-thirds of the manufacturing cost increase was attributable to variable costs — primarily higher material costs and supply chain-related inefficiencies. The remainder of the manufacturing cost increase was due to higher period manufacturing costs; the significant increase in *Machinery and Engines* sales volume was a key driver. For the year, period manufacturing costs increased 13 percent on a sales increase of 20 percent.

Non-manufacturing-related core operating costs were up \$372 million — primarily the result of higher SG&A and R&D

expenses to support new product programs and growth. Full-year Machinery and Engines SG&A as a percent of sales declined from 9.0 percent to 8.2 percent but was up \$176 million in 2005 versus 2004, excluding the impact of currency and retirement benefits. Full-year Machinery and Engines R&D as a percent of sales declined from 3.3 percent to 3.2 percent but was up \$138 million in 2005 versus 2004, excluding the impact of currency and retirement benefits.

Full-year Machinery and Engines Other Operating Costs were up \$58 million. This was due primarily to about \$70 million in charges related to our dealer distribution support software and the global telehandler alliance that was announced in the fourth quarter of 2005.

Operating Profit by Principal Line of Business

| (Millions of dollars) | 2005 | 2004 | Change \$ | Change % |
|--|-----------------|-----------------|-----------------|-------------|
| Machinery ⁽¹⁾ | \$ 2,431 | \$ 1,756 | \$ 675 | 38% |
| Engines ⁽¹⁾ | 1,071 | 589 | 482 | 82% |
| Financial Products | 531 | 470 | 61 | 13% |
| <i>Consolidating Adjustments</i> | (249) | (131) | (118) | |
| Consolidated Operating Profit | <u>\$ 3,784</u> | <u>\$ 2,684</u> | <u>\$ 1,100</u> | 41% |

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

MANAGEMENT'S DISCUSSION AND ANALYSIS *continued*

Machinery operating profit of \$2.431 billion was up \$675 million, or 38 percent, from 2004. The favorable impact of improved price realization and higher sales volume was partially offset by higher core operating costs and higher retirement benefits.

Engines operating profit of \$1.071 billion was up \$482 million, or 82 percent, from 2004. The favorable impact of improved price realization and higher sales volume was partially offset by higher core operating costs and higher retirement benefits.

Financial Products operating profit of \$531 million was up \$61 million, or 13 percent, from 2004. The increase was primarily due to \$123 million favorable impact from the continued growth of earning assets at Cat Financial. Partially offsetting this increase were \$33 million in higher operating expenses, primarily related to growth at Cat Financial and a \$28 million decrease in operating profit at Cat Insurance, primarily due to less favorable insurance reserve adjustments in 2005 than in 2004.

OTHER PROFIT/LOSS ITEMS

Other income/expense was income of \$377 million compared with income of \$253 million in 2004. The improvement was due to the favorable impact of currency, higher interest income and the absence of a number of expense items incurred during 2004 that were individually not significant.

The provision for income taxes in 2005 reflects an annual tax rate of 29.5 percent, excluding the discrete items discussed below, and compares to a 27 percent rate in 2004. The increase is primarily due to a reduction in our Extraterritorial Income Exclusion (ETI) benefits, partially attributable to the impact of the American Jobs Creation Act (AJCA) permitting only 80 percent of ETI benefits in 2005 and to a change in our geographic mix of profits.

During 2005, we repatriated earnings of \$1.4 billion, which includes approximately \$500 million subject to preferential tax treatment allowed by the AJCA. We recognized a charge of \$33 million related to this repatriation. In connection with our current repatriation plan, we changed our intention of repatriating earnings for a few selected non-U.S. subsidiaries and recognized an income tax benefit of \$38 million. In addition, we recognized an income tax benefit of \$26 million from the settlement of several

non-U.S. tax issues. The net impact of these items is a \$31 million discrete benefit to our 2005 provision for income taxes.

Supplemental Information

| (Millions of dollars) | 2005 | 2004 | 2003 |
|---------------------------------------|------------------|------------------|------------------|
| Identifiable Assets: | | | |
| Machinery | \$ 14,877 | \$ 13,717 | \$ 11,806 |
| Engines | 9,110 | 8,552 | 7,645 |
| Financial Products | 27,052 | 24,612 | 20,972 |
| Consolidating Adjustments... | (3,970) | (3,786) | (3,712) |
| Total | <u>\$ 47,069</u> | <u>\$ 43,095</u> | <u>\$ 36,711</u> |
| Capital Expenditures: | | | |
| Machinery | \$ 685 | \$ 546 | \$ 386 |
| Engines | 426 | 297 | 278 |
| Financial Products | 1,304 | 1,271 | 1,101 |
| Total | <u>\$ 2,415</u> | <u>\$ 2,114</u> | <u>\$ 1,765</u> |
| Depreciation and Amortization: | | | |
| Machinery | \$ 476 | \$ 442 | \$ 453 |
| Engines | 359 | 353 | 345 |
| Financial Products | 642 | 602 | 549 |
| Total | <u>\$ 1,477</u> | <u>\$ 1,397</u> | <u>\$ 1,347</u> |

Caterpillar operations are highly integrated; therefore, the company uses a number of allocations to determine lines of business financial data.

UAW LABOR AGREEMENT

In January 2005 the company and about 9,000 employees represented by the United Auto Workers reached a new six-year labor agreement that will expire on March 1, 2011. This agreement positions the company and all our employees for long-term competitiveness. While the initial impact was about a \$100 million increase in retirement benefits in 2005, with the establishment of a very competitive market-based new hire wage package, the introduction of employee and retiree health care cost-sharing and other operational effectiveness improvements, we believe we have a long-term cost structure that enables us to compete from our traditional manufacturing and logistics locations.

FOURTH QUARTER 2005 COMPARED WITH FOURTH QUARTER 2004

Sales and Revenues by Geographic Region

| (Millions of dollars) | Total | % Change | North America | % Change | EAME | % Change | Latin America | % Change | Asia/Pacific | % Change |
|---------------------------------------|-----------------|----------|-----------------|----------|-----------------|----------|---------------|----------|-----------------|----------|
| Fourth Quarter 2005 | | | | | | | | | | |
| Machinery | \$ 5,857 | 14% | \$ 3,375 | 21 % | \$ 1,238 | (3)% | \$ 465 | 4% | \$ 779 | 20% |
| Engines ⁽¹⁾ | 3,184 | 10% | 1,162 | (4)% | 1,130 | 18 % | 347 | 26% | 545 | 19% |
| Financial Products ⁽²⁾ ... | 622 | 18% | 447 | 23 % | 85 | (3)% | 43 | 26% | 47 | 21% |
| | <u>\$ 9,663</u> | 13% | <u>\$ 4,984</u> | 14 % | <u>\$ 2,453</u> | 6 % | <u>\$ 855</u> | 13% | <u>\$ 1,371</u> | 20% |
| Fourth Quarter 2004 | | | | | | | | | | |
| Machinery | \$ 5,157 | | \$ 2,783 | | \$ 1,279 | | \$ 447 | | \$ 648 | |
| Engines ⁽¹⁾ | 2,902 | | 1,213 | | 955 | | 276 | | 458 | |
| Financial Products ⁽²⁾ ... | 525 | | 364 | | 88 | | 34 | | 39 | |
| | <u>\$ 8,584</u> | | <u>\$ 4,360</u> | | <u>\$ 2,322</u> | | <u>\$ 757</u> | | <u>\$ 1,145</u> | |

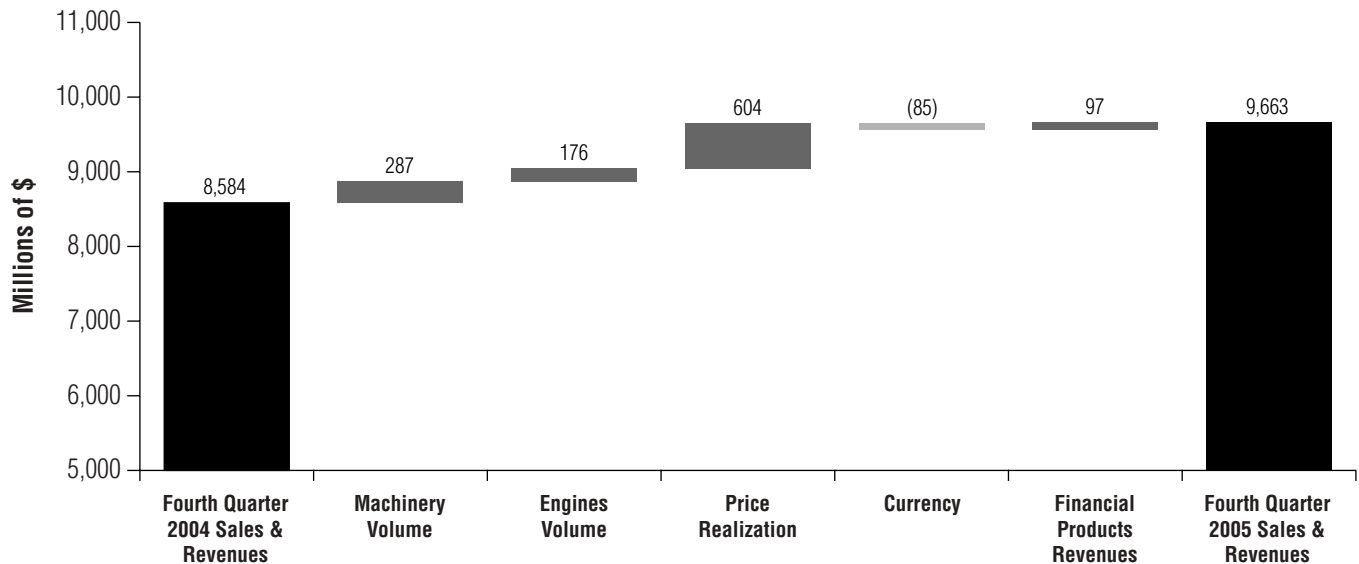
⁽¹⁾ Does not include internal engine transfers of \$458 million and \$420 million in 2005 and 2004, respectively. Internal engines transfers are valued at prices comparable to those for unrelated parties.

⁽²⁾ Does not include revenues earned from Machinery and Engines of \$93 million and \$57 million in 2005 and 2004, respectively.

SALES AND REVENUES

Consolidated Sales and Revenues Comparison

Fourth Quarter 2005 vs. Fourth Quarter 2004



The chart above graphically illustrates reasons for the change in Consolidated Sales and Revenues between Fourth Quarter 2004 (at left) and Fourth Quarter 2005 (at right). Items favorably impacting sales and revenues appear as upward stair steps with the corresponding dollar amounts above each bar, while items negatively impacting sales and revenues appear as downward stair steps with the corresponding dollar amount in parentheses above each bar. Caterpillar management utilizes these charts internally to visually communicate with its Board and employees.

Sales and revenues for the fourth quarter of 2005 were \$9.663 billion, up \$1.079 billion, or 13 percent, from fourth quarter 2004. Price realization improved \$604 million, Machinery volume was up \$287 million, Engines volume was up \$176 million and currency had an unfavorable impact on sales of \$85 million due primarily to a weaker euro compared with fourth quarter 2004. In addition, Financial Products revenues increased \$97 million.

Machinery sales in fourth quarter 2005 were \$5.857 billion, an increase of \$700 million, or 14 percent, from fourth quarter 2004. Price realization accounted for \$456 million of the increase, sales volume added \$287 million and currency had an unfavorable impact of \$43 million.

Dealers reported continued strong gains in deliveries to end users in most regions and industries. Dealers added much less to inventories than in the fourth quarter 2004. Worldwide machine inventories in months of deliveries, as reported by dealers, were lower than a year earlier.

- **North America** sales were up \$592 million, or 21 percent, from fourth quarter 2004; price realization increased \$308 million and sales volume added \$284 million. The growth in sales volume resulted from increased sales through our dealer network due to continued good growth in dealer deliveries from a year earlier when activity benefited from the ending of depreciation incentives in the United States. Low long-term interest rates, good corporate profits and passage of a highway bill in the United States boosted construction spending. Higher metals and coal prices supported investment in mining.
- **EAME** sales decreased 3 percent, or \$41 million, compared to fourth quarter 2004. Currency unfavorably impacted sales

by \$62 million, and sales volume declined \$50 million. These items were partially offset by \$71 million of improved price realization. Dealers reduced inventories much more in fourth quarter 2005 than they did in the fourth quarter 2004, more than offsetting good growth in reported deliveries. The decline in sales volume was largely in Europe, where the economy just started to show some improvement in the last half of the year. Sales volume in Africa/Middle East increased significantly in response to higher commodity prices, particularly oil.

- **Latin America** sales rose \$18 million, or 4 percent, from the same quarter last year — \$35 million from improved price realization and \$16 million from the impact of currency. These items were partially offset by a \$33 million decline in sales volume, the result of dealers not building inventory as they did last year. Both construction and mining continued to do well in most countries.
- **Asia/Pacific** sales were 20 percent, or \$131 million, higher than last year — \$86 million from higher volume, \$42 million from improved price realization and the remaining \$3 million due to currency. The growth in sales volume occurred largely in China, where sales through our dealer network continued to recover from last year's sharp decline.

Engines sales were \$3.184 billion in fourth quarter 2005 — up 10 percent from the fourth quarter 2004. Sales volume accounted for 6 percent of the increase, while price realization accounted for 5 percent partially offset by a 1 percent unfavorable impact of currency on sales.

Dealer engine inventory increased during both fourth quarter 2005 and fourth quarter 2004. The 2005 inventory increase was

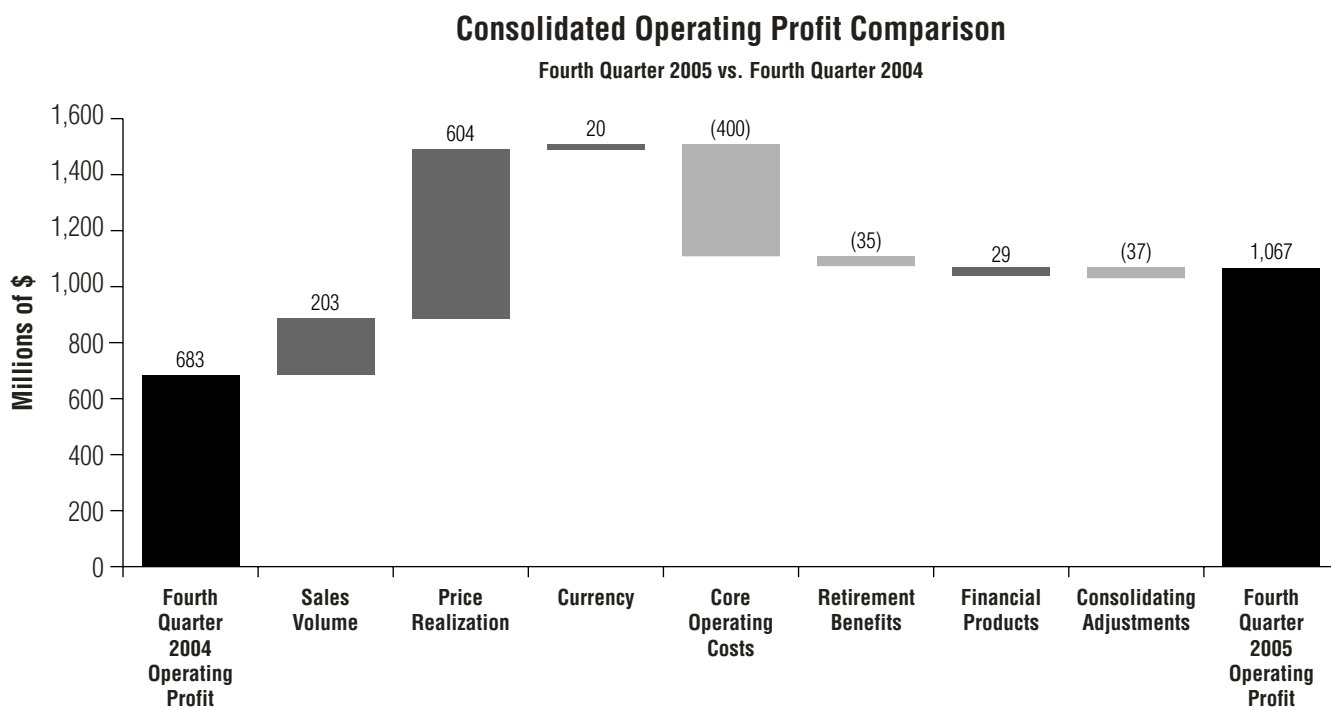
less than the 2004 increase, which slightly reduced the company's quarter-over-quarter sales growth. Months of inventory relative to deliveries declined in most regions and sectors compared to fourth quarter 2004.

- **North America** sales were down 4 percent. Sales of petroleum engines increased 32 percent, primarily from increased sales of reciprocating engines to support gas drilling and compression, supported by high gas prices and well service and frac applications. Sales of electric power engines increased 20 percent, with widespread demand for reciprocating generator sets to support data center and non residential construction activity. Sales of marine engines were up 32 percent, primarily due to increased workboat activity driven by high petroleum demand. Sales of on-highway truck engines decreased 26 percent, with the majority of the reduction due to truck original equipment manufacturers' (OEM) decisions to reduce finished engine inventory holdings as engine availability improved.
- **EAME** sales increased 18 percent. Sales of engines into the electric power sector were up 17 percent, with widespread growth in demand for reciprocating generator sets partially offset by reduced demand for turbines and turbine-related services. Sales of petroleum engines increased 57 percent, primarily due to increased turbine sales to support oil production in Africa. Sales of engines to the industrial sector declined 10 percent with reduced demand for agricultural equipment and some impact from vertical engine integration. Sales of marine engines declined 13 percent, driven by reduced demand for oceangoing vessel engines.

- **Latin America** sales were up 26 percent. Sales of petroleum engines increased 89 percent from increased sales of turbines and turbine-related services to support increased investment in oil production. Sales of electric power engines doubled due to increased sales of power plant projects and widespread demand for small standby generator sets. Sales of industrial engines declined 47 percent with reduced demand for engines for agricultural equipment. Sales of marine engines declined 38 percent, impacted by shipyard capacity.
- **Asia/Pacific** sales were up 19 percent. Sales of engines to the petroleum sector were up 13 percent, primarily due to drill rig power applications to support oil production. Sales of industrial engines increased 59 percent with increased market preference for Caterpillar engines. Sales of marine engines remained about flat as full shipyard order books partially influenced demand for oceangoing engines. Sales of electric power engines dropped 18 percent, primarily due to reduced demand in China for generator sets to support electricity reliability and availability.

Financial Products revenues were \$622 million, up \$97 million, or 18 percent, from fourth quarter 2004. The increase was due primarily to a \$43 million favorable impact from continued growth of Earning Assets at Cat Financial and a \$33 million impact of higher interest rates on new and existing finance receivables at Cat Financial. Also, there was a \$19 million increase in revenues at Cat Insurance due primarily to an increase in earned premiums.

OPERATING PROFIT



The chart above graphically illustrates reasons for the change in Consolidated Operating Profit between Fourth Quarter 2004 (at left) and Fourth Quarter 2005 (at right). Items favorably impacting operating profit appear as upward stair steps with the corresponding dollar amounts above each bar, while items negatively impacting operating profit appear as downward stair steps with dollar amounts reflected in parentheses above each bar. Caterpillar management utilizes these charts internally to visually communicate with its Board and employees.

Fourth-quarter operating profit improved \$384 million, or 56 percent, over a year ago, driven by higher price realization, sales volume and the favorable impact of currency.

Partially offsetting the favorable items were \$400 million in higher core operating costs and \$35 million of higher retirement benefits. Manufacturing costs represented \$225 million of the total increase in core operating costs. Approximately two-thirds of the manufacturing cost increase was due to an increase in period manufacturing costs associated with building our products. Period manufacturing costs increased 17 percent, or approximately \$150 million. The majority of the increase resulted from costs incurred to support 12 percent higher sales. These include items such as repair and maintenance and factory rearrangement.

The increase also includes costs not directly related to changes in volume, such as depreciation and manufacturing process engineering to support new product introduction.

The remainder of the manufacturing cost increase was attributable to variable cost increases resulting from volume-related inefficiencies due to operating at near capacity levels in many of our facilities.

Non-manufacturing-related core operating costs were up \$175 million — a result of higher SG&A and R&D expenses to support product programs and the growth in volume. Also included in this amount was about \$70 million of charges related to changes in our dealer distribution support software and the global telehandler alliance that was announced in the fourth quarter of 2005.

Operating Profit by Principal Line of Business

| (Millions of dollars) | Fourth Quarter 2005 | Fourth Quarter 2004 | Change \$ | Change % |
|-------------------------------------|---------------------------|---------------------------|---------------|-------------|
| Machinery ⁽¹⁾ | \$ 644 | \$ 366 | \$ 278 | 76% |
| Engines ⁽¹⁾ | 358 | 244 | 114 | 47% |
| Financial Products | 142 | 113 | 29 | 26% |
| Consolidating Adjustments | (77) | (40) | (37) | |
| Consolidated Operating Profit | <u>\$ 1,067</u> | <u>\$ 683</u> | <u>\$ 384</u> | 56% |

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

Machinery operating profit of \$644 million was up \$278 million, or 76 percent, from fourth quarter 2004. The favorable impact of improved price realization and higher sales volume was partially offset by higher core operating costs and higher retirement benefits.

Engines operating profit of \$358 million was up \$114 million, or 47 percent, from fourth quarter 2004. The favorable impact of improved price realization and higher sales volume was partially offset by higher core operating costs and higher retirement benefits.

Financial Products operating profit of \$142 million was up \$29 million, or 26 percent, from fourth quarter 2004. The increase was primarily due to a \$26 million impact from the continued growth of Earning Assets at Cat Financial.

OTHER PROFIT/LOSS ITEMS

Other income/expense was income of \$99 million compared with income of \$82 million in fourth quarter 2004. The improvement was due to a reserve adjustment related to the termination of certain capital lease obligations, higher interest income and the absence of a number of expense items incurred during the

fourth quarter of 2004 that were individually insignificant. These items were partially offset by the unfavorable impact of currency.

The provision for income taxes in the fourth quarter reflects an estimated annual tax rate of 29.5 percent as compared to a 27 percent rate in 2004. The increase is primarily due to a reduction in our Extraterritorial Income Exclusion (ETI) benefits, partially attributable to the impact of the American Jobs Creation Act (AJCA) permitting only 80 percent of ETI benefits in 2005 and also to a change in our geographic mix of profits. A favorable adjustment of \$14 million was recorded this quarter related to the first nine months of 2005 as a result of a decrease in the estimated annual tax rate from 30 to 29.5 percent, primarily due to better than expected ETI benefits. Our estimated annual tax rate excludes the impact of the discrete benefits discussed below.

The fourth quarter 2005 provision for income taxes also includes a discrete benefit of \$42 million resulting from a \$26 million benefit from the settlement of several non-U.S. tax issues and a \$16 million decrease in our charge for earnings repatriation under the provisions of the AJCA.

2004 COMPARED WITH 2003

Sales and Revenues by Geographic Region

| (Millions of dollars) | Total | % Change | North America | % Change | EAME | % Change | Latin America | % Change | Asia/ Pacific | % Change |
|---------------------------------------|-----------------|-------------|------------------|-------------|-----------------|-------------|------------------|-------------|------------------|-------------|
| 2004 | | | | | | | | | | |
| Machinery..... | \$18,844 | 38% | \$10,337 | 41% | \$ 4,511 | 25% | \$ 1,510 | 63% | \$ 2,486 | 35% |
| Engines ⁽¹⁾ | 9,492 | 29% | 4,184 | 30% | 2,994 | 27% | 862 | 9% | 1,452 | 45% |
| Financial Products ⁽²⁾ ... | 1,970 | 12% | 1,384 | 12% | 338 | 8% | 118 | — | 130 | 43% |
| | <u>\$30,306</u> | 33% | <u>\$15,905</u> | 35% | <u>\$ 7,843</u> | 25% | <u>\$ 2,490</u> | 35% | <u>\$ 4,068</u> | 39% |
| 2003 | | | | | | | | | | |
| Machinery..... | \$13,678 | | \$ 7,310 | | \$ 3,596 | | \$ 928 | | \$ 1,844 | |
| Engines ⁽¹⁾ | 7,370 | | 3,222 | | 2,356 | | 793 | | 999 | |
| Financial Products ⁽²⁾ ... | 1,759 | | 1,237 | | 313 | | 118 | | 91 | |
| | <u>\$22,807</u> | | <u>\$11,769</u> | | <u>\$ 6,265</u> | | <u>\$ 1,839</u> | | <u>\$ 2,934</u> | |

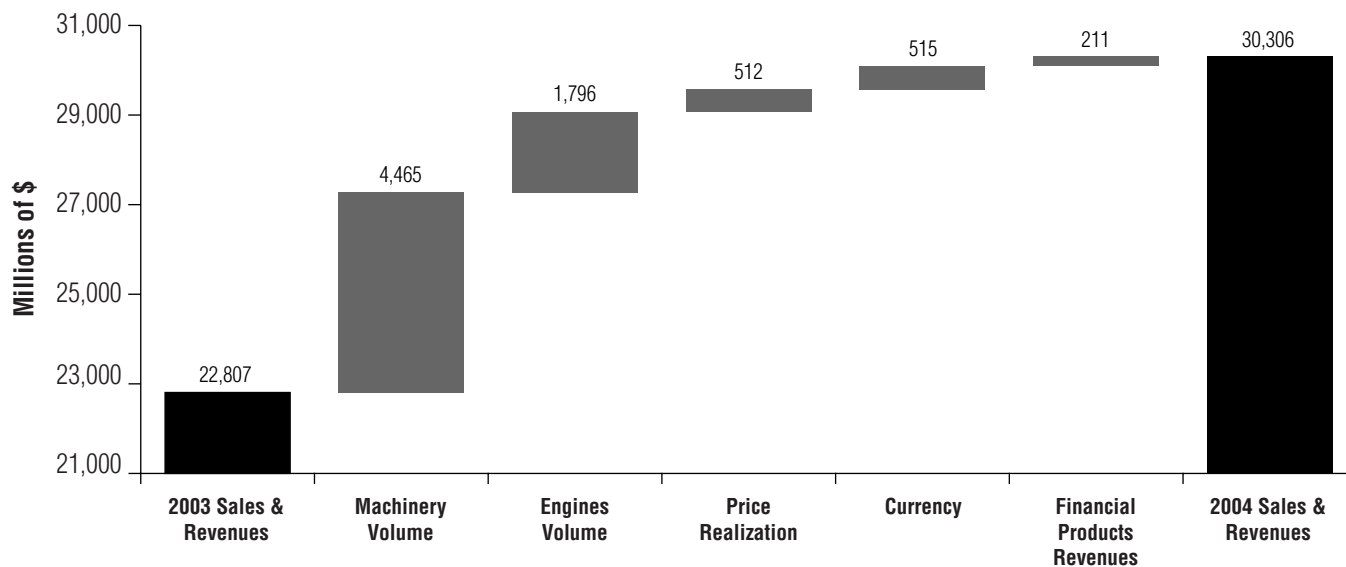
⁽¹⁾ Does not include internal engine transfers of \$1,745 million and \$1,358 million in 2004 and 2003, respectively. Internal engines transfers are valued at prices comparable to those for unrelated parties.

⁽²⁾ Does not include revenues earned from Machinery and Engines of \$199 million and \$194 million in 2004 and 2003, respectively.

SALES AND REVENUES

Consolidated Sales and Revenues Comparison

2004 vs. 2003



The chart above graphically illustrates reasons for the change in Consolidated Sales and Revenues between 2003 (at left) and 2004 (at right). Items favorably impacting sales and revenues appear as upward stair steps with the corresponding dollar amounts above each bar. Caterpillar management utilizes these charts internally to visually communicate with its Board and employees.

Sales and revenues for 2004 were \$30.31 billion, \$7.50 billion or 33 percent higher than 2003. The increase was due to higher Machinery and Engines volume of \$6.26 billion, the favorable impact of currency on sales of \$515 million due primarily to the strengthening euro and British pound, improved price realization of \$512 million and higher Financial Products revenues of \$211 million.

Machinery sales were \$18.84 billion in 2004, a \$5.17 billion or 38 percent increase over 2003. Sales volume, up 33 percent from 2003, accounted for most of the gain. Improved price realization added about 3 percent and the favorable impact of currency accounted for the remaining 2 percent. The volume increase was the result of a 28 percent increase in dealer deliveries to end users and an increase in dealer inventories to meet future demand. Dealers carried about the same months of sales in inventory at the end of 2004 as they did at the end of 2003.

In North America, 2004 sales were 41 percent higher than in 2003. Volume increased 37 percent. The rest of the gain resulted from improved price realization. Volume benefited from a 33 percent increase in dealer deliveries, with sizable gains occurring in most applications. Low interest rates, higher commodity prices and accelerated depreciation provisions all encouraged users to replace existing machines and increase fleet sizes. EAME sales rose 25 percent, with about 16 percent coming from more volume, about 7 percent due to the favorable impact of a stronger euro and the remainder due to improved price realization. Half the volume growth occurred in Europe, where low interest rates contributed to some recovery in construction. Volume increased in both Africa/Middle East (AME) and the CIS, largely due to higher metals and energy prices. Sales in Latin America increased 63 percent, the fastest growth of any region. Volume surged about 55 percent, improved price realization contributed about 7 percent with the remainder due to currency. Dealers delivered 56 percent more machines to end users and built inventories even faster to accommodate the steep recovery in activity. The Asia/Pacific region had a 35 percent increase in sales in 2004, primarily due to volume. Volume declined in China, but this was more than offset by large gains in Australia, Indonesia and India. Dealer deliveries into coal mining, benefiting from higher coal prices, increased sharply in all three countries.

Engines sales were \$9.49 billion, an increase of \$2.12 billion or 29 percent from 2003. Sales volume was up about 24 percent, the favorable impact of currency accounted for about 3 percent and the remainder was due to improved price realization.

Engine sales increased substantially in all regions. The North America engine sales gain of 30 percent was driven primarily by a 37 percent increase in sales of on-highway truck engines, as strong freight demand and improved industry financial health drove expansion and replacement. Sales of engines to the electric power sector increased 25 percent compared to 2003, benefiting

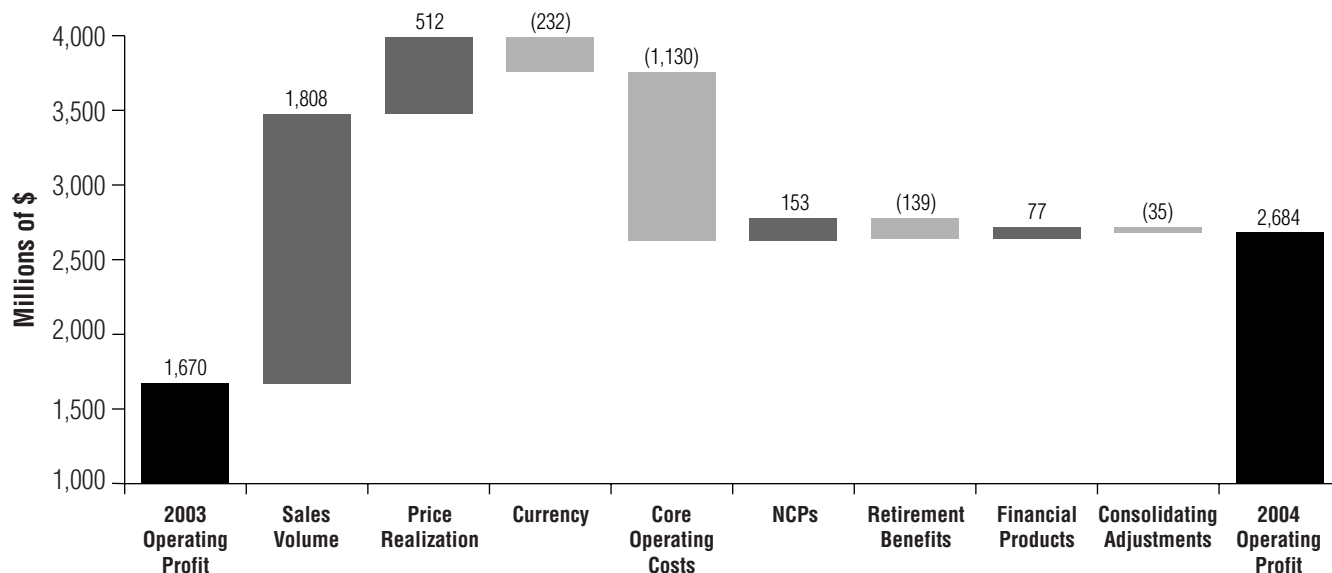
from increased demand for quality power, and growth in non-residential construction and business investment. Sales of engines to the industrial sector rose 62 percent, with strong widespread demand from industrial Original Equipment Manufacturer (OEM) products and growing preference for Caterpillar engines. Sales of marine engines increased 20 percent primarily from healthy demand for pleasure craft engines. Sales of petroleum engines remained about flat compared to 2003, as strong demand for reciprocating engines to maximize existing production was slightly more than offset by reduced investment in turbines and turbine related services for pipeline and major infrastructure expansion. Engine sales rose 27 percent in EAME with strong increases in all sectors. Sales of engines into the electric power sector increased 54 percent due to stronger demand for prime and cogeneration systems, Middle Eastern demand for large engines and power modules, and favorable currency versus euro-based competition. Sales of engines to the petroleum sector increased 29 percent, with the vast majority of the increase coming from sales of turbines and turbine-related services to support increases in petroleum investment. Sales of engines to the marine sector increased 27 percent due to increased investment in oceangoing and workboat vessels, driven by higher demand for inland waterway transportation and strengthening oceangoing vessel lease rates. Sales of engines into the industrial sector increased 10 percent. Engine sales in Latin America increased 9 percent with gains in most sectors from an improved business investment climate. Sales of petroleum engines in Latin America increased 16 percent with increased demand for turbines and turbine related services for pipeline applications. Sales of electric power engines in Latin America decreased 27 percent, primarily due to the absence of a large turbine electric power project that occurred during 2003. Widespread economic growth in Asia/Pacific contributed to the 45 percent increase in engine sales. Sales of engines into the electric power sector nearly doubled as strong growth drove increased demand for commercial standby and self-generation, as well as for generator sets to support ongoing demand from transmission shortages in China. Sales of petroleum engines increased 30 percent as growth in exploration and production drove strong demand for turbines and turbine related services. Sales of engines to the marine sector increased 48 percent due to increased demand for dredge equipment in support of construction growth, as well as broad increases in demand for offshore supply boats, pleasure craft and oceangoing vessels.

Financial Products revenues were \$1.97 billion, an increase of \$211 million or 12 percent from 2003. The increase was due primarily to a \$228 million favorable impact at Cat Financial from continued growth of Earning Assets, partially offset by a \$60 million impact of lower interest rates on new and existing finance receivables. Also, there was a \$19 million increase in earned premiums at Cat Insurance and a \$14 million increase in electric plant revenue at Cat Power Ventures.

OPERATING PROFIT

Consolidated Operating Profit Comparison

2004 vs. 2003



The chart above graphically illustrates reasons for the change in Consolidated Operating Profit between 2003 (at left) and 2004 (at right). Items favorably impacting operating profit appear as upward stair steps with the corresponding dollar amounts above each bar, while items negatively impacting operating profit appear as downward stair steps with dollar amounts reflected in parenthesis above each bar. Caterpillar management utilizes these charts internally to visually communicate with its Board and employees.

Higher sales volume in all regions resulted in a favorable operating profit impact of \$1.81 billion. Operating profit was also favorably impacted by improved price realization of \$512 million, the absence of \$153 million of *Non-Conformance Penalties (NCPs)* that were recorded in 2003 and improved profitability of Financial Products of \$77 million.

Partially offsetting the favorable items were \$1.13 billion in higher core operating costs, a \$232 million unfavorable impact of currency on operating profit due primarily to the weakening of the dollar compared with the British pound and the Japanese yen and \$139 million of higher retirement benefits.

Our main focus throughout 2004 was to satisfy unprecedented customer demand despite incurring additional core operating costs

to respond to the steep market upturn. The additional core operating costs reflect increases in manufacturing costs and higher general support costs to meet demand. These additional manufacturing costs included higher material costs resulting primarily from steel related and commodity price increases and higher freight and expediting costs to ensure timely delivery of material. The remainder of the core operating cost increase is largely attributable to higher SG&A expense to support growth and development programs, planned spending on product development, higher incentive compensation costs as well as increased warranty expense. These unfavorable items were partially offset by ongoing cost reductions resulting from hundreds of 6 Sigma projects.

Operating Profit by Principal Line of Business

| (Millions of dollars) | 2004 | 2003 | Change \$ | Change % |
|-------------------------------------|-----------------|-----------------|-----------------|-------------|
| Machinery ⁽¹⁾ | \$ 1,756 | \$ 1,199 | \$ 557 | 46% |
| Engines ⁽¹⁾ | 589 | 183 | 406 | 222% |
| Financial Products | 470 | 393 | 77 | 20% |
| Consolidating Adjustments | (131) | (105) | (26) | |
| Consolidated Operating Profit | <u>\$ 2,684</u> | <u>\$ 1,670</u> | <u>\$ 1,014</u> | 61% |

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

Machinery operating profit of \$1.76 billion was up \$557 million, or 46 percent, from 2003. The favorable impact of higher sales volume and improved price realization was partially offset by higher core operating costs (as outlined above), the unfavorable impact of currency and higher retirement benefits.

Engines operating profit of \$589 million was up \$406 million, or 222 percent, from 2003. The favorable impact of higher sales volume, the absence of NCPs and improved price realization were partially offset by higher core operating costs (as outlined above), higher retirement benefits and the unfavorable impact of currency.

Financial Products operating profit of \$470 million was up \$77 million, or 20 percent, from 2003. The increase was primarily due to a \$105 million impact from the growth of earning assets and a \$45 million increase in underwriting income (\$26 million due to favorable reserve adjustments resulting from better than anticipated claim experience; remainder due to growth) at Cat Insurance. These favorable items were partially offset by a \$39 million increase in operating expenses at Cat Financial primarily related to increased labor costs to support growth in earning assets and a \$34 million impact of lower interest spreads.

OTHER PROFIT/LOSS ITEMS

Interest expense excluding Financial Products was \$16 million lower compared to 2003 primarily due to lower average borrowing rates.

Other income/expense was income of \$253 million compared with income of \$53 million in 2003 for a favorable impact of \$200 million. The change was primarily due to the favorable impact of Machinery and Engines currency gains of \$75 million, the absence of a \$55 million bond retirement charge recorded in the third quarter 2003 and the absence of investment impairments at Cat Insurance of \$27 million.

The provision for income taxes for both 2003 and 2004 reflects an effective annual tax rate of 27 percent. A change in our geographic mix of profits was offset by the benefit related to the tax exempt federal subsidy provided by the Medicare Prescription Drug, Improvement and Modernization Act of 2003 in accordance with FASB Staff Position 106-2.

The equity in profit/loss of unconsolidated affiliated companies favorably impacted profit by \$39 million over 2003, primarily driven by increased profitability at Shin Caterpillar Mitsubishi Ltd. (SCM). The increase in profitability at SCM was driven largely by increased exports.

GLOSSARY OF TERMS

- Consolidating Adjustments** — Eliminations of transactions between Machinery and Engines and Financial Products.
- Core Operating Costs** — Machinery and Engines variable manufacturing cost change adjusted for volume and change in period costs. Excludes the impact of currency and retirement benefits for periods comparing 2005 to 2004 and 2004 to 2003. For periods comparing 2006 to 2005, excludes the impact of currency and stock-based compensation.
- 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 Financial Products revenues and operating profit are included in the Financial Products portions of the respective analyses. With respect to other income/expense, currency represents the effects of 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 for consolidated results.
- EAME** — Geographic region including Europe, Africa, the Middle East and the Commonwealth of Independent States (CIS).
- Earning Assets** — These assets consist primarily of total finance receivables net of unearned income, plus retained interests in securitized trade receivables, plus equipment on operating leases, less accumulated depreciation at Cat Financial.
- 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 21,500 horsepower (4 to over 16 000 kilowatts). Turbines range from 1,600 to 20,500 horsepower (1 200 to 15 000 kilowatts).
- 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.
- Latin America** — Geographic region including the Central and South American countries and Mexico.
- 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, telehandlers, skid steer loaders and related parts. Also includes logistics services for other companies.
- 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.
- Manufacturing Costs** — Manufacturing costs represent the volume-adjusted change for variable costs and the absolute dollar change for period manufacturing costs. Variable manufacturing costs are defined as having a direct relationship with the volume of production. This includes material costs, direct labor and other costs that vary directly with production volume such as freight, power to operate machines, and supplies that are consumed in the manufacturing process. Period manufacturing costs support production but are

defined as generally not having a direct relationship to short-term changes in volume. Examples include machine and equipment repair, depreciation on manufacturing assets, facility support, procurement, factory scheduling, manufacturing planning and operations management. Manufacturing costs exclude the impact of currency and retirement benefits for periods comparing 2005 to 2004 and 2004 to 2003. For periods comparing 2006 to 2005, excludes the impact of currency and stock-based compensation.

12. **Non-Conformance Penalties (NCP)** — Pursuant to a consent decree Caterpillar and other engine manufacturers entered into with the United States Environmental Protection Agency (EPA), the company was required to meet certain emission standards by October 2002 for engines manufactured for on-highway use. Under the consent decree, an engine manufacturer was required to pay a non-conformance penalty (NCP) to the EPA for each engine manufactured after October 1, 2002 that did not meet the standards. The amount of the NCP was based on how close to meeting the standards the engine came — the more the engine was out of compliance, the higher the penalty per engine.
13. **Period Costs** — Comprised of Machinery and Engines period manufacturing costs, SG&A expense, R&D expense and other operating costs. Excludes the impact of currency and retirement benefits for periods comparing 2005 to 2004. For periods comparing 2006 to 2005, excludes the impact of currency and stock-based compensation.
14. **Price Realization** — The impact of net price changes excluding currency. Includes the impact of changes in the relative weighting of sales between geographic regions.
15. **Retirement Benefits** — Cost of defined benefit pension plans, defined contribution plans and retirement health care and life insurance.
16. **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.
17. **Stock-Based Compensation** — As required by Statement of Financial Accounting Standard 123R, we will begin expensing stock-based compensation awards in 2006. We will adopt this new guidance using the modified perspective method. Compensation cost is based on the fair value of the award on the date of grant.
18. **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.

19. **2010 Goals** — The Company's 2010 goals are a part of its enterprise strategy to achieve its "Vision 2020", which was made public on October 31, 2005. The 2010 goals are grouped under the "3Ps" of people, performance, and profitable growth. The people goals include a highly engaged workforce and world-class safety. The performance goals are related to quality and market leadership and product and service parts availability. Profitable growth goals include the 2010 sales and revenues target and a goal for earnings per share growth.

LIQUIDITY AND CAPITAL RESOURCES

Sources of funds

We generate our capital resources primarily through operations and, in 2004, through collections of certificated retained interests in trade receivables. Collections of certificated retained interests took place when Machinery and Engines sold certain trade receivables to Cat Financial, who would place them into a securitization trust and then sell a portion to third party purchasers. For the receivables retained by the trust, Cat Financial would receive an interest in the trust assets (certificated retained interests). Subsequent collections of these retained interests were reflected as an investing activity in our Consolidated Statement of Cash Flow. From September 2004 through May 2005, the trust was consolidated, and in June 2005 the trust was terminated. We therefore did not have collections of certificated retained interests in trade receivables after August 2004.

In 2005, operating cash flow was \$3.11 billion. In 2004, operating cash flow was negative \$3.99 billion and collections of certificated retained interests in trade receivables were \$5.72 billion totaling positive \$1.73 billion. The increase in the total of these sources of funds from \$1.73 billion in 2004 to \$3.11 billion in 2005 is the result of higher profitability and lower working capital requirements in 2005. See further discussion under Machinery and Engines and Financial Products. 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 A-61.

Total debt as of December 31, 2005, was \$25.75 billion, an increase of \$2.22 billion from year-end 2004. Debt related to Machinery and Engines increased \$166 million, primarily to support the stock repurchase program and the payment of dividends. On September 13, 2005, \$116 million of 9.375 percent debentures due in 2021 and \$117 million of 8.00 percent debentures due in 2023 were exchanged for \$307 million of 5.30 percent debentures due in 2035 and \$23 million of cash. Additionally, capital lease obligations in the amount of \$565 million were paid in the fourth quarter of 2005 and a related security deposit of \$530 million was released and reclassified from Other assets to Cash and short-term investments in the Consolidated Statement of Financial Position. Debt related to Financial Products increased \$2.05 billion due to growth at Cat Financial.

We have three global credit facilities with a syndicate of banks totaling \$5.75 billion available in the aggregate to both Machinery and Engines and Financial Products to support commercial paper programs. A five-year facility of \$1.63 billion expires in 2010, a five-year facility of \$2.5 billion expires in 2009 and a 364-day facility of \$1.63 billion expires in September 2006. The facility expiring in

2006 has a provision that allows Caterpillar or Cat Financial to obtain a one-year loan that would mature in September 2007. Based on management's allocation decision, which can be revised at any time, the portion of the facility available to Cat Financial at December 31, 2005 was \$5.15 billion. As part of the 2005 global credit facilities renewal, Cat Financial's year-end leverage covenant has been increased to 8.5:1, from the previous level of 8:1, which aligns it with the 8.5:1 six-month moving average leverage covenant. At December 31, 2005, there were no borrowings under these lines and Cat Financial was in compliance with all debt covenants. Our total credit commitments as of December 31, 2005 were:

| | (Millions of dollars) | | |
|---|-----------------------|--------------------------|-----------------------|
| | Consolidated | Machinery and Engines | Financial Products |
| Credit lines available: | | | |
| Global credit facilities..... | \$5,750 | \$ 600 | \$5,150 |
| Other external | <u>2,177</u> | <u>911</u> | <u>1,266</u> |
| Total credit lines available..... | 7,927 | 1,511 | 6,416 |
| Less: Global credit facilities supporting commercial paper ... | 4,563 | 328 | 4,235 |
| Less: Utilized credit | <u>531</u> | <u>143</u> | <u>388</u> |
| Available credit..... | <u>\$2,833</u> | <u>\$1,040</u> | <u>\$1,793</u> |

To maintain an alternative funding source, Cat Financial periodically (generally once a year) securitizes retail (customer) installment sale contracts and finance leases. In this process, these finance receivables are sold into a public asset-backed securitization trust. The trusts, bankruptcy remote qualified special purpose entities (QSPEs) that are not consolidated in our financial statements, held total assets of \$980 million related to these securitizations at year-end 2005. We use QSPEs in a manner consistent with conventional practices in the securitization industry to isolate these finance receivables, which are secured by new and used equipment, for the benefit of securitization investors. Our sensitivity analysis indicated that the impact of a 20 percent adverse change to all individual assumptions used to calculate the fair value of all our retained interests at December 31, 2005 would be \$2 million or less.

The use of the QSPEs enables us to access the U.S. securitization market for the sale of these types of financial assets. The amounts of funding from securitizations reflect such factors as capital market accessibility, relative costs of funding sources, and assets available for securitization. We had total proceeds from initial sales of these receivables of \$850 million and \$659 million, and recognized a pre-tax gain of \$12 million and \$13 million for 2005 and 2004, respectively. Subordinated retained interests in the public securitizations totaled \$72 million and \$73 million at December 31, 2005 and 2004, respectively.

We do not generate material funding through structured finance transactions.

Machinery and Engines

Net cash provided by operating activities was \$2.81 billion compared with \$1.92 billion for the same period a year ago. The favorable change is due to higher profitability. In total, working capital requirements in 2005 were about the same as 2004.

Inventories increased throughout 2005 due to higher demand, but at a much lower rate than 2004. Accounts payable reflect

comparable purchase activity year over year; however, 2004 operating cash flow was favorably affected by a change in invoice payment terms that impacted most of our U.S. locations. Additionally, 2005 operating cash flow reflects a higher level of receivable sales to Cat Financial and pension contributions of \$912 million, \$235 million higher than 2004.

Pursuant to the share repurchase program authorized by the Board of Directors in October 2003, \$1.68 billion was spent to purchase 34 million shares in 2005. The goal of the share repurchase program, which expires in October 2008, is to reduce the company's outstanding shares to 640 million. There were 671 million shares outstanding at the end of 2005.

Capital expenditures, excluding equipment leased to others, during 2005 were \$1.16 billion, an increase of \$321 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 \$1.08 billion in 2005, compared with \$962 million for the same period a year ago. Cash used to purchase equipment leased to others was \$1.27 billion in 2005, an increase of \$79 million from the same period a year ago. In addition, net cash used for finance receivables and retained interests in securitized assets was \$3.08 billion in 2005, compared with \$3.15 billion in 2004.

Financial Products total borrowings were \$21.82 billion at December 31, 2005, an increase of \$2.05 billion 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 December 31, 2005, finance receivables past due over 30 days were 1.42 percent, compared with 1.55 percent at December 31, 2004. The allowance for credit losses was 1.35 percent of finance receivables, net of unearned income, at December 31, 2005, compared to 1.38 percent at December 31, 2004. Receivables written off due to uncollectibility, net of recoveries on receivables previously written off, were \$45 million and \$72 million for 2005 and 2004, respectively.

Dividends paid per common share⁽¹⁾

| Quarter | 2005 | 2004 | 2003 |
|--------------|----------------|----------------|----------------|
| First..... | \$.205 | \$.185 | \$.175 |
| Second..... | .205 | .185 | .175 |
| Third..... | .250 | .205 | .175 |
| Fourth | .250 | .205 | .185 |
| | <u>\$ 0.91</u> | <u>\$ 0.78</u> | <u>\$ 0.71</u> |

⁽¹⁾ Per share data reflects the July 2005 2-for-1 stock split.

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

Contractual obligations

The company has committed cash outflow related to long-term debt, operating lease agreements, purchase obligations and other contractual obligations. Minimum payments for these long-term obligations are:

| (Millions of dollars) | 2006 | 2007 | 2008 | 2009 | 2010 | After 2010 | Total |
|--|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| Long-term debt: | | | | | | | |
| Machinery and Engines..... | \$ 340 | \$ 88 | \$ 25 | \$ 550 | \$ 1 | \$ 1,987 | \$ 2,991 |
| Financial Products..... | 4,159 | 3,882 | 2,731 | 1,994 | 2,333 | 2,020 | 17,119 |
| Total long-term debt..... | 4,499 | 3,970 | 2,756 | 2,544 | 2,334 | 4,007 | 20,110 |
| Capital leases..... | — | 2 | 2 | 3 | 3 | 56 | 66 |
| Operating leases..... | 213 | 167 | 146 | 113 | 97 | 365 | 1,101 |
| Postretirement obligations ⁽¹⁾ | 570 | 860 | 1,770 | 410 | 405 | 2,400 | 6,415 |
| Purchase obligations: | | | | | | | |
| Accounts payable ⁽²⁾ | 3,471 | — | — | — | — | — | 3,471 |
| Purchase orders ⁽³⁾ | 4,896 | — | — | — | — | — | 4,896 |
| Other contractual obligations ⁽⁴⁾ | 162 | 122 | 116 | 112 | 110 | 268 | 890 |
| Total purchase obligations..... | 8,529 | 122 | 116 | 112 | 110 | 268 | 9,257 |
| Other long-term obligations ⁽⁵⁾ | 125 | 82 | 62 | 61 | 60 | 3 | 393 |
| Interest on long-term debt ⁽⁶⁾ | 779 | 614 | 495 | 380 | 294 | 4,358 | 6,920 |
| Total contractual obligations..... | <u>\$14,715</u> | <u>\$ 5,817</u> | <u>\$ 5,347</u> | <u>\$ 3,623</u> | <u>\$ 3,303</u> | <u>\$11,457</u> | <u>\$44,262</u> |

⁽¹⁾ Amounts represent expected contributions to our pension and other postretirement benefit plans through 2015, offset by expected Medicare Part D subsidy receipts.

⁽²⁾ Amount represents invoices received and recorded as liabilities in 2005, but scheduled for payment in 2006. These represent short-term obligations made in the ordinary course of business.

⁽³⁾ Amount represents contractual obligations for material and services on order at December 31, 2005 but not yet delivered. These represent short-term obligations made in the ordinary course of business.

⁽⁴⁾ Amounts represent long-term commitments entered into with key suppliers for minimum purchases quantities.

⁽⁵⁾ Amounts represent contractual obligations related to software license contracts, IT consulting contracts and outsourcing contracts for benefit plan administration and software system support.

⁽⁶⁾ Amounts represent estimated contractual interest payments on long-term debt.

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.

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 were 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. To validate the discount rate, a detailed analysis of the individual plans' expected cash flows is made annually. This involves analyzing Caterpillar's projected cash

flows against a high quality bond yield curve, calculated using a wide population of corporate Aa bonds. The modeled discount rate that results from matching the aggregate expected future cash flow from the Caterpillar benefit plans to the yield curve of high quality corporate bonds is consistent with the annualized Moody's Aa rate. 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 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 — Management's ongoing evaluation of the adequacy of the allowance for credit losses considers both impaired and unimpaired finance receivables and takes into consideration past loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of underlying collateral and current economic conditions. In estimating probable losses we review accounts that are past due, non-performing, in bankruptcy or otherwise identified as at risk for potential credit loss. Accounts are identified as at risk for potential credit loss using information available about the customer, such as financial statements, news reports, and published credit ratings as well as general information regarding industry trends and the general economic environment.

The allowance for credit losses attributable to specific accounts is based on the most probable source of repayment, which is normally the liquidation of collateral. In determining collateral value we estimate current fair market value of collateral and factor in credit enhancements such as additional collateral and third party guarantees. The allowance for credit losses attributable to the remaining accounts is a general allowance based upon the risk in the portfolio, primarily using probabilities of default and an estimate of associated losses. In addition qualitative factors not able to be fully captured in previous analysis including industry trends, macroeconomic factors and model imprecision are considered in the evaluation of the adequacy of the allowance for credit losses. These qualitative factors are subjective and require a degree of management judgment.

While management believes it has exercised prudent judgment and applied reasonable assumptions which have resulted in an allowance presented in accordance with generally accepted accounting principles, there can be no assurance that in the future, changes in economic conditions or other factors might cause changes in the financial health of our customers which could change the timing and level of payments received thus necessitate a change to our estimated losses.

Income tax reserve — Despite our belief that our tax return positions are consistent with applicable tax laws, 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 and penalties. Unfavorable adjustments to our tax filing position for issues included in our tax reserves would require use of our cash. Favorable resolution would be recognized as a reduction to income tax expense at the time of resolution.

EMPLOYMENT

Caterpillar's worldwide employment was 85,116 in 2005 compared with 76,920 in 2004. The increase was primarily due to about 4,200 hourly labor additions to support higher volume and the conversion of about 2,000 supplemental employees to full-time employment. In addition, about 2,000 salaried and management employees were added in 2005 to support higher volume, new product introductions and growth of our service businesses.

Full-Time Employees at Year End

| | 2005 | 2004 | 2003 |
|---------------------|---------------|---------------|---------------|
| Inside U.S. | 43,878 | 38,128 | 35,260 |
| Outside U.S. | 41,238 | 38,792 | 33,909 |
| Total..... | <u>85,116</u> | <u>76,920</u> | <u>69,169</u> |
| By Region: | | | |
| North America..... | 43,933 | 38,396 | 35,486 |
| EAME..... | 23,137 | 22,169 | 20,547 |
| Latin America | 11,688 | 10,733 | 8,533 |
| Asia/Pacific..... | 6,358 | 5,622 | 4,603 |
| Total | <u>85,116</u> | <u>76,920</u> | <u>69,169</u> |

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 addition to governing our manufacturing and other operations, these laws often impact the development of our products, including through required compliance with air emissions standards applicable to internal combustion engines. Compliance

with these existing laws has not had a material impact on our capital expenditures, earnings, or competitive position.

We are cleaning up contamination at a number of locations, often with other companies, pursuant to federal and state laws. When it is probable we will pay cleanup 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 or others.

The amount recorded for environmental cleanup is not material and is included in "Accrued expenses" in Statement 2.

We cannot estimate costs on sites in the very early stages of cleanup. Currently, we have several sites in the very early stages of cleanup, and there is no more than a remote chance that a material amount for cleanup at any individual site or at all sites in the aggregate will be required.

Pursuant to a consent decree Caterpillar entered with the United States Environmental Protection Agency (EPA), the company was required to meet certain emission standards by October 2002. The decree provides that if engine manufacturers were unable to meet the standards at that time, they would be required to pay a Non-Conformance Penalty (NCP) on each engine sold that did not meet the standard. The amount of the NCP would be based on how close to meeting the standard the engine came — the more out of compliance the higher the penalty. The company began introduction of fully compliant ACERT engines in 2003 and by the end of 2003 Caterpillar was only producing fully compliant engine models. As a result, NCPs were not payable for any engines built in 2004. NCPs of \$153 million were paid in 2003.

In addition, the consent decree required Caterpillar to pay a fine of \$25 million, which was expensed in 1998, and to make investments totaling \$35 million in environmental-related products by July 7, 2007. During the first quarter of 2005, Caterpillar made qualifying investments of \$3 million surpassing its investment requirement in environmental-related products with an accumulated investment of \$38 million. A future benefit is expected to be realized from these environmental projects related to Caterpillar's ability to capitalize on the technologies it developed in complying with its environmental project obligations. In short, Caterpillar expects to receive a positive net return on the environmental projects by being able to market the technology it developed.

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 of these unresolved actions 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, among other things, 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 December 31, 2005, the net past due receivable from Navistar regarding the foregoing and included in "Long-term receivables — trade and other" in Statement 2 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. As of December 31, 2005, the net past due receivables for the foregoing, included in "Long-term receivables — trade and other" in Statement 2 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 September 30, 2005, International Truck and Engine Corporation (International) commenced an action against Caterpillar in the Circuit Court of the Tenth Judicial Circuit of Illinois in Peoria, Illinois. The lawsuit states that it arises out of the May 31, 1988 Purchase Agreement described above. The Complaint alleges, among other things, that Caterpillar procured the May 31, 1988 Purchase Agreement by fraudulently misrepresenting or concealing information related to the business of selling fuel injectors to International, and that Caterpillar breached the Purchase Agreement. International's Complaint does not specify the amount of damages being sought. Caterpillar intends to defend itself vigorously in this case.

On May 7, 2002, 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 has filed a counterclaim seeking a declaration that the term sheet has 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 contained allegations similar to the allegations contained in the first lawsuit. International also alleged in the second lawsuit that Caterpillar materially breached the subsequent agreement. On June 15, 2005 International voluntarily dismissed its complaint in the first lawsuit. The second lawsuit has been consolidated with Caterpillar's counterclaims from the first lawsuit. Trial is currently scheduled to begin during the third quarter of 2006. This case is not 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, 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.

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 are vigorously disputing 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.

RETIREMENT BENEFITS

We recognized pension expense of \$366 million in 2005 as compared to \$274 million in 2004. The increase in expense was primarily a result of both the amortization of actuarial losses resulting largely 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 return on plan assets for computing current year pension expense. Differences between the actual and expected asset returns are also amortized into earnings as actuarial gains and losses. At the end of 2005, total unrecognized

actuarial losses were \$3.82 billion, as compared to \$3.28 billion in 2004. The majority of the unrecognized actuarial losses are due to declining discount rates in recent years. The \$538 million increase during 2005 was mainly the result of a lower discount rate and changes to certain demographic assumptions, slightly offset by better than expected asset returns.

In 2005, we recognized other postretirement benefit expense of \$347 million compared to \$256 million in 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 \$1.60 billion at the end of 2005. These losses mainly reflect a declining discount rate and an increase in expected health care inflation. The unrecognized losses were \$363 million higher than at the end of 2004 due to the unfavorable impact of an increase in expected health care inflation, a lower discount rate and changes to certain demographic assumptions, slightly offset by better than expected asset returns.

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, actual demographic experience 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 2005, the average remaining service period of active employees was 11 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 \$70 million in 2006 as compared to 2005, primarily because of a decrease in the discount rate.

For our U.S. pension plans, our current asset allocation is 72 percent equity securities and 28 percent debt securities, and our target allocation for 2006 is 70 percent equity securities and 30 percent debt securities. The current asset allocation for our non-U.S. pension plans is 63 percent equity securities, 30 percent debt securities, 5 percent real estate and 2 percent other. The target allocation for 2006 for our non-U.S. pension plans is 64 percent equity securities, 29 percent debt securities, 6 percent real estate and 1 percent other. Our target asset allocations reflect our investment strategy of maximizing the rate of return on plan assets and the resulting funded status, within an appropriate level of risk. The U.S. plans are rebalanced to plus or minus five percentage points of the target asset allocation ranges on a monthly basis. The frequency of rebalancing for the non-U.S. plans varies depending on the plan.

SFAS 87 requires the recognition of an Additional Minimum Liability if the market value of plan assets is less than the accumulated benefit obligation at the end of the measurement date. Based on these values, the company's Additional Minimum Liability was decreased in the fourth quarter 2005 by \$233 million, which offset the first quarter 2005 increase due to the plan changes from the new UAW labor agreement (see below). The net effect of these adjustments resulted in a decrease in Accumulated Other Comprehensive Income (a component of Shareholder's

Equity on the Consolidated Financial Position) of \$96 million after tax. The fourth quarter decrease differed from our third-quarter 2005 estimate primarily because of higher than expected fourth quarter cash contributions to one of our U.S. pension plans. This resulted in plan assets being greater than the accumulated benefit obligation and thus no additional minimum pension liability was required. Future changes to the Additional Minimum Liability will be dependent on several factors including our assumed discount rate, actual returns on our pension plan assets, company contributions and benefit plan changes. During 2005, we made cash contributions of \$543 million to our U.S. defined benefit pension plans and \$369 million to our non-U.S. pension plans.

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 percent. 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) increased \$29 million. In addition to the increase in pension expense, the plan changes increased the Additional Minimum Pension Liability by \$233 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 percent. 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) increased \$69 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 percent. The decrease will be amortized into earnings on a straight-line basis over nine 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 decreased \$18 million. After 2005, the annual expense (until the plan change is fully amortized) will decrease approximately \$24 million.

Although we have no ERISA funding requirements in 2006, we expect to make approximately \$10 million of contributions to our U.S. pension plans and \$30 million of contributions to our

non-U.S. pension plans during the year. We have adequate liquidity resources to fund both U.S. and non-U.S. pension plans. Also during 2006, in addition to our funding of ongoing cash benefit payments of approximately \$350 million, we expect to make an additional contribution of \$200 million to our other postretirement benefit plans.

Actuarial assumptions have a significant impact on both pension and other postretirement benefit expenses. The effects of a one percentage point change in our primary actuarial assumptions on 2005 benefit costs and year-end obligations are included in the table on page A-57.

SENSITIVITY

Foreign Exchange Rate Sensitivity

Machinery and Engines 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. Based on the anticipated and firmly committed cash inflow and outflow for our Machinery and Engines operations for the next 12 months and the foreign currency derivative instruments in place at year end, a hypothetical 10 percent weakening of the U.S. dollar relative to all other currencies would adversely affect our expected 2006 cash flow for our Machinery and Engines operations by approximately \$178 million. Last year similar assumptions and calculations yielded a potential \$200 million adverse impact on 2005 cash flow. We determine our net exposures by calculating the difference in cash inflow and outflow by currency and adding or subtracting outstanding foreign currency derivative instruments. We multiply these net amounts by 10 percent to determine the sensitivity.

Since our policy for Financial Products operations is to hedge the foreign exchange risk when the currency of our debt portfolio does not match the currency of our receivable portfolio, a 10 percent change in the value of the U.S. dollar relative to all other currencies would not have a material effect on our Consolidated Financial Position, results of operations or cash flow. Neither our policy nor the effect of a 10 percent change in the value of the U.S. dollar has changed from that reported at the end of last year.

The effect of the hypothetical change in exchange rates ignores the effect this movement may have on other variables, including competitive risk. If it were possible to quantify this competitive impact, the results would probably be different from the sensitivity effects shown above. In addition, it is unlikely that all currencies would uniformly strengthen or weaken relative to the U.S. dollar. In reality, some currencies may weaken while others may strengthen. Our primary exposure (excluding competitive risk) is to exchange rate movements in the British pound and Japanese yen.

Interest Rate Sensitivity

For our Machinery and Engines operations, we have the option to use interest rate swaps to lower the cost of borrowed funds by attaching fixed-to-floating interest rate swaps to fixed-rate debt. A hypothetical 100 basis point adverse move (increase) in interest rates along the entire interest rate yield curve would adversely affect 2006 pretax earnings of Machinery and Engines by

Postretirement Benefit Plan Actuarial Assumptions Sensitivity

Following are the effects of a one percentage-point change in our primary pension and other postretirement benefit actuarial assumptions (included in the following table) on 2005 pension and other postretirement benefits costs and obligations:

| (Millions of dollars) | 2005 Benefit Cost | | Year-end Benefit Obligation | |
|---|-------------------------------|-------------------------------|-------------------------------|-------------------------------|
| | One percentage-point increase | One percentage-point decrease | One percentage-point increase | One percentage-point decrease |
| Pension benefits: | | | | |
| Assumed discount rate..... | \$ (120) | \$ 126 | \$(1,465) | \$1,661 |
| Expected rate of compensation increase | 56 | (51) | 213 | (207) |
| Expected long-term rate of return on plan assets | (95) | 95 | — | — |
| Other postretirement benefits: | | | | |
| Assumed discount rate..... | (31) | 62 | (573) | 637 |
| Expected rate of compensation increase | 1 | (1) | 3 | (3) |
| Expected long-term rate of return on plan assets | (8) | 8 | — | — |
| Assumed health care cost trend rate | 77 | (52) | 418 | (364) |

Primary Actuarial Assumptions

| | U.S. Pension Benefits | | | Non-U.S. Pension Benefits | | | Other Postretirement Benefits | | |
|---|-----------------------|------|------|---------------------------|------|------|-------------------------------|------|------|
| | 2005 | 2004 | 2003 | 2005 | 2004 | 2003 | 2005 | 2004 | 2003 |
| Weighted-average assumptions used to determine benefit obligations, end of year: | | | | | | | | | |
| Discount rate | 5.6% | 5.9% | 6.2% | 4.6% | 5.2% | 5.1% | 5.6% | 5.9% | 6.1% |
| Rate of compensation increase | 4.0% | 4.0% | 4.0% | 3.7% | 3.5% | 3.2% | 4.0% | 4.0% | 4.0% |
| Weighted-average assumptions used to determine net cost: | | | | | | | | | |
| Discount rate..... | 5.9% | 6.2% | 7.0% | 5.2% | 5.1% | 5.4% | 5.8% | 6.1% | 7.0% |
| Expected return on plan assets | 9.0% | 9.0% | 9.0% | 7.1% | 7.4% | 7.1% | 9.0% | 9.0% | 9.0% |
| Rate of compensation increase | 4.0% | 4.0% | 4.0% | 3.5% | 3.2% | 3.3% | 4.0% | 4.0% | 4.0% |
| Health care cost trend rates at year end: | | | | | | | | | |
| Health care trend rate assumed for next year..... | | | | | | | 8.5% | 8.4% | 8.5% |
| Rate that the cost trend rate gradually declines to | | | | | | | 5.0% | 5.0% | 4.5% |
| Year that the cost trend rate reaches ultimate rate | | | | | | | 2013 | 2012 | 2009 |

\$15 million. Last year, similar assumptions and calculations yielded a potential \$5 million adverse impact on 2005 pretax earnings. This effect is caused by the interest rate fluctuations on our short-term debt.

For our Financial Products operations, we use interest rate derivative instruments primarily to meet our match funding objectives and strategies. We have a match funding policy whereby the interest rate profile (fixed or floating rate) of our debt portfolio is matched to the interest rate profile of our earning asset portfolio (finance receivables and operating leases) within certain parameters. In connection with that policy, we use interest rate swap agreements to modify the debt structure. Match funding assists us in maintaining our interest rate spreads, regardless of the direction interest rates move.

In order to properly manage our sensitivity to changes in interest rates, we measure the potential impact of different interest rate assumptions on pretax earnings. All on-balance sheet positions, including derivative financial instruments, are included in

the analysis. The primary assumptions included in the analysis are that there are no new fixed rate assets or liabilities, the proportion of fixed rate debt to fixed rate assets remains unchanged and the level of floating rate assets and debt remain constant. Based on the December 31, 2005 balance sheet under these assumptions, the analysis estimates the impact of a 100 basis point immediate and sustained parallel rise in interest rates to be a \$9 million decrease to pretax earnings for 2006. In 2005, changes were made to specific assumptions related to certain short-term assets and liabilities and the treatment of equity that we feel provide a more realistic estimate of the impact of changes in interest rates. Based on these revised assumptions, the estimated impact for 2005 was a \$20 million decrease in pretax earnings versus the \$13 million decrease in 2005 pretax earnings reported in 2004.

This analysis does not necessarily represent our current outlook of future market interest rate movement, nor does it consider any actions management could undertake in response to changes in interest rates. Accordingly, no assurance can be given that actual results would be consistent with the results of our estimate.

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 A-58 to A-60 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 parts

distribution operations. 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 A-58 to A-60 reconcile Machinery and Engines with Financial Products on the Equity Basis to Caterpillar Inc. Consolidated financial information.

**Supplemental Data for Results of Operations
For The Years Ended December 31**

(Millions of dollars)

| | Supplemental consolidating data | | | | | | | | | | | |
|---|---------------------------------|-----------|-----------|--------------------------------------|-----------|-----------|--------------------|--------|--------|---------------------------|----------------------|----------------------|
| | Consolidated | | | Machinery and Engines ⁽¹⁾ | | | Financial Products | | | Consolidating Adjustments | | |
| | 2005 | 2004 | 2003 | 2005 | 2004 | 2003 | 2005 | 2004 | 2003 | 2005 | 2004 | 2003 |
| Sales and revenues: | | | | | | | | | | | | |
| Sales of Machinery and Engines..... | \$ 34,006 | \$ 28,336 | \$ 21,048 | \$ 34,006 | \$ 28,336 | \$ 21,048 | \$ — | \$ — | \$ — | \$ — | \$ — | \$ — |
| Revenues of Financial Products..... | 2,333 | 1,970 | 1,759 | — | — | — | 2,650 | 2,169 | 1,953 | (317) ⁽²⁾ | (199) ⁽²⁾ | (194) ⁽²⁾ |
| Total sales and revenues..... | 36,339 | 30,306 | 22,807 | 34,006 | 28,336 | 21,048 | 2,650 | 2,169 | 1,953 | (317) | (199) | (194) |
| Operating costs: | | | | | | | | | | | | |
| Cost of goods sold..... | 26,558 | 22,497 | 16,997 | 26,558 | 22,497 | 16,997 | — | — | — | — | — | — |
| Selling, general and administrative expenses..... | 3,190 | 2,926 | 2,322 | 2,786 | 2,548 | 2,009 | 446 | 441 | 382 | (42) ⁽³⁾ | (63) ⁽³⁾ | (69) ⁽³⁾ |
| Research and development expenses..... | 1,084 | 928 | 669 | 1,084 | 928 | 669 | — | — | — | — | — | — |
| Interest expense of Financial Products..... | 768 | 524 | 474 | — | — | — | 786 | 536 | 486 | (18) ⁽⁴⁾ | (12) ⁽⁴⁾ | (12) ⁽⁴⁾ |
| Other operating expenses..... | 955 | 747 | 675 | 76 | 18 | (9) | 887 | 722 | 692 | (8) ⁽³⁾ | 7 ⁽³⁾ | (8) ⁽³⁾ |
| Total operating costs..... | 32,555 | 27,622 | 21,137 | 30,504 | 25,991 | 19,666 | 2,119 | 1,699 | 1,560 | (68) | (68) | (89) |
| Operating profit | 3,784 | 2,684 | 1,670 | 3,502 | 2,345 | 1,382 | 531 | 470 | 393 | (249) | (131) | (105) |
| Interest expense excluding Financial Products..... | 260 | 230 | 246 | 266 | 235 | 259 | — | — | — | (6) ⁽⁴⁾ | (5) ⁽⁴⁾ | (13) ⁽⁴⁾ |
| Other income (expense)..... | 377 | 253 | 53 | 85 | 92 | (17) | 49 | 35 | (22) | 243 ⁽⁵⁾ | 126 ⁽⁵⁾ | 92 ⁽⁵⁾ |
| Consolidated profit before taxes | 3,901 | 2,707 | 1,477 | 3,321 | 2,202 | 1,106 | 580 | 505 | 371 | — | — | — |
| Provision for income taxes..... | 1,120 | 731 | 398 | 926 | 566 | 286 | 194 | 165 | 112 | — | — | — |
| Profit of consolidated companies..... | 2,781 | 1,976 | 1,079 | 2,395 | 1,636 | 820 | 386 | 340 | 259 | — | — | — |
| Equity in profit (loss) of unconsolidated affiliated companies..... | 73 | 59 | 20 | 64 | 56 | 16 | 9 | 3 | 4 | — | — | — |
| Equity in profit of Financial Products' subsidiaries..... | — | — | — | 395 | 343 | 263 | — | — | — | (395) ⁽⁶⁾ | (343) ⁽⁶⁾ | (263) ⁽⁶⁾ |
| Profit | \$ 2,854 | \$ 2,035 | \$ 1,099 | \$ 2,854 | \$ 2,035 | \$ 1,099 | \$ 395 | \$ 343 | \$ 263 | \$ (395) | \$ (343) | \$ (263) |

⁽¹⁾ Represents Caterpillar Inc. and its subsidiaries with Financial Products accounted for on the equity basis.

⁽²⁾ Elimination of Financial Products revenues earned from Machinery and Engines.

⁽³⁾ Elimination of net expenses recorded by Machinery and Engines paid to Financial Products.

⁽⁴⁾ Elimination of interest expense recorded between Financial Products and Machinery and Engines.

⁽⁵⁾ 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.

⁽⁶⁾ Elimination of Financial Products profit due to equity method of accounting.

**Supplemental Data for Financial Position
At December 31**

(Millions of dollars)

| | Supplemental consolidating data | | | | | | | |
|--|---------------------------------|------------------|--------------------------------------|------------------|--------------------|------------------|---------------------------|-------------------------|
| | Consolidated | | Machinery and Engines ⁽¹⁾ | | Financial Products | | Consolidating Adjustments | |
| | 2005 | 2004 | 2005 | 2004 | 2005 | 2004 | 2005 | 2004 |
| Assets | | | | | | | | |
| Current assets: | | | | | | | | |
| Cash and short-term investments | \$ 1,108 | \$ 445 | \$ 951 | \$ 270 | \$ 157 | \$ 175 | \$ — | \$ — |
| Receivables — trade and other | 7,526 | 7,463 | 2,833 | 3,276 | 419 | 465 | 4,274 ⁽²⁾⁽³⁾ | 3,722 ⁽²⁾⁽³⁾ |
| Receivables — finance | 6,442 | 5,182 | — | — | 11,058 | 9,325 | (4,616) ⁽³⁾ | (4,143) ⁽³⁾ |
| Deferred and refundable income taxes | 344 | 398 | 276 | 333 | 68 | 65 | — | — |
| Prepaid expenses | 2,146 | 1,369 | 2,139 | 1,367 | 26 | 16 | (19) ⁽⁴⁾ | (14) ⁽⁴⁾ |
| Inventories | 5,224 | 4,675 | 5,224 | 4,675 | — | — | — | — |
| Total current assets | 22,790 | 19,532 | 11,423 | 9,921 | 11,728 | 10,046 | (361) | (435) |
| Property, plant and equipment — net | 7,988 | 7,682 | 5,067 | 4,820 | 2,921 | 2,862 | — | — |
| Long-term receivables — trade and other | 1,037 | 764 | 301 | 255 | 36 | 37 | 700 ⁽²⁾⁽³⁾ | 472 ⁽²⁾⁽³⁾ |
| Long-term receivables — finance | 10,301 | 9,903 | — | — | 11,036 | 10,410 | (735) ⁽³⁾ | (507) ⁽³⁾ |
| Investments in unconsolidated affiliated companies | 565 | 517 | 526 | 479 | 39 | 39 | — | (1) ⁽⁵⁾ |
| Investments in Financial Products subsidiaries | — | — | 3,253 | 3,012 | — | — | (3,253) ⁽⁶⁾ | (3,012) ⁽⁶⁾ |
| Deferred income taxes | 768 | 674 | 1,057 | 950 | 32 | 27 | (321) ⁽⁷⁾ | (303) ⁽⁷⁾ |
| Intangible assets | 424 | 315 | 418 | 307 | 6 | 8 | — | — |
| Goodwill | 1,451 | 1,450 | 1,451 | 1,450 | — | — | — | — |
| Other assets | 1,745 | 2,258 | 491 | 1,075 | 1,254 | 1,183 | — | — |
| Total assets | \$ 47,069 | \$ 43,095 | \$ 23,987 | \$ 22,269 | \$ 27,052 | \$ 24,612 | \$ (3,970) | \$ (3,786) |
| Liabilities | | | | | | | | |
| Current liabilities: | | | | | | | | |
| Short-term borrowings | \$ 5,569 | \$ 4,157 | \$ 871 | \$ 93 | \$ 4,897 | \$ 4,396 | \$ (199) ⁽⁸⁾ | \$ (332) ⁽⁸⁾ |
| Accounts payable | 3,471 | 3,580 | 3,347 | 3,459 | 261 | 205 | (137) ⁽⁹⁾ | (84) ⁽⁹⁾ |
| Accrued expenses | 2,617 | 2,261 | 1,605 | 1,426 | 1,038 | 855 | (26) ⁽¹⁰⁾ | (20) ⁽¹⁰⁾ |
| Accrued wages, salaries and employee benefits | 1,845 | 1,730 | 1,826 | 1,716 | 19 | 14 | — | — |
| Customer advances | 395 | 447 | 395 | 447 | — | — | — | — |
| Dividends payable | 168 | 141 | 168 | 141 | — | — | — | — |
| Deferred and current income taxes payable | 528 | 259 | 448 | 212 | 84 | 47 | (4) ⁽⁷⁾ | — |
| Long-term debt due within one year | 4,499 | 3,531 | 340 | 6 | 4,159 | 3,525 | — | — |
| Total current liabilities | 19,092 | 16,106 | 9,000 | 7,500 | 10,458 | 9,042 | (366) | (436) |
| Long-term debt due after one year | 15,677 | 15,837 | 2,752 | 3,697 | 12,960 | 12,175 | (35) ⁽⁸⁾ | (35) ⁽⁸⁾ |
| Liability for postemployment benefits | 2,991 | 2,986 | 2,991 | 2,986 | — | — | — | — |
| Deferred income taxes and other liabilities | 877 | 699 | 812 | 619 | 381 | 383 | (316) ⁽⁷⁾ | (303) ⁽⁷⁾ |
| Total liabilities | 38,637 | 35,628 | 15,555 | 14,802 | 23,799 | 21,600 | (717) | (774) |
| Stockholders' equity | | | | | | | | |
| Common stock | 1,859 | 1,231 | 1,859 | 1,231 | 875 | 888 | (875) ⁽⁶⁾ | (888) ⁽⁶⁾ |
| Treasury stock | (4,637) | (3,277) | (4,637) | (3,277) | — | — | — | — |
| Profit employed in the business | 11,808 | 9,937 | 11,808 | 9,937 | 2,197 | 1,824 | (2,197) ⁽⁶⁾ | (1,824) ⁽⁶⁾ |
| Accumulated other comprehensive income | (598) | (424) | (598) | (424) | 181 | 300 | (181) ⁽⁶⁾ | (300) ⁽⁶⁾ |
| Total stockholders' equity | 8,432 | 7,467 | 8,432 | 7,467 | 3,253 | 3,012 | (3,253) | (3,012) |
| Total liabilities and stockholders' equity | \$ 47,069 | \$ 43,095 | \$ 23,987 | \$ 22,269 | \$ 27,052 | \$ 24,612 | \$ (3,970) | \$ (3,786) |

⁽¹⁾ Represents Caterpillar Inc. and its subsidiaries with Financial Products accounted for on the equity basis.⁽²⁾ Elimination of receivables between Machinery and Engines and Financial Products.⁽³⁾ Reclassification of Machinery and Engines trade receivables purchased by Cat Financial and Cat Financial's wholesale inventory receivables.⁽⁴⁾ Elimination of Machinery and Engines insurance premiums that are prepaid to Financial Products.⁽⁵⁾ Elimination of Machinery and Engines investment in Financial Products subsidiary.⁽⁶⁾ Elimination of Financial Products equity which is accounted for on Machinery and Engines on the equity basis.⁽⁷⁾ Reclassification reflecting required netting of deferred tax assets/liabilities by taxing jurisdiction.⁽⁸⁾ Elimination of debt between Machinery and Engines and Financial Products.⁽⁹⁾ Elimination of payables between Machinery and Engines and Financial Products.⁽¹⁰⁾ Elimination of prepaid insurance in Financial Products' accrued expenses.

MANAGEMENT'S DISCUSSION AND ANALYSIS *continued*
**Supplemental Data for Statement of Cash Flow
For The Years Ended December 31**

(Millions of dollars)

| | Supplemental consolidating data | | | | | | | |
|---|---------------------------------|----------------|---|----------------|--------------------|----------------|------------------------------|---------------------------|
| | Consolidated | | Machinery and Engines ⁽¹⁾ | | Financial Products | | Consolidating Adjustments | |
| | 2005 | 2004 | 2005 | 2004 | 2005 | 2004 | 2005 | 2004 |
| Cash flow from operating activities: | | | | | | | | |
| Profit | \$ 2,854 | \$ 2,035 | \$ 2,854 | \$ 2,035 | \$ 395 | \$ 343 | \$ (395) ⁽²⁾ | \$ (343) ⁽²⁾ |
| Adjustments for non-cash items: | | | | | | | | |
| Depreciation and amortization | 1,477 | 1,397 | 835 | 795 | 642 | 602 | — | — |
| Undistributed profit of Financial Products | — | — | (373) | (328) | — | — | 373 ⁽³⁾ | 328 ⁽³⁾ |
| Other | (20) | (113) | 7 | (111) | (205) | (145) | 178 ⁽⁴⁾ | 143 ⁽⁴⁾ |
| Changes in assets and liabilities: | | | | | | | | |
| Receivables — trade and other | (908) | (7,616) | (39) | (531) | 7 | 43 | (876) ⁽⁴⁾⁽⁵⁾ | (7,128) ⁽⁴⁾⁽⁵⁾ |
| Inventories | (568) | (1,391) | (568) | (1,391) | — | — | — | — |
| Accounts payable and accrued expenses | 532 | 1,457 | 353 | 1,325 | 238 | 11 | (59) ⁽⁴⁾ | 121 ⁽⁴⁾ |
| Other assets — net | (866) | 337 | (854) | 240 | (34) | 7 | 22 ⁽⁴⁾ | 90 ⁽⁴⁾ |
| Other liabilities — net | 612 | (97) | 595 | (116) | 34 | 101 | (17) ⁽⁴⁾ | (82) ⁽⁴⁾ |
| Net cash provided by (used for) operating activities | <u>3,113</u> | <u>(3,991)</u> | <u>2,810</u> | <u>1,918</u> | <u>1,077</u> | <u>962</u> | <u>(774)</u> | <u>(6,871)</u> |
| Cash flow from investing activities: | | | | | | | | |
| Capital expenditures — excluding equipment leased to others | (1,201) | (926) | (1,162) | (841) | (39) | (85) | — | — |
| Expenditures for equipment leased to others | (1,214) | (1,188) | — | (2) | (1,265) | (1,186) | 51 ⁽⁴⁾ | — |
| Proceeds from disposals of property, plant and equipment | 637 | 486 | 45 | 27 | 592 | 459 | — | — |
| Additions to finance receivables | (10,334) | (8,930) | — | — | (33,961) | (20,515) | 23,627 ⁽⁵⁾ | 11,585 ⁽⁵⁾ |
| Collections of finance receivables | 7,057 | 6,216 | — | — | 29,449 | 16,963 | (22,392) ⁽⁵⁾ | (10,747) ⁽⁵⁾ |
| Proceeds from sale of finance receivables | 900 | 700 | — | — | 1,430 | 1,363 | (530) ⁽⁵⁾ | (663) ⁽⁵⁾ |
| Additions to retained interests in securitized trade receivables | — | — | — | — | — | (6,686) | — | 6,686 ⁽⁶⁾ |
| Collections of retained interests in securitized trade receivables | — | 5,722 | — | — | — | 5,722 | — | — |
| Net intercompany borrowings | — | — | 111 | 159 | — | 209 | (111) ⁽⁷⁾ | (368) ⁽⁷⁾ |
| Investments and acquisitions (net of cash acquired) | (13) | (290) | (13) | (295) | — | — | — | 5 ⁽⁴⁾ |
| Proceeds from sale of partnership investment | — | 290 | — | — | — | 290 | — | — |
| Proceeds from release of security deposit | 530 | — | 530 | — | — | — | — | — |
| Proceeds from sale of available-for-sale securities | 257 | 408 | 15 | 13 | 242 | 395 | — | — |
| Investments in available-for-sale securities | (338) | (609) | (20) | (107) | (318) | (502) | — | — |
| Other — net | 194 | 198 | 10 | 12 | 197 | 192 | (13) ⁽⁸⁾ | (6) ⁽⁸⁾ |
| Net cash provided by (used for) investing activities | <u>(3,525)</u> | <u>2,077</u> | <u>(484)</u> | <u>(1,034)</u> | <u>(3,673)</u> | <u>(3,381)</u> | <u>632</u> | <u>6,492</u> |
| Cash flow from financing activities: | | | | | | | | |
| Dividends paid | (618) | (534) | (618) | (534) | (22) | (15) | 22 ⁽⁹⁾ | 15 ⁽⁹⁾ |
| Common stock issued, including treasury shares reissued | 482 | 317 | 482 | 317 | (14) | (2) | 14 ⁽⁸⁾ | 2 ⁽⁸⁾ |
| Treasury shares purchased | (1,684) | (539) | (1,684) | (539) | — | — | — | — |
| Net intercompany borrowings | — | — | — | (209) | (111) | (159) | 111 ⁽⁷⁾ | 368 ⁽⁷⁾ |
| Proceeds from debt issued (original maturities greater than three months) | 14,574 | 10,490 | 574 | 55 | 14,000 | 10,435 | — | — |
| Payments on debt (original maturities greater than three months) | (11,620) | (8,690) | (654) | (78) | (10,966) | (8,612) | — | — |
| Short-term borrowings (original maturities three months or less) — net | 19 | 830 | 317 | 18 | (298) | 812 | — | — |
| Net cash provided by (used for) financing activities | <u>1,153</u> | <u>1,874</u> | <u>(1,583)</u> | <u>(970)</u> | <u>2,589</u> | <u>2,459</u> | <u>147</u> | <u>385</u> |
| Effect of exchange rate changes on cash | (78) | 143 | (62) | 136 | (11) | 13 | (5) ⁽¹⁰⁾ | (6) ⁽¹⁰⁾ |
| Increase (decrease) in cash and short-term investments | 663 | 103 | 681 | 50 | (18) | 53 | — | — |
| Cash and short-term investments at beginning of period | 445 | 342 | 270 | 220 | 175 | 122 | — | — |
| Cash and short-term investments at end of period | <u>\$ 1,108</u> | <u>\$ 445</u> | <u>\$ 951</u> | <u>\$ 270</u> | <u>\$ 157</u> | <u>\$ 175</u> | <u>\$ —</u> | <u>\$ —</u> |

⁽¹⁾ Represents Caterpillar Inc. and its subsidiaries with Financial Products accounted for on the equity basis.

⁽²⁾ Elimination of Financial Products profit after tax due to equity method of accounting.

⁽³⁾ Non-cash adjustment for the undistributed earnings from Financial Products.

⁽⁴⁾ Elimination of non-cash adjustments and changes in assets and liabilities related to consolidated reporting. 2004 receivables amounts include adjustment for consolidated non-cash receipt of retained interests in securitized trade receivables. See Notes 2 and 6 on pages A-12 and A-16, respectively, for further discussion.

⁽⁵⁾ Reclassification of Cat Financial's cash flow activity from investing to operating for receivables that arose from the sale of inventory.

⁽⁶⁾ Elimination of Cat Financial's additions to retained interests in securitized trade receivables that arose from an intercompany purchase of receivables.

⁽⁷⁾ Net proceeds and payments to/from Machinery and Engines and Financial Products.

⁽⁸⁾ Change in investment and common stock related to Financial Products.

⁽⁹⁾ Elimination of dividend from Financial Products to Machinery and Engines.

⁽¹⁰⁾ Elimination of the effect of exchange on intercompany balances.

OUTLOOK

SALES AND REVENUES OUTLOOK

Sales and revenues are expected to increase about 10 percent in 2006, which would set a new record of about \$40 billion. Of the 10 percent increase, about 7 percent is from higher Machinery and Engines volume and Financial Products revenues and about 3 percent from improved price realization.

Inflation remains low in most countries, which should encourage central banks to continue to be cautious in raising interest rates. We expect short-term and long-term interest rates in most countries will remain attractive for business investment.

Relatively low inflation and a low interest rate environment should support continued growth in the world economy. We forecast worldwide economic growth of around 3.5 percent in 2006, about the same as in 2005. Somewhat faster growth in Europe and Japan should offset slower growth in the United States. Relatively high commodity prices have contributed to strong growth in developing countries over the past three years, and we expect that trend to continue in 2006.

Worldwide consumption of most base metals exceeded production in 2005, driving inventories relative to consumption to the lowest level in many years. As a result, metals prices reached new highs in early 2006, resulting in the longest price upturn since the late 1970s. With mine production difficulties continuing, we expect metals prices will remain very favorable for new investments this year.

Energy industries should provide attractive sales opportunities for machines, reciprocating engines and gas turbines in 2006. The world has little surplus production capacity, and we expect both oil and gas prices to trade at or above 2005 averages. Those price levels should encourage further growth in exploration, drilling and pipeline expenditures.

Construction spending, as well as investments in standby electric power, should increase further in 2006 to support growing economies. Investments in nonresidential structures should benefit from low long-term interest rates, good corporate profits and higher office rental rates. We expect governments in the commodity-exporting countries will use earnings from high prices to further increase infrastructure spending.

Existing orders for oceangoing vessels should have shipyards producing near capacity in 2006. Deliveries of feeder container ships, port service vessels and oil and gas offshore supply vessels should increase in 2006.

North America (United States and Canada)

Machinery and Engines sales are expected to increase about 12 percent in 2006.

We believe the U.S. Federal Reserve will not raise interest rates significantly in 2006, suggesting a peak Federal Funds rate of less than 5 percent this year. Economic growth slowed in 2005, and we project a further slowing to a little over 3 percent in 2006. Some consumer-related industries likely will continue to struggle due to modest growth in personal incomes and rising imports. But factors supporting business investment — low interest rates and high corporate profits — should continue.

U.S. housing starts exceeded 2 million units in 2005, the best year since 1972. Although opinions on housing are overwhelmingly negative, a collapse in activity seems unlikely. Mortgage rates, while up some from 2005 lows, are well below those rates that prevailed in the last housing cycle. Most of the other factors that recently benefited housing construction — rising home prices, household formations, demand for second homes and a shift away from mobile homes — remained in place at the start of 2006. We expect housing starts in 2006 to be moderately below 2005 levels.

Commercial and industrial lending and architectural billings — past leading indicators of nonresidential construction — have increased. With corporate profits near a record share of national income, we expect businesses to increase investments in structures at least 5 percent in 2006, roughly matching the recovery pattern of the upturn in the 1990s.

We expect highway contracting to increase about 7 percent in 2006 as a result of increased federal funding and further improvement in state and local government budgets.

Coal production declined slightly in 2005, driving coal stocks in months of consumption to a record low. Continued high coal prices, resolution of some transportation bottlenecks and a rebuilding of coal stocks should drive a 4 percent increase in coal production in 2006.

Natural gas production has not fully recovered from the impact of Hurricane Katrina, and prices in early January were up more than 30 percent from a year earlier. Those high prices should encourage further investment in exploration and development, which should boost engine sales.

North American production of large on-highway trucks should be near capacity in 2006 and about even with 2005 levels. Positives include strong freight movements, high trucking company profits and accelerated ordering in advance of stricter 2007 emission standards.

The Bank of Canada raised interest rates three times in 2005, but inflation is below the middle of the central bank's target range. We expect interest rates, which are below those in the United States, to remain low enough to allow slightly better economic growth in 2006. Mining, energy and nonresidential construction should do well.

EAME

Machinery and Engines sales are expected to increase about 5 percent in 2006.

Economic indicators suggest economic growth improved in the last half of 2005 in several Eurozone economies, due largely to a recovery in manufacturing. Leading indicators and business surveys indicate this positive momentum is continuing into 2006.

The European Central Bank's (ECB) decision to raise interest rates last December was controversial, and the bank subsequently indicated a less aggressive policy on rate increases. However, inflation is above the ECB's target, so we expect at least one more rate increase this year. The Bank of England, which cut interest rates once in 2005, probably will hold rates steady throughout 2006 since economic growth appears to be rebounding.

With economic growth improving and interest rates remaining low, the European economy should grow slightly more than

2 percent in 2006. The Central European and Nordic economies should continue to outperform the Eurozone.

Eurozone housing permits increased more than 7 percent yearly over the past three years, and home prices are increasing in many European countries. With continued low interest rates and rising personal incomes, we expect housing construction to improve further in 2006. Construction surveys suggest other types of construction spending should recover, benefiting from low long-term interest rates and rising corporate profits.

We project economic growth in AME will exceed 5 percent in 2006, the fourth consecutive year of good growth. The current period is the best for sustained growth since the 1970s. High energy and metals prices are boosting investment in those sectors as well as providing governments the funds to increase infrastructure investment. Good economic growth should encourage more investment in standby electrical power.

In the CIS, we project economic growth will slow to around 6 percent, the fourth straight year of strong growth. Recoveries in energy and metals prices contributed significantly to better economic growth. We do not anticipate that recent disputes over natural gas prices will impact energy investments in Russia this year.

Latin America

Machinery and Engines sales are expected to increase about 6 percent in 2006.

Interest rate trends within the region will likely diverge in 2006. Brazil, which started cutting interest rates last year in response to some slowing in manufacturing, is forecast to further reduce interest rates this year. Mexico is also expected to cut interest rates due to slowing inflation and moderate economic growth.

Most other countries should raise interest rates slightly, but from some of the lowest rates in years.

We expect economic growth in the region will slow to slightly less than 4 percent in 2006. Economic growth in all key countries should remain strong enough to support growth in construction. Mine production is increasing in most countries, which, along with high metals prices, should encourage more investment in mining.

Asia/Pacific

Machinery and Engines sales are expected to increase about 11 percent in 2006.

We project the regional economy will again be the fastest growing in the world, with 2006 growth continuing slightly above 6 percent. Low interest rates, competitive exchange rates and increased international trade should support the regional economy. Faster economic growth in Australia and developing Asia should offset a modest slowing in China's economic growth rate.

Steaming coal prices softened in late 2005 but remained above prices that would discourage new investments. We expect contract prices for iron ore to increase again in April and coking coal prices to hold much of the increases negotiated in 2005. Investments in new mine capacity and supporting infrastructure should increase further in 2006.

We expect construction spending to increase as well. Growing populations and higher home prices should boost housing construction, and rapid economic growth will likely require businesses to invest more in structures.

Financial Products Revenues

We expect continued growth in Financial Products for 2006. Revenues are expected to increase approximately 18 percent versus 2005, primarily due to higher average earning assets in 2006.

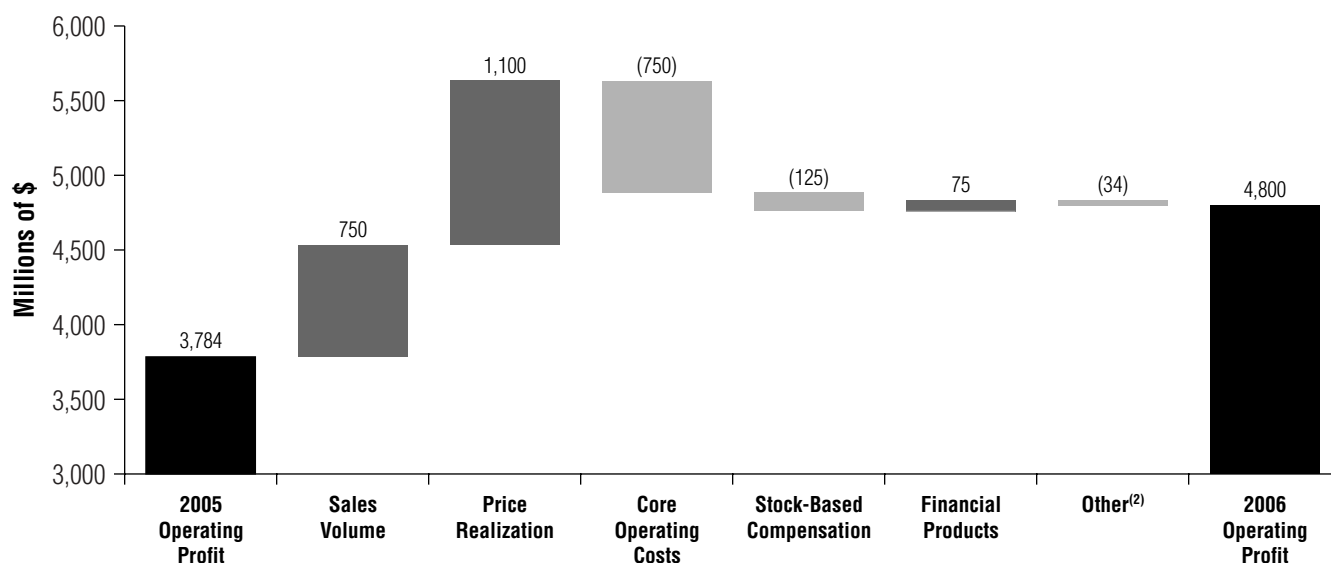
Sales and Revenues Outlook

| (Millions of dollars) | 2005 Actual | 2006 Outlook | % Change |
|---|------------------|------------------|-------------|
| Machinery and Engines | | | |
| North America | \$ 17,709 | \$ 19,850 | 12% |
| EAME | 8,860 | 9,300 | 5% |
| Latin America | 3,024 | 3,200 | 6% |
| Asia/Pacific | 4,413 | 4,900 | 11% |
| Total Machinery and Engines | <u>34,006</u> | <u>37,250</u> | 10% |
| Financial Products ⁽¹⁾ | 2,333 | 2,750 | 18% |
| Total | <u>\$ 36,339</u> | <u>\$ 40,000</u> | 10% |

⁽¹⁾ Does not include revenues earned from Machinery and Engines of \$350 million and \$317 million in 2006 and 2005, respectively.

Consolidated Operating Profit Comparison⁽¹⁾

2006 vs. 2005



⁽¹⁾ The PPS outlook is between \$4.65 and \$5.00. The above chart illustrates operating profit at the midpoint of this profit range. Each of the stair steps in the chart may individually vary within the outlook range.

⁽²⁾ Other includes the impact of currency, consolidating adjustments and the effects of rounding.

PROFIT OUTLOOK

We expect profit per share to be in the range of \$4.65 to \$5.00, up 15 percent to 24 percent from 2005. The year is expected to benefit from improved price realization and higher sales volume partially offset by core operating costs and *stock-based compensation* expense.

About half of the expected core operating cost increase is from manufacturing costs and about half from SG&A and R&D. Manufacturing costs are expected to be higher due to an increase in material costs of about 1 percent and an increase in manufacturing period costs to support higher volume.

SG&A expense is expected to increase — a result of labor inflation and developmental programs to support the growth envisioned by Caterpillar's enterprise strategy. However, we expect SG&A as a percent of sales to be flat with 2005. R&D expense is expected to increase to comply with emissions requirements, introduce new products and support future growth.

Incentive compensation expense at the midpoint of our outlook range for 2006 is expected to be about \$50 to \$75 million, or 10 to 15 percent lower than 2005. This expense includes both a short-term and long-term component. In addition, we will begin expensing

stock-based compensation in accordance with SFAS 123R in 2006. We estimate our 2006 stock-based compensation expense will be approximately \$125 million. We expect 2006 retirement benefits to be the same as 2005.

In 2005, we recognized \$90 million of gains from Machinery and Engines long-term hedges in Other Income/Expense. These hedges expired at the end of 2005, and we do not expect similar gains in 2006.

Excluding discrete items, we expect our effective tax rate for 2006 will increase approximately one percentage point from the 2005 rate due to the continued phase-out of ETI. The American Jobs Creation Act provides for the phase-out of ETI with 80 percent of benefit in 2005, 60 percent of benefit in 2006 and complete phase-out in 2007.

* * *

The information included in the Outlook section is forward looking and involves risks and uncertainties that could significantly affect expected results. A discussion of these risks and uncertainties is contained in Item 7 of this Form 10-K.

MANAGEMENT'S DISCUSSION AND ANALYSIS ■

SUPPLEMENTAL STOCKHOLDER INFORMATION

Shareholder Services:

Stock Transfer Agent

Mellon Investor Services
P.O. Box 3315
South Hackensack, NJ 07606-3315
phone: (866) 203-6622 (U.S. and Canada)
(201) 680-6578 (Outside U.S. and Canada)
hearing impaired:
(800) 231-5469 (U.S. and Canada)
(201) 680-6610 (Outside U.S. and Canada)

Internet home page: www.melloninvestor.com

Caterpillar Assistant Secretary

Laurie J. Huxtable
Assistant Secretary
Caterpillar Inc.
100 N.E. Adams Street
Peoria, IL 61629-7310
phone: (309) 675-4619
fax: (309) 675-6620
e-mail: CATshareservices@cat.com

Stock Purchase Plan:

Current shareholders and other interested investors may purchase Caterpillar Inc. common stock directly through the Investor Services Program sponsored and administered by our Transfer Agent. Current shareholders can get more information on the program from our Transfer Agent using the contact information provided above. Non-shareholders can request program materials by calling: (800) 842-7629 (U.S. and Canada) or (201) 329-8660 (outside the U.S. and Canada). The Investor Services Program materials are available on-line from Mellon's website or linked from www.CAT.com/dspp.

Investor Relations:

Institutional analysts, portfolio managers, and representatives of financial institutions seeking additional information about the Company should contact:

Director of Investor Relations

Mike DeWalt
Caterpillar Inc.
100 N.E. Adams Street, Peoria, IL 61629-5310
phone: (309) 675-4549
fax: (309) 675-4457
e-mail: CATir@CAT.com
Internet website: www.CAT.com/investor

Common Stock (NYSE: CAT)

Listing Information: Caterpillar common stock is listed on the New York, Pacific and Chicago stock exchanges in the United States, and on stock exchanges in Belgium, France, Germany, Great Britain and Switzerland.

Compliance: Caterpillar files Annual CEO Certifications in compliance with New York and Pacific stock exchange rules and certifications in compliance with Sections 302 and 906 of the Sarbanes-Oxley Act of 2002. These certifications are included as exhibits to our Form 10-K filing for the relevant fiscal year.

Price Ranges: Quarterly price ranges of Caterpillar common stock on the New York Stock Exchange, the principal market in which the stock is traded, were:

| Quarter | 2005 ⁽¹⁾ | | 2004 ⁽¹⁾ | |
|--------------|---------------------|---------|---------------------|---------|
| | High | Low | High | Low |
| First | \$ 49.98 | \$43.20 | \$42.85 | \$36.26 |
| Second | \$ 51.49 | \$41.31 | \$42.38 | \$36.01 |
| Third | \$ 59.88 | \$47.43 | \$40.65 | \$34.25 |
| Fourth | \$ 59.84 | \$48.25 | \$49.36 | \$38.38 |

⁽¹⁾ Price ranges reflect July 2005 2-for-1 stock split.

Number of Stockholders: Stockholders of record at year-end totaled 38,329, compared with 37,639 at the end of 2004. Approximately 68 percent of our issued shares are held by institutions and banks, 26 percent by individuals, and 6 percent by employees through company investment plans.

Caterpillar qualified investment plans held 40,601,400 shares at year-end, including 3,789,649 shares acquired during 2005. Non-U.S. employee stock purchase plans held an additional 5,024,633 shares at year-end, including 1,002,151 shares acquired during 2005.

Company Information:

Current information:

- phone our Information Hotline — (800) 228-7717 (U.S. and Canada) or (858) 244-2080 (outside U.S. and Canada) to request company publications by mail, listen to a summary of Caterpillar's latest financial results and current outlook, or to request a copy of results by fax or mail
- request, view, or download materials on-line or register for email alerts by visiting www.CAT.com/materialsrequest

Historical information:

- view/download on-line at www.CAT.com/historical

Annual Meeting:

On Wednesday, June 14, 2006, at 1:30 p.m., Central Time, the annual meeting of stockholders will be held at the Northern Trust Corporation building in Chicago, Illinois. Proxy materials are being sent to stockholders with this report on or about April 28, 2006.

Internet:

Visit us on the Internet at www.CAT.com.

Information contained on our website is not incorporated by reference into this document.

DIRECTORS AND OFFICERS

| Directors/Committee Membership (as of December 31, 2005) | | | | |
|---|--------------|---------------------|-------------------|----------------------|
| | Audit | Compensation | Governance | Public Policy |
| W. Frank Blount | ✓ | | ✓ | |
| John R. Brazil | | ✓ | | ✓* |
| John T. Dillon | ✓ | | ✓* | |
| Eugene V. Fife | ✓* | | | |
| Gail D. Fosler | | ✓ | | ✓ |
| Juan Gallardo | | | ✓ | ✓ |
| David R. Goode | ✓ | | ✓ | |
| Peter A. Magowan | | ✓ | ✓ | |
| William A. Osborn | | ✓* | | |
| Gordon R. Parker | ✓ | | | ✓ |
| Charles D. Powell | | ✓ | | ✓ |
| Edward B. Rust, Jr. | ✓ | | ✓ | |
| Joshua I. Smith | | ✓ | | ✓ |
| * Chairman of Committee | | | | |

OFFICERS

| | | | |
|------------------------|--|-------------------------------|---------------------|
| James W. Owens | Chairman and CEO | Hans A. Haefeli | Vice President |
| Stuart L. Levenick | Group President | John S. Heller | Vice President |
| Douglas R. Oberhelman | Group President | Richard P. Lavin | Vice President |
| Gerald L. Shaheen | Group President | Robert R. Macier ¹ | Vice President |
| G rard R. Vittecoq | Group President | William D. Mayo | Vice President |
| Steven H. Wunning | Group President | Daniel M. Murphy | Vice President |
| Kent M. Adams | Vice President | Gerald Palmer | Vice President |
| Ali M. Bahaj | Vice President | James J. Parker | Vice President |
| Sidney C. Banwart | Vice President | Mark R. Pfloderer | Vice President |
| Michael J. Baunton | Vice President | Edward J. Rapp | Vice President |
| Rodney C. Beeler | Vice President | William J. Rohner | Vice President |
| Mary H. Bell | Vice President | Christiano V. Schena | Vice President |
| James B. Buda | Vice President, General Counsel and Secretary | William F. Springer | Vice President |
| David B. Burritt | Vice President, Chief Financial Officer | Gary A. Stroup | Vice President |
| Rodney L. Bussell | Vice President | James D. Waters | Vice President |
| Christopher C. Curfman | Vice President | Donald G. Western | Vice President |
| Paolo Fellin | Vice President | Robert T. Williams | Vice President |
| Steven L. Fisher | Vice President | Bradley M. Halverson | Controller |
| Thomas A. Gales | Vice President | Kevin E. Colgan | Treasurer |
| Stephen A. Gosselin | Vice President | Robin D. Beran | Assistant Treasurer |
| | | Tinkie E. Demmin | Assistant Secretary |
| | | Laurie J. Huxtable | Assistant Secretary |

Note: All director/officer information is as of December 31, 2005, except as noted.

¹Retired effective January 1, 2006.

NOTES

NOTES

Our Values in Action

Integrity

Excellence

Teamwork

Commitment

Caterpillar's Worldwide Code of Conduct

A message from the Chairman

Caterpillar people come from many places. Our backgrounds and experiences are different. So are the businesses we work for within Caterpillar—each with its own unique culture and character. And we are clearly a better company because of this diversity. But what brings us together?

I believe the answer lies in our roots and the Caterpillar culture that's grown from this foundation over the years. Our Worldwide Code of Conduct, first published in 1974, defines what we stand for and believe in, documenting the uncompromisingly high ethical standards our company has upheld since its founding in 1925. This updated version builds on that heritage and takes it a step further by explicitly describing the values-based culture we are building across our company.

The Code of Conduct is the most important document we produce at Caterpillar. Its purpose is not to provide a set of rules that covers every situation or challenge we may face, but to serve as a daily guide for putting our values in action. It explains what integrity, excellence, teamwork, and commitment mean to us and how we use these values to make sound, ethical decisions in the best interests of all Caterpillar stakeholders.

When we all work to understand the values contained in this document and guide our individual behavior by them, we protect one of our greatest assets—our reputation. Every decision we make, every action we take, can affect employee morale, the way the world perceives our company and the sustainable results we achieve—factors that impact our own lives and livelihoods. In great measure, we have achieved our worldwide leadership position by upholding our reputation for acting with the highest values and principles. We will continue to lead only if we keep that reputation intact.

Generations of Caterpillar people before us built an honorable reputation and exceptional culture through their words and deeds. Now it's our turn to carry the banner. What a tremendous responsibility and opportunity. Let's work together to make those who came before us proud and set an example for those who will follow.

Thanks in advance for taking the time to read and understand our Code of Conduct—and more importantly, for taking personal responsibility to be sure we always live up to these expectations.

A handwritten signature in black ink that reads "Jim Owens". The signature is written in a cursive, flowing style.

James W. Owens, Chairman and Chief Executive Officer

INTEGRITY

The Power of Honesty

Integrity is the foundation of all we do. It is a constant. Those with whom we work, live and serve can rely on us. We align our actions with our words and deliver what we promise. We build and strengthen our reputation through trust. We do not improperly influence others or let them improperly influence us. We are respectful and behave in an open and honest manner. In short, the reputation of the enterprise reflects the ethical performance of the people who work here.

We put Integrity in action when...

We Are Honest and Act with Integrity

We hold ourselves to the highest standard of integrity and ethical behavior. We tell the truth. We promise only what we can reasonably expect to deliver. We strive to keep our commitments. Our company's shareholders, customers, dealers, those with whom we do business, and our fellow employees must be able to trust what we say and to believe that we will always keep our word.

We Avoid and Manage Conflicts and Potential Conflicts of Interest

We must not engage in activities that create, or even appear to create, conflict between our personal interests and the interests of the company. These situations arise where a personal interest or family or other relationship makes it difficult for an individual to represent the company fully and fairly. Conflicts of interest can arise in any part of Caterpillar's operations. The most serious conflicts of interest usually arise where an employee or former employee has authority to spend the company's money, has authority to hire or engage a person outside the company, or has information that could be valuable to a person outside the company. A conflict of interest or the appearance of a conflict of interest very often arises where an employee is offered a gift, favor, or entertainment. While some of this activity is part of a normal business relationship, we do not accept gifts, favors, or entertainment that have a value greater than we could reasonably reciprocate or that obligate or appear to obligate us to act in any way contrary to the law, Caterpillar business interests or Caterpillar's ethical business practices.

We Compete Fairly

Caterpillar believes that fair competition is fundamental to free enterprise. In relationships with competitors, dealers, suppliers, and customers, we avoid arrangements that restrict our ability to compete with others. There must be no arrangements or understandings with competitors affecting prices, terms upon which products are sold, or the number and type of products manufactured or sold.

We Ensure Accuracy and Completeness of our Financial Reports and Accounting Records

Investors, creditors, and others have a legitimate interest in our company's financial and accounting information. The integrity of Caterpillar's financial reports and accounting records is based on validity, accuracy, completeness, timeliness and understandability of basic information supporting entries to the company's books of account. We will ensure every accounting or financial entry accurately reflects that which is described by the supporting information. We expect employees involved in creating, processing, or recording such information to be personally responsible for its integrity. The same standards of integrity that apply to external financial reporting also apply to the financial statements that are used as internal management tools.

We Are Fair, Honest and Open In Our Communications

We communicate with each other in a respectful, fair, honest and open manner. We keep investors, creditors, securities trading markets, employees, dealers, suppliers, and the general public informed on a timely basis through public release of relevant and understandable financial and other information about our company. In releasing information about Caterpillar, we make every effort to ensure that full disclosure is made to everyone without preference or favoritism to any individual or group. We respond to public inquiries - including those from the news media, governments, and others -- with prompt, courteous, honest answers through members of our executive leadership and employees who are authorized to speak publicly on behalf of Caterpillar.

We Handle “Inside Information” Appropriately and Lawfully

Inside information may be defined as information about a company not known to the public. Such information – certain financial data, technical materials, and future plans for example – may have significant value to others and therefore must be kept strictly confidential. Anyone who has "material" inside information about Caterpillar must not use it for personal gain or provide it to others. Information is "material" if an investor would consider it important in making an investment in Caterpillar or in another organization. A Caterpillar employee who has undisclosed information about a supplier, customer, or competitor should not trade in that company's stock, nor should an employee advise others to do so. We expect all employees, their families, and others whose relationships with Caterpillar give them access to such information to comply with these principles.

We Refuse to Make Improper Payments

In dealing with public officials, other corporations, and private citizens, we firmly adhere to ethical business practices. We will not seek to influence others, either directly or indirectly, by paying bribes or kickbacks, or by any other measure that is unethical or that will tarnish our reputation for honesty and integrity. Even the appearance of such conduct must be avoided.

EXCELLENCE

The Power of Quality

We set and achieve ambitious goals. The quality of our products and services reflects the power and heritage of Caterpillar -- the pride we take in what we do and what we make possible. We are passionate about people, process, product, and service excellence. We are determined to serve our customers through innovation, continuous improvement, an intense focus on customer needs, and a dedication to meet those needs with a sense of urgency. For us, Excellence is not only a value; it is a discipline and a means for making the world a better place.

We put Excellence in action when...

We Establish a Work Environment That Supports Excellence

Caterpillar employees expect our work environment to promote personal achievement, continual learning, and a feeling of self-worth. Employees have the right to express their good-faith opinions about how we can improve our own performance and the performance of the company. We actively listen, respond, encourage teamwork, and make decisions based on facts and data.

We Select, Place and Evaluate Employees Based on their Qualifications and Performance

Caterpillar selects employees, and places them in positions, based on their personal qualifications and skills for the job. We evaluate and reward employees based on the quality of the work they do and the contributions they make to Caterpillar.

We Provide Employees with Opportunities to Develop

We ask employees to give their best efforts, learn from their successes and setbacks, and pursue opportunities to improve their performance on their own initiative, as well as through continual learning programs offered by the company. We encourage self-development and will assist employees in mastering their current jobs and improving their job skills. We are committed to assuring opportunities for all employees to develop their abilities and contribute to Caterpillar's success.

We Accept Nothing But the Best Quality in Our Products and Services

Our strong commitment to excellence, and our focus on the needs of our customers, drives us to continuously improve the quality and reliability of our products and services. Historically, we have been recognized for providing the highest quality. Our continued success depends on exceeding the quality expectations of our customers and standing behind everything we do.

We Focus on Delivering the Highest Value to Our Customers, Always with A Sense of Urgency

We have built a reputation for excellence by listening to our customers, understanding their needs, and delivering products and services that help them succeed. Our customers expect the best from Caterpillar, and each of us must ensure that our individual decisions and actions contribute to a positive perception of the company, enhance our customers' satisfaction, and promote their loyalty. We aim to deliver the highest possible value in the products and services we offer to our customers and to deliver that value with a sense of urgency. Our commitment to continuous improvement in all we do makes that possible.

We See Risk As Something to be Managed, And As Potential Opportunity

Because we realize that business and risk are inseparable, we proactively identify, assess and manage risks that have the most potential to impact our business. For us, managing risk also involves looking for opportunities for potential competitive advantage.

We take an "Enterprise Point of View"

Taking an "enterprise point of view" means promoting the best interests of our company as a whole, even where we may have to make sacrifices at the local level. While entrepreneurial thinking in our local business units is critical to our business success, we must always base decisions on what is best for Caterpillar as a whole.

TEAMWORK

The Power of Working Together

We help each other succeed. We are a team, sharing our unique talents to help those with whom we work, live and serve. The diverse thinking and decision making of our people strengthens our team. We respect and value people with different opinions, experiences and backgrounds. We strive to understand the big picture, then do our part. We know that by working together, we can produce better results than any of us can achieve alone.

We put Teamwork in action when...

We Treat Others with Respect and Do Not Tolerate Intimidation or Harassment

The full value of each individual's contribution can be realized only when we treat one another with the respect, trust, and dignity we ourselves expect. Caterpillar insists on a work environment free of intimidation and harassment. As individual employees, we have the right to expect a positive working environment, along with the responsibility to speak out and ask for change if we observe conduct that runs contrary to this principle.

We Treat People Fairly and Prohibit Discrimination

We build and maintain a productive, motivated work force by treating all employees fairly and equitably. We respect and recognize the contributions of employees as well as other stakeholders. We will select and place employees on the basis of their qualifications for the work to be performed, considering accommodations as appropriate and needed -- without regard to their race, religion, national origin, color, gender, sexual orientation, age, and/or physical or mental disability. We support and obey laws that prohibit discrimination everywhere we do business. We expect to conduct our business in such a way that employees will not feel the need for representation by unions or other third parties. Where employees have chosen such representation, or been required by law to do so, we will pursue an honest, business-like approach in working with those representatives.

We Foster an Inclusive Environment

We understand and accept the uniqueness, and are non-judgmental regarding differences, of individuals. We value the diversity of unique talents, skills, abilities, and experiences that enable Caterpillar people to achieve superior business and personal results. We know that when we seek out, and are receptive to, different

points of view this brings many benefits to Caterpillar -- innovative solutions and approaches to decision-making that can strengthen the company and make us more successful.

We Conduct Business Worldwide With Consistent Global Standards

As a global company, we understand that there are many differing economic and political philosophies and forms of government throughout the world. We acknowledge the wide diversity that exists among the social customs and cultural traditions in the countries in which we operate. We respect such differences, and to the extent that we can do so in keeping with the principles of our Code of Conduct, we will maintain the flexibility to adapt our business practices to them. We will leverage our global experience to achieve the best results for the enterprise.

We Collaborate With Key Entities and Organizations Outside Our Company

The company's strength and longevity are the result of our ability to sustain long-lasting, mutually rewarding relationships with our customers, dealers, suppliers, investors, and others with whom we do business. We engage in meaningful dialogue with these business partners as well as appropriate governmental and non-governmental organizations. We listen, learn and innovate, and we continuously work to strengthen these relationships through conscientious, trustworthy behavior.

We Build Outstanding Relationships with Our Dealers and Distribution Channel Members

Our dealers and other distribution channel members serve as a critical link between our company and our customers worldwide. We rely on them to participate with us as partners in building and maintaining the long-standing customer relationships that have made Caterpillar successful. We value their positive contributions to our reputation and their deep commitment to the customers and communities they serve. We sustain our outstanding relationships with them through trust, communication and shared rewards. We work constantly with them to provide products, services, and support solutions necessary to satisfy customer needs worldwide.

We View Our Suppliers As Our Business Allies

We seek strong, mutually rewarding business relationships with suppliers who can enhance the quality of our products and services. We look for suppliers and business allies who demonstrate strong values and ethical principles and who support our commitment to quality. We avoid those who violate the law or fail to comply with the sound business practices we promote. No supplier is required to buy Caterpillar products in order to compete for business or to continue as a supplier. We do reserve the right, consistent with applicable law, to require suppliers to use Caterpillar equipment when performing work on Caterpillar premises and where Caterpillar offers a product appropriate for the work being performed. We encourage fair competition among our potential suppliers, contractors, and other vendors, and work equitably and reasonably with all.

COMMITMENT

The Power of Responsibility

We embrace our responsibilities. Individually and collectively we make meaningful commitments -- first to each other, and then to those with whom we work, live and serve. We understand and focus on the needs of our customers. We are global citizens and responsible members of our communities who are dedicated to safety, care for our environment, and manage our business ethically. We know it is both our duty and our honor to carry the Caterpillar heritage forward.

We put Commitment in action when...

We Take Personal Responsibility

Using our individual skills and talents, we each take personal responsibility for meeting our shared goals and keeping our commitments.

We Protect the Health and Safety of Others and Ourselves

As a company, we strive to contribute toward a global environment in which all people can work safely and live healthy, productive lives, now and in the future. We actively promote the health and safety of employees

with policies and practical programs that help individuals safeguard themselves and their co-workers. As employees, we take many precautions to prevent occupational illness or injury, and we make appropriate changes in our behavior or work environment that will contribute to improving the health and safety of others and ourselves. We are committed to providing our customers with products and services that are the safest and most reliable available in the marketplace. We actively promote safety and safe practices throughout our value chain – from suppliers to end users.

We Protect Our Hard Assets, Our Brands and Our Other Intellectual Property

We go to extraordinary lengths to preserve, protect, and responsibly use all of our assets. This includes tangible as well as intangible assets, such as our brands, technology, business information, and intellectual capital. We will not make unauthorized disclosure of trade secrets or other sensitive information belonging to the company, our customers, dealers or suppliers -- either during employment by our company or thereafter. While we may hire individuals who have knowledge and experience in various technical areas, we do not employ people as a means of gaining access to trade secrets and sensitive information of others. We have a personal responsibility to use every appropriate means to safeguard our company's assets from loss, theft, or misuse.

We Safeguard Our Confidential Information

We consider every piece of information we own an asset. Some of it we share with others through advertising, product documentation, news releases, and public financial reporting. Everything else -- including trade secrets, confidential financial information, new product or service development plans, and other sensitive corporate and personal information -- we protect through careful attention to interpersonal communication, the secure use of all communications media and, where appropriate, legally enforceable agreements.

We Use Electronic Communications Technology Responsibly and Professionally

Electronic communication technology plays a vital role in how we conduct our business every day. Access to the Internet and use of Caterpillar Intranet systems, e-mail, telephones, portable telephones, digital assistants and fax machines, have become increasingly important. The company maintains this technology for legitimate business activities by authorized individuals, and to support a positive, professional business climate. As employees, we are expected to use such technology responsibly and professionally at all times.

We Recognize and Respect Personal Privacy

We recognize and respect the personal information privacy interest of individuals. We collect and process only relevant, accurate information needed or appropriate for business purposes, and do so only by lawful and fair means. We appropriately safeguard the security and confidentiality of company records containing personal information whether those records are held by Caterpillar or by a Caterpillar business partner, and limit access to such information only to those who have a legitimate business need for it when permitted by law.

We Support Environmental Responsibility Through Sustainable Development

Our products and services are intended to support sustainable development of global resources and they will meet or exceed applicable regulations and standards wherever they are initially sold. We establish and adhere to environmentally sound policies and practices in product design, engineering, and manufacturing. We educate and encourage our customers to use the products they purchase from us in environmentally responsible ways. We take effective steps to continually increase the natural resources efficiency and cleanliness of our facilities. We offer leadership and financial support to industry and community initiatives that share our commitment to the environment.

We Are Pro-Active Members of Our Communities

As individuals and as a company, we contribute significant time and resources to promoting the health, welfare, and economic stability of our communities around the world. We encourage all employees to participate in community activities that promote the common good. We believe that our success should also contribute to the quality of life in, and the prosperity and sustainability of, communities where we work and live.

We Make Responsible Ownership and Investment Decisions

Caterpillar investments must be compatible with social and economic priorities, local laws, customs, and traditions of the countries where we do business. In all cases, our conduct should promote acceptance and respect for our company. We also expect that our host countries will recognize our need for stability, growth, and business success, and that they will honor their agreements, including those relating to rights and properties of citizens of other nations.

We Participate in Public Matters in an Appropriate Manner

Our employees should feel free to participate in public matters and political processes according to their individual beliefs and citizenship rights. Where we participate as individuals in public matters or the political process we must be mindful that such activity is done in our individual capacity as private citizens and not on behalf of our company, and we must make this clear to all involved. The company supports committees aimed at encouraging political contributions by individuals and, from time to time -- with the approval of the Chairman -- may make political contributions as laws allow.

Living by the Code

Integrity. Excellence. Teamwork. Commitment. The words in this Code of Conduct define us. Despite our differences -- in geography, culture, language, and business -- we are one Caterpillar, one company united by these common principles and a shared commitment to the highest standards of conduct.

While we conduct our business within the framework of applicable laws and regulations, for us, mere compliance with the law is not enough. We strive for more than that. Through our Code of Conduct, we envision a work environment all can take pride in, a company others respect and admire, and a world made better by our actions. Together, we are laying the foundation for the values-based culture that will carry us forward to even higher levels of success. Together, we are upholding the reputation of one of the world's great companies -- and strengthening it for tomorrow.

This Code of Conduct applies to the daily activities of employees of Caterpillar Inc. and its subsidiaries and affiliates worldwide and members of the Board of Directors of Caterpillar Inc. Each of us is personally responsible to read the Code of Conduct, understand what it means, and apply it consistently. Those in our company who lead others hold a special position as advisors on how we conduct ourselves as representatives of Caterpillar.

Reporting Rights and Responsibilities

Each of us who becomes aware of a circumstance or action that violates, or appears to violate, the Code of Conduct, enterprise policy or applicable law, should contact his or her supervisor or local management as soon as possible. Each of us has a further personal right and responsibility to report any circumstance or action that violates, or appears to violate, the Code of Conduct, enterprise policy or applicable law. We must use these reporting rights responsibly and must report issues only where we reasonably believe there has been a violation, and not where the report is intended to be harassing, is based on personal opinion only, or is otherwise trivial. You can raise a question or concern, or make such a report, to your supervisor, local business unit management, or the Office of Business Practices.

No Retaliation Policy

Caterpillar will not take any action against you as a result of raising an ethical issue in good faith. Also, Caterpillar does not tolerate any reprisal by any individual against an employee for raising a concern or making a report in good faith.

If you are not able to get an answer to a question, or resolve an issue, under the Code of Conduct by working with your supervisor or local management, you can contact the Office of Business Practices:

Direct Telephone: +1-309-494-4393 (English only)

Toll-Free Helpline: Caterpillar maintains toll-free Helpline numbers in various countries. Inside Canada, the United States and the U.S. Virgin Islands the number is 1-800-300-7898. Toll-free numbers currently in effect for other countries are posted on the Caterpillar Intranet at <https://codeofconduct.cat.com> and language translation is available for those numbers.

Call Collect Helpline: +1-770-582-5275 (language translation available)

Confidential Fax: +1-309-494-4818

Internet E-Mail: BusinessPractices@cat.com

You can request a copy of the Office of Business Practices Data Privacy Statement using any of the methods listed above.

Policy Letters and Additional Information

Enterprise Policy Letters and other more detailed company policies, as well as additional information and guidance on this Code of Conduct, are available to employees on the Caterpillar Intranet at <https://codeofconduct.cat.com>, or by contacting the Office of Business Practices using any of the methods listed previously. The Policy Letters in force at the time this Code of Conduct was published are:

1. Company Owned Facilities
2. Safeguarding Company Assets
3. Worldwide Product Uniformity
4. Establishing and Maintaining Uniform Nomenclature
5. Warranties
6. Metrication
7. Marketing of Caterpillar Branded Engines and Components to Original Equipment Manufacturers (OEMs)
8. Selection, Appointment, and Termination of Dealers
9. Purchase of Materials and Services
10. Business Entertainment, Favors and Gifts
11. Legal Matters
12. Oral and Written Contracts
13. Indemnification of Employees
14. Intellectual Property Rights
15. Company Attitudes on Partisan Politics and Public Issues
16. Prohibition Against Certain Payments To Public Officials
17. Freer Trade
18. Public Communications
19. Employment of Relatives
20. Positions With Organizations Other Than Caterpillar
21. Safeguarding Confidential Information
22. Production/Parts Material Priorities
23. Security of Electronically Processed Information
24. Modems Attached to the Caterpillar Network
25. Electronic Communications
26. Government Contracts
27. Data Privacy

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EXHIBIT 21

CATERPILLAR INC.
SUBSIDIARIES AND AFFILIATES
(as of December 31, 2005)

| <u>Name of Company</u> | <u>Where Organized</u> |
|--|------------------------|
| 10G LLC | Delaware |
| A.S.V., Inc. | Minnesota |
| Ace Power Embilipitiya Private Limited | Sri Lanka |
| Acefun S.A. de C.V. | Mexico |
| Aceros Fundidos Internacionales LLC | Delaware |
| Aceros Fundidos Internacionales S. de R.L. de C.V. | Mexico |
| Advanced Filtration Systems Inc. | Delaware |
| AE-Steam SA | Switzerland |
| Aiwa Co., Ltd. | Japan |
| Akoya, Inc. | Delaware |
| Amberly Investments | New Zealand |
| Anchor Coupling Inc. | Delaware |
| Arch Development Fund I L.P. | Delaware |
| Asia Power Systems (Tianjin) Ltd. | China |
| AsiaTrak (Tianjin) Ltd. | China |
| ASIMCO International Casting (Shanxi) Co. Ltd. | China |
| Bio-Energy Partners | Illinois |
| CAE Co., Ltd. | Japan |
| Carter Machinery Company, Incorporated | Delaware |
| Carter Rental, Inc. | Virginia |
| Cat Redistribution Services Corporation | Japan |
| Caterpillar (Africa) (Proprietary) Limited | South Africa |
| Caterpillar (Bermuda) Funding Company | Bermuda |
| Caterpillar (Bermuda) Funding Parent Company | Bermuda |
| Caterpillar (Bermuda) Holding Company | Bermuda |
| Caterpillar (Bermuda) Investments Funding Company | Bermuda |
| Caterpillar (Bermuda) Investments Parent Company | Bermuda |
| Caterpillar (Bermuda) Ltd. | Bermuda |
| Caterpillar (China) Financial Leasing Co., Ltd. | China |
| Caterpillar (China) Investment Co., Ltd. | China |
| Caterpillar (HK) Limited | Hong Kong |
| Caterpillar (Thailand) Limited | Thailand |
| Caterpillar (U.K.) Limited | England |
| Caterpillar (Xuzhou) Design Center Ltd. | China |
| Caterpillar AccessAccount Corporation | Nevada |
| Caterpillar Americas Co. | Delaware |
| Caterpillar Americas Funding Inc. | Delaware |
| Caterpillar Americas Mexico, S. de R.L. de C.V. | Mexico |
| Caterpillar Americas SARL | Switzerland |
| Caterpillar Americas Services Co. | Delaware |
| Caterpillar Arrendadora Financiera, S.A. de C.V. | Mexico |
| Caterpillar Asia Limited | Hong Kong |
| Caterpillar Asia Pacific L.P. | Bermuda |
| Caterpillar Asia Pte. Ltd. | Singapore |

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| Caterpillar Belgium S. A. | Belgium |
| Caterpillar Brasil Ltda. | Brazil |
| Caterpillar Brasil Servicos Ltda. | Brazil |
| Caterpillar Brazil LLC | Delaware |
| Caterpillar CDD, S.L. | Spain |
| Caterpillar China Limited | Hong Kong |
| Caterpillar CIS LLC | Russia |
| Caterpillar CMC Finance Corporation | Delaware |
| Caterpillar CMC, LLC | Delaware |
| Caterpillar Commercial Australia Pty. Ltd. | Australia |
| Caterpillar Commercial Holding S.A.R.L. | Switzerland |
| Caterpillar Commercial LLC | Delaware |
| Caterpillar Commercial Northern Europe Limited | England and Wales |
| Caterpillar Commercial Private Limited | India |
| Caterpillar Commercial S.A. | Belgium |
| Caterpillar Commercial S.A.R.L. | France |
| Caterpillar Commercial Services S.A.R.L. | France |
| Caterpillar Commerciale S.r.L. | Italy |
| Caterpillar Communications LLC | Delaware |
| Caterpillar Corporativo Mexico, S. de R.L. de C.V. | Mexico |
| Caterpillar Credito, S.A. de C.V. | Mexico |
| Caterpillar Distribution Mexico S.R.L. de C.V. | Mexico |
| Caterpillar Distribution Services Europe BVBA | Belgium |
| Caterpillar Engine Systems Inc. | Delaware |
| Caterpillar Engine Systems Mexico, S. de R.L. de C.V. | Mexico |
| Caterpillar Environmental Technologies Mexico, S. de R.L. de C.V. | Mexico |
| Caterpillar European Finance s.r.o. | Czechoslovakia |
| Caterpillar Factoraje Financiero, S.A. de C.V. | Mexico |
| Caterpillar Finance France S.A. | France |
| Caterpillar Finance Kabushiki Kaisya | Japan |
| Caterpillar Finance, s.r.o. | Czech Republic |
| Caterpillar Financial Acquisition Funding LLC | Delaware |
| Caterpillar Financial Acquisition Funding Partners | United Kingdom |
| Caterpillar Financial Australia Limited | Australia |
| Caterpillar Financial Corporacion Financiera, S.A., E.F.C. | Spain |
| Caterpillar Financial Dealer Funding LLC | Delaware |
| Caterpillar Financial Funding Corporation | Nevada |
| Caterpillar Financial Member Company | Delaware |
| Caterpillar Financial New Zealand Limited | New Zealand |
| Caterpillar Financial Nordic Services A.B. | Sweden |
| Caterpillar Financial Nova Scotia Corporation | Canada |
| Caterpillar Financial OOO | Russia |
| Caterpillar Financial Receivables Corporation | Nevada |
| Caterpillar Financial Renting, S.A. | Spain |
| Caterpillar Financial S.A. Arrendamento Mercantil | Brazil |
| Caterpillar Financial S.A. Credito, Financiamento e Investimento | Brazil |
| Caterpillar Financial SARL | Switzerland |
| Caterpillar Financial Services (Ireland) plc | Ireland |
| Caterpillar Financial Services (UK) Limited | England |
| Caterpillar Financial Services Argentina S.A. | Argentina |
| Caterpillar Financial Services Asia Pte. Ltd. | Singapore |
| Caterpillar Financial Services Belgium S.P.R.L. | Belgium |
| Caterpillar Financial Services Corporation | Delaware |

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| Caterpillar Financial Services CR, s.r.o. | Czech Republic |
| Caterpillar Financial Services Korea, Ltd. | Korea |
| Caterpillar Financial Services Limited | Canada |
| Caterpillar Financial Services Malaysia Sdn Bhd | Malaysia |
| Caterpillar Financial Services Netherlands B.V. | Netherlands |
| Caterpillar Financial Services Norway AS | Norway |
| Caterpillar Financial Services Philippines Inc. | Philippines |
| Caterpillar Financial Services Poland Sp. z o.o. | Poland |
| Caterpillar Financial Services S.A. | Switzerland |
| Caterpillar Financial Services Yugen Kaisya | Japan |
| Caterpillar Fomento Comercial Ltda. | Brazil |
| Caterpillar Forest Products Inc. | Delaware |
| Caterpillar Formacion Tecnica, S. L. | Spain |
| Caterpillar France SAS | France |
| Caterpillar GB, L.L.C. | Delaware |
| Caterpillar Global Mining Pty. Ltd. | Australia |
| Caterpillar Group Limited | England and Wales |
| Caterpillar Group Services S.A. | Belgium |
| Caterpillar Holding (France) S.A.S. | France |
| Caterpillar Holding Germany GmbH | Germany |
| Caterpillar Holding Ltd. | Bermuda |
| Caterpillar Holding Spain, S.L. | Spain |
| Caterpillar Holdings Australia Pty. Ltd. | Australia |
| Caterpillar Holdings Singapore Pte. Ltd. | Singapore |
| Caterpillar Hungary Component Manufacturing Company Ltd. | Hungary |
| Caterpillar Impact Products Limited | United Kingdom |
| Caterpillar India Private Limited | India |
| Caterpillar Industrial Inc. | Ohio |
| Caterpillar Institute (Vic-Tas) Pty Ltd | Australia |
| Caterpillar Institute (WA) Pty Ltd | Australia |
| Caterpillar Insurance Co. Ltd. | Bermuda |
| Caterpillar Insurance Company | Missouri |
| Caterpillar Insurance Holdings Inc. | Delaware |
| Caterpillar Insurance Services Corporation | Tennessee |
| Caterpillar International Finance plc | Ireland |
| Caterpillar International Holding S.A.R.L. | Switzerland |
| Caterpillar International Investments Coöperatie U.A. | Netherlands |
| Caterpillar International Investments S.A.R.L. | Switzerland |
| Caterpillar International Leasing L.L.C. | Delaware |
| Caterpillar International Ltd. | Bermuda |
| Caterpillar International Services Corporation | Nevada |
| Caterpillar International Services del Peru S.A. | Peru |
| Caterpillar Investment Management Ltd. | Delaware |
| Caterpillar Investments | England and Wales |
| Caterpillar Latin America Services de Mexico, S. de R.L. de C.V. | Mexico |
| Caterpillar Latin America Services de Puerto Rico, S. en C. | Puerto Rico |
| Caterpillar Latin America Services, S.R.L. | Costa Rica |
| Caterpillar Latin America Servicios de Chile Limitada | Chile |
| Caterpillar Leasing (Thailand) Limited | Thailand |
| Caterpillar Leasing Chile, S.A. | Chile |
| Caterpillar Leasing GmbH (Leipzig) | Germany |
| Caterpillar Life Insurance Company | Missouri |
| Caterpillar Logistics (Shanghai) Co. Ltd. | China |

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| Caterpillar Logistics Administrative Services de Mexico, S. de R.L. de C.V. | Mexico |
| Caterpillar Logistics Client Administrative Services de Mexico, S. de R.L. de C.V. | Mexico |
| Caterpillar Logistics Client Services de Mexico, S. de R.L. de C.V. | Mexico |
| Caterpillar Logistics France SAS | France |
| Caterpillar Logistics FT Services (UK) Limited | England and Wales |
| Caterpillar Logistics FT Services Canada Ltd. | Canada |
| Caterpillar Logistics FT Services Inc. | Delaware |
| Caterpillar Logistics FT Services LLC | Delaware |
| Caterpillar Logistics ML Services France SAS | France |
| Caterpillar Logistics NV | Belgium |
| Caterpillar Logistics Services (France) SARL | France |
| Caterpillar Logistics Services (Tianjin) Ltd. | China |
| Caterpillar Logistics Services (UK) Limited | England and Wales |
| Caterpillar Logistics Services China Limited | China |
| Caterpillar Logistics Services de Mexico, S. de R.L. de C.V. | Mexico |
| Caterpillar Logistics Services Germany GmbH | Germany |
| Caterpillar Logistics Services India Private Limited | India |
| Caterpillar Logistics Services International | Russia |
| Caterpillar Logistics Services International NV | Belgium |
| Caterpillar Logistics Services Polska Sp. z o.o. | Poland |
| Caterpillar Logistics Services Spain, S.A. | Spain |
| Caterpillar Logistics Services, Inc. | Delaware |
| Caterpillar Logistics Services-Egypt Ltd. | Egypt |
| Caterpillar Logistics Technology Services (UK) Limited | England and Wales |
| Caterpillar Logistics Technology Services LLC | Delaware |
| Caterpillar Luxembourg S.a.r.l. | Luxembourg |
| Caterpillar Marine Asia Pacific Pte. Ltd. | Singapore |
| Caterpillar Marine Trading (Shanghai) Co., Ltd. | China |
| Caterpillar Materiels Routiers S.A. | France |
| Caterpillar Mexico, S.A. de C.V. | Mexico |
| Caterpillar Motoren (Guangdong) Co. Ltd. | China |
| Caterpillar Motoren GmbH & Co. KG | Germany |
| Caterpillar Motoren Rostock GmbH | Germany |
| Caterpillar Motoren Verwaltungs-GmbH | Germany |
| Caterpillar New Zealand Depositary Company | Netherlands |
| Caterpillar New Zealand Funding Company | Netherlands |
| Caterpillar New Zealand Investments Company | New Zealand |
| Caterpillar New Zealand Securities Company | Bermuda |
| Caterpillar North America S.A.R.L. | New Zealand |
| Caterpillar NZ Funding Parent Limited | Netherlands |
| Caterpillar of Australia Pty. Ltd. | Australia |
| Caterpillar of Canada Corporation | Canada |
| Caterpillar of Delaware, Inc. | Delaware |
| Caterpillar Overseas Credit Corporation S.A.R.L. | Switzerland |
| Caterpillar Overseas Investment Holding, S.A.R.L. | Switzerland |
| Caterpillar Overseas Limited | United Kingdom |
| Caterpillar Overseas S.A.R.L. | Switzerland |
| Caterpillar Paving Products Inc. | Oklahoma |
| Caterpillar Paving Products Xuzhou Ltd. | China |
| Caterpillar Pension Trust Limited | England and Wales |
| Caterpillar Poland Sp. z o.o. | Poland |
| Caterpillar Power Generations Systems L.L.C. | Delaware |
| Caterpillar Power Systems Inc. | Delaware |

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| Caterpillar Power Systems y Compañía Limitada | Nicaragua |
| Caterpillar Power Ventures Corporation | Delaware |
| Caterpillar Power Ventures Europe B.V. | Netherlands |
| Caterpillar Power Ventures International Mauritius Ltd. | Mauritius |
| Caterpillar Power Ventures International, Ltd. | Bermuda |
| Caterpillar Prodotti Stradali S.r.l. | Italy |
| Caterpillar Product Development S.A.R.L. | Switzerland |
| Caterpillar Product Services Corporation | Missouri |
| Caterpillar R & D Center (China) Co., Ltd. | China |
| Caterpillar Redistribution Services Inc. | Delaware |
| Caterpillar Redistribution Services International S.A.R.L. | Switzerland |
| Caterpillar Remanufacturing Limited | England and Wales |
| Caterpillar Remanufacturing Services (Shanghai) Co. Ltd. | China |
| Caterpillar Renting France S.A.S. | France |
| Caterpillar S.A.R.L. | Switzerland |
| Caterpillar Securities Inc. | Delaware |
| Caterpillar Services Limited | Delaware |
| Caterpillar Servicios Mexico, S. de R.L. de C.V. | Mexico |
| Caterpillar Skinningrove Limited | England and Wales |
| Caterpillar Special Services Belgium SPRL | Belgium |
| Caterpillar Switchgear Holding Inc. | Georgia |
| Caterpillar Technologies Singapore Pte. Ltd. | Singapore |
| Caterpillar Torreon S. de R.L. de C.V. | Mexico |
| Caterpillar Tosno, L.L.C. | Russia |
| Caterpillar Transmissions France SARL | France |
| Caterpillar Trimble Control Technologies LLC | Delaware |
| Caterpillar UK Acquisition Partners LP | United Kingdom |
| Caterpillar UK Employee Trust Limited | England and Wales |
| Caterpillar UK Group Limited | United Kingdom |
| Caterpillar UK Holding Company Limited | United Kingdom |
| Caterpillar UK Holdings Limited | England and Wales |
| Caterpillar Underground Mining Pty. Ltd. | Australia |
| Caterpillar Work Tools B.V. | Netherlands |
| Caterpillar Work Tools Canada Ltd. | Canada |
| Caterpillar Work Tools Verwaltungs-GmbH | Germany |
| Caterpillar Work Tools, Inc. | Kansas |
| Caterpillar World Trading Corporation | Delaware |
| Caterpillar World Trading of Europe S.A.R.L. | Switzerland |
| Caterpillar Xuzhou Ltd. | China |
| Caterpillar/SCB Investments LP | Delaware |
| Caterpillar/SCB Receivables Finance LP | Nevada |
| Catsub I, Inc. | Oregon |
| Central Japan Caterpillar Mitsubishi Construction Equipment Sales, Ltd. | Japan |
| Centre de Distribution de Wallonie SA | Belgium |
| CFRC/CFMC Investments, LLC | Delaware |
| Clean World Co. | Japan |
| CM Rental Hokkaido Co., Ltd. | Japan |
| CM Rental Kinki Co., Ltd. | Japan |
| CM Rental Tokai Co., Ltd. | Japan |
| Cramo Holding AB | Sweden |
| Cramo Holding B.V. | The Netherlands |
| Depositary (Bermuda) Limited | Bermuda |
| Dia Rental Hokuriku Co., Ltd. | Japan |

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| Diamond Office Management Co., Ltd. | Japan |
| Dynamic Automation Systems Pty. Ltd. | Australia |
| East Japan Caterpillar Mitsubishi Construction Equipment Sales, Ltd. | Japan |
| Easytop Limited | England and Wales |
| EDC European Excavator Design Center GmbH & Co. KG | Germany |
| EDC European Excavator Design Center Verwaltungs GmbH | Germany |
| Elektrocieplownia Starahowice Sp. z o.o. | Poland |
| Endeavour Caterpillar New Zealand Finance Company | New Zealand |
| Energy Services International Limited | Bermuda |
| Energyst B.V. | Netherlands |
| Ensambladora Tecnologica de Mexico, S.A. de C.V. | Mexico |
| Eurenov S.A.S. | France |
| F.G. Wilson (Engineering) Limited | Northern Ireland |
| F.G. Wilson (Proprietary) Limited | South Africa |
| F.G. Wilson (USA) L.L.C. | Delaware |
| F.G. Wilson Generators India Private Limited | India |
| FCC Equipment Financing, Inc. | Singapore |
| Federal Financial Services LLC | Delaware |
| Financieringsmaatschappij Bolier B.V. | Netherlands |
| Firefly Energy Inc. | Delaware |
| FMS Equipment Rentals Inc. | Delaware |
| Forcheater do Brasil Ltda. | Brazil |
| Forcheater International S.A. | Uruguay |
| Germanischer Lloyd AG | Germany |
| GFCM Servicios, S.A. de C.V. | Mexico |
| Grupo Financiero Caterpillar Mexico, S.A. de C.V. | Mexico |
| Guangzhou MaK Diesel Engine Limited Company | China |
| Hama-rental Co. | Japan |
| Hindustan Powerplus Limited | India |
| Hokkaido Caterpillar Mitsubishi Construction Equipment Sales, Ltd. | Japan |
| Hokken Service Co. | Japan |
| Hydropro S.r.l. | Italy |
| Inmobiliaria Conek, S.A. | Mexico |
| Intelligent Switchgear Organization LLC | Delaware |
| Ironmart LLC | Delaware |
| IronPlanet.com, Inc. | Delaware |
| JAX Reman, L.L.C. | Delaware |
| JHT Holdings, Inc. | Delaware |
| Jupiter Power (Cambodia) Co., Ltd. | Cambodia |
| Jupiter Power Asia Co., Ltd. | Cambodia |
| Jupiter Power Holdings Ltd. | Bermuda |
| Kasargod Power Corporation Private Limited | India |
| Kiden Lease Co., Ltd. | Japan |
| K-Lea Co., Ltd. | Japan |
| Laminex V.o.F. | Netherlands |
| Let's Co., Ltd. | Japan |
| Loegering Mfg. Inc. | North Dakota |
| M.O.P.E.S.A. Motores Power, S.A. | Mexico |
| Machida Kiko Co., Ltd. | Japan |
| Machinefabriek Bolier B.V. | Netherlands |
| MaK Americas Inc. | Canada |
| MaK Americas Inc. | Illinois |
| MaK Beteiligungs GmbH | Germany |

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| MaK Mediterranee S.A.S. | France |
| MaK Netherland B.V. | Netherlands |
| MaK Power Systems Lanka (Private) Ltd. | Sri Lanka |
| MaK Trainings GmbH | Germany |
| MCFA Canada Ltd. | Ontario |
| MCFA FSC Inc. | Barbados |
| Mec-Track S.r.l. | Italy |
| Merwedehaven Beheer B.V. | Netherlands |
| Metalmark Financial Services Limited | Netherlands |
| MICA Energy Systems | Michigan |
| Mincom Limited | Australia |
| Mistubishi Caterpillar Forklift Europe B.V. | Netherlands |
| Mitsubishi Caterpillar Forklift America de Argentina S.A. | Argentina |
| Mitsubishi Caterpillar Forklift America Inc. | Delaware |
| Mitsubishi Caterpillar Forklift Asia Pte. Ltd. | Singapore |
| Monte Rio Power Corporation Ltd. | Bermuda |
| Motores Diesel Andinos S.A. | Peru |
| Motori Perkins S.P.A. | Italy |
| Nagano Kouki Co., Ltd. | Japan |
| Necoles Investments B.V. | Netherlands |
| Nihon Kenki Lease Co., Ltd. | Japan |
| Okinawa Caterpillar Mitsubishi Construction Equipment Sales, Ltd. | Japan |
| OTSG, Inc. | Delaware |
| P. T. Caterpillar Finance Indonesia | Indonesia |
| P. T. Natra Raya | Indonesia |
| P. T. Solar Services Indonesia | Indonesia |
| Perkins Engines (Asia Pacific) Pte Ltd | Singapore |
| Perkins Engines (Latin America) Inc. | Delaware |
| Perkins Engines (Tianjin) Company Limited | China |
| Perkins Engines Company Limited | England and Wales |
| Perkins Engines, Inc. | Maryland |
| Perkins Executive Pension Trust Limited | England and Wales |
| Perkins France (SAS) | France |
| Perkins Holdings Limited | Delaware and England and Wales |
| Perkins International Inc. | Delaware |
| Perkins Limited | England and Wales |
| Perkins Motoren GmbH | Germany |
| Perkins Motores do Brasil Ltda. | Brazil |
| Perkins Pension Trust Limited | England and Wales |
| Perkins Shibaura Engines Limited | England and Wales |
| Perkins Shibaura Engines LLC | Delaware |
| Perkins Technology Inc. | Delaware |
| Pioneer Distribution, Inc. | South Carolina |
| Pioneer Machinery LLC | Delaware |
| PMHC LLC | Delaware |
| PointGuard LLC | Delaware |
| Przedsiębiorstwem Energetyki Ciepłncj (Bugaj) | Poland |
| R.V.K. Energy Private Limited | India |
| Rapidparts Inc. | Delaware |
| Rapisarda Industries Srl | Italy |
| Rega Kyushu Co., Ltd. | Japan |
| RelayStar SA | Belgium |

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| Rex World Co., Ltd. | Japan |
| Sabre Engines Limited | England |
| Sanko Rental Co. | Japan |
| SCM Akashi General Services Co., Ltd. | Japan |
| SCM Operator Training Co., Ltd. | Japan |
| SCM Sagami Engineering Co., Ltd. | Japan |
| SCM Sagami General Services Co., Ltd. | Japan |
| SCM Singapore Holdings Pte. Ltd. | Singapore |
| SCM System Service Co., Ltd. | Japan |
| Servtech Limited | Ireland |
| Shandong SEM Machinery Co Ltd. | China |
| Shin Caterpillar Mitsubishi Ltd. | Japan |
| Simply Reliable Power Inc. | Delaware |
| Societe de Electricite d'el Bibane | Tunisia |
| Solar Turbines Cameroon Limited | Cameroon |
| Solar Turbines Canada Ltd./Ltee. | Canada |
| Solar Turbines Europe S.A. | Belgium |
| Solar Turbines Incorporated | Delaware |
| Solar Turbines International Company | Delaware |
| Solar Turbines Overseas Pension Scheme Limited | Guernsey |
| Solar Turbines Services Company | California |
| Solar Turbines Services Nigeria Limited | Nigeria |
| Solar Turbines Trinidad & Tobago | Trinidad and Tobago |
| SPL Software Alliance LLC | Delaware |
| STI Capital Company | Delaware |
| Tech Itoh Co., Ltd. | Japan |
| Technocast, S.A. de C.V. | Mexico |
| Tecnologia Modificada, S.A. de C.V. | Mexico |
| The Heartland Community Development Corporation | Illinois |
| Tohoku Rental Service Co., Ltd. | Japan |
| Tokyo Rental Co., Ltd. | Japan |
| Tone Lease Co. | Japan |
| Tri-County Venture Capital Fund I, LLC | Delaware |
| Tunnel Rental Co., Ltd. | Japan |
| Turbinas Solar de Venezuela, C.A. | Venezuela |
| Turbo Tecnologia de Reparaciones S.A. de C.V. | Mexico |
| Turbomach (India) Private Limited | India |
| Turbomach Asia Ltd. | Thailand |
| Turbomach Deutschland GmbH | Germany |
| Turbomach Endustriyel Gaz Turbinleri Sanayi V | Turkey |
| Turbomach Engergie S.A.R.L. | France |
| Turbomach Limited | United Kingdom |
| Turbomach Netherlands B.V. | Netherlands |
| Turbomach Pakistan (Private) Limited | Pakistan |
| Turbomach S.r.L. | Italy |
| Turbomach SA - Spain | Spain |
| Turbomach SA - Switzerland | Switzerland |
| Turbomach Sp. Z o.o. | Poland |
| Turboservices SDN BHD | Malaysia |
| Turner Powertrain Systems Limited | England and Wales |
| UK Hose Assembly Limited | England |
| UK Partners Limited Partnership | Ontario |
| VALA (UK) LP | United Kingdom |

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| VALA B.V. | Netherlands |
| VALA C.V. | Netherlands |
| VALA Inc. | Delaware |
| VALA LLC | Delaware |
| Veratech Holding B.V. | Netherlands |
| West Japan Caterpillar Mitsubishi Construction Equipment Sales, Ltd. | Japan |
| West Kanto Rental Co., Ltd. | Japan |
| Williams Technologies, Inc. | South Carolina |
| Wright Equipment Company (Proprietary) Limited | South Africa |
| XPART Limited | England and Wales |
| Yeep Co. | Japan |



CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We hereby consent to the incorporation by reference in the Registration Statement on Form S-3 (Nos. 333-43133, 33-46194, 333-22041, 333-43983, 333-57512, 333-71468, 333-121003) and Form S-8 (Nos. 2-90123, 33-14116, 33-40598, 2-97450, 333-37353, 33-8003, 333-03609, 333-41464, 333-98197, 333-115837, 333-32853, 33-32851, 333-111355, 333-128342) and Form S-4 (No.333-121003) of Caterpillar Inc. of our report dated February 21, 2006 relating to the financial statements and management's assessment of the effectiveness of internal control over financial reporting and the effectiveness of internal control over financial reporting, which appears in this Form 10-K.

/s/PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Peoria, Illinois
February 21, 2006

SECTION 302 CERTIFICATION

I, James W. Owens, certify that:

1. I have reviewed this annual report on Form 10-K 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.

/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 annual report on Form 10-K 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.

/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 annual report of Caterpillar Inc. (the "Company") on Form 10-K for the period ending December 31, 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.

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

Chairman of the Board and
Chief Executive Officer

/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.

Annual CEO Certification
(Section 303A.12(a))

As the Chief Executive Officer of Caterpillar Inc.
(Name of the Company)

and as required by Section 303A.12(a) of the New York Stock Exchange Listed Company Manual, I hereby certify that as of the date hereof I am not aware of any violation of the Company of NYSE's Corporate Governance listing standards, other than has been notified to the Exchange pursuant to Section 303A.12(b) and disclosed as Exhibit H to the Company's Section 303A Annual Written Affirmation.

By: /s/James W. Owens
Printed Name: James W. Owens
Title: Chairman and Chief Executive Officer
Date: May 10, 2005

**Annual CEO Certification
(Rule 5.3(m))**

As the Chief Executive Officer of Caterpillar Inc.
(Name of the Company)

and as required by Rule 5.3(m) of PCX Equities, Inc. ("PCXE"), I hereby certify that as of the date hereof I am not aware of any violation by the Company of PCXE's Corporate Governance listing standards, other than has been disclosed to PCXE pursuant to Rule 5.3(m) and described on Exhibit C to the Company's Rule 5.3(k)(5)(D) Annual Written Affirmation.

By: /s/James W. Owens
Printed Name: James W. Owens
Title: Chairman and Chief Executive Officer
Date: October 26, 2005