CATERPILLAR INC
Form 10-Q
October 30, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q
[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2015
OR
[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission File Number: 1-768
CATERPILLAR INC.
(Exact name of registrant as specified in its charter)

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

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

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

Large accelerated filer	x	Accelerated filer	o
Non-accelerated filer	o	Smaller reporting company	o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x
At September 30, 2015, 582,233,801 shares of common stock of the registrant were outstanding.

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

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Part I. FINANCIAL INFORMATION

Item 1. Financial Statements

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

	Three Months Ended September 30, 2015	2014
Sales and revenues:		
Sales of Machinery, Energy & Transportation	$10,285	$12,758
Revenues of Financial Products	677	791
Total sales and revenues	10,962	13,549
Operating costs:		
Cost of goods sold	7,954	9,634
Selling, general and administrative expenses	1,225	1,446
Research and development expenses	534	533
Interest expense of Financial Products	142	157
Other operating (income) expenses	394	387
Total operating costs	10,249	12,157
Operating profit	713	1,392
Interest expense excluding Financial Products	127	128
Other income (expense)	(68)	117
Consolidated profit before taxes	518	1,381
Provision (benefit) for income taxes	144	364
Profit of consolidated companies	374	1,017
Equity in profit (loss) of unconsolidated affiliated companies	(3)	4
Profit of consolidated and affiliated companies	371	1,021
Less: Profit (loss) attributable to noncontrolling interests	3	4
Profit [1]	$368	$1,017
Profit per common share	$0.63	$1.66
Profit per common share – diluted [2]	$0.62	$1.63
Weighted-average common shares outstanding (millions)		
– Basic	588.4	611.5
– Diluted [2]	594.8	622.8

Cash dividends declared per common share	$—	$—

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

See accompanying notes to Consolidated Financial Statements.

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

	Three Months Ended September 30,	
	2015	2014
Profit of consolidated and affiliated companies	$371	$1,021
Other comprehensive income (loss), net of tax:		
Foreign currency translation, net of tax (provision)/benefit of: 2015 - $(5); 2014 - $(44)	(235)	(710)
Pension and other postretirement benefits:		
Current year actuarial gain (loss), net of tax (provision)/benefit of: 2015 - $(21); 2014 - $(2)	44	4
Amortization of actuarial (gain) loss, net of tax (provision)/benefit of: 2015 - $(56); 2014 - $(44)	108	86
Current year prior service credit (cost), net of tax (provision)/benefit of: 2015 - $(1); 2014 - $(1)	1	—
Amortization of prior service (credit) cost, net of tax (provision)/benefit of: 2015 - $5; 2014 - $3	(8)	(6)
Derivative financial instruments:		
Gains (losses) deferred, net of tax (provision)/benefit of: 2015 - $7; 2014 - $17	(12)	(30)
(Gains) losses reclassified to earnings, net of tax (provision)/benefit of: 2015 - $(11); 2014 - $1	20	—
Available-for-sale securities:		
Gains (losses) deferred, net of tax (provision)/benefit of: 2015 - $10; 2014 - $5	(15)	(5)
(Gains) losses reclassified to earnings, net of tax (provision)/benefit of: 2015 - $9; 2014 - $7	(18)	(13)
Total other comprehensive income (loss), net of tax	(115)	(674)
Comprehensive income	256	347
Less: comprehensive income attributable to the noncontrolling interests	(2)	(4)
Comprehensive income attributable to stockholders	$254	$343

See accompanying notes to Consolidated Financial Statements.

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

	Nine Months Ended September 30, 2015	2014
Sales and revenues:		
Sales of Machinery, Energy & Transportation	$33,829	$38,642
Revenues of Financial Products	2,152	2,298
Total sales and revenues	35,981	40,940
Operating costs:		
Cost of goods sold	25,559	29,268
Selling, general and administrative expenses	3,932	4,175
Research and development expenses	1,612	1,557
Interest expense of Financial Products	440	470
Other operating (income) expenses	1,068	1,205
Total operating costs	32,611	36,675
Operating profit	3,370	4,265
Interest expense excluding Financial Products	381	358
Other income (expense)	76	236
Consolidated profit before taxes	3,065	4,143
Provision (benefit) for income taxes	870	1,201
Profit of consolidated companies	2,195	2,942
Equity in profit (loss) of unconsolidated affiliated companies	1	6
Profit of consolidated and affiliated companies	2,196	2,948
Less: Profit (loss) attributable to noncontrolling interests	7	10
Profit [1]	$2,189	$2,938
Profit per common share	$3.66	$4.73
Profit per common share – diluted [2]	$3.62	$4.64
Weighted-average common shares outstanding (millions)		
– Basic	597.9	620.6
– Diluted [2]	605.3	632.7
Cash dividends declared per common share	$1.47	$1.30

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

See accompanying notes to Consolidated Financial Statements.

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

	Nine Months Ended September 30,	
	2015	2014
Profit of consolidated and affiliated companies	$2,196	$2,948
Other comprehensive income (loss), net of tax:		
Foreign currency translation, net of tax (provision)/benefit of: 2015 - $(60); 2014 - $(52)	(810)	(643)
Pension and other postretirement benefits:		
Current year actuarial gain (loss), net of tax (provision)/benefit of: 2015 - $(35); 2014 - $(7)	68	14
Amortization of actuarial (gain) loss, net of tax (provision)/benefit of: 2015 - $(168); 2014 - $(132)	326	258
Current year prior service credit (cost), net of tax (provision)/benefit of: 2015 - $(1); 2014 - $(1)	1	1
Amortization of prior service (credit) cost, net of tax (provision)/benefit of: 2015 - $14; 2014 - $10	(26)	(18)
Derivative financial instruments:		
Gains (losses) deferred, net of tax (provision)/benefit of: 2015 - $9; 2014 - $33	(15)	(57)
(Gains) losses reclassified to earnings, net of tax (provision)/benefit of: 2015 - $(40); 2014 - $7	69	(10)
Available-for-sale securities:		
Gains (losses) deferred, net of tax (provision)/benefit of: 2015 - $10; 2014 - $(6)	(13)	18
(Gains) losses reclassified to earnings, net of tax (provision)/benefit of: 2015 - $10; 2014 - $11	(21)	(23)
Total other comprehensive income (loss), net of tax	(421)	(460)
Comprehensive income	1,775	2,488
Less: comprehensive income attributable to the noncontrolling interests	2	(9)
Comprehensive income attributable to stockholders	$1,777	$2,479

See accompanying notes to Consolidated Financial Statements.

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

	September 30, 2015	December 31, 2014
Assets		
Current assets:		
Cash and short-term investments	$6,046	$7,341
Receivables – trade and other	6,783	7,737
Receivables – finance	8,862	9,027
Deferred and refundable income taxes	1,446	1,739
Prepaid expenses and other current assets	993	818
Inventories	11,150	12,205
Total current assets	35,280	38,867
Property, plant and equipment – net	15,955	16,577
Long-term receivables – trade and other	1,266	1,364
Long-term receivables – finance	13,551	14,644
Investments in unconsolidated affiliated companies	231	257
Noncurrent deferred and refundable income taxes	1,559	1,404
Intangible assets	2,841	3,076
Goodwill	6,546	6,694
Other assets	1,740	1,798
Total assets	$78,969	$84,681
Liabilities		
Current liabilities:		
Short-term borrowings:		
Machinery, Energy & Transportation	$12	$9
Financial Products	6,068	4,699
Accounts payable	5,206	6,515
Accrued expenses	3,306	3,548
Accrued wages, salaries and employee benefits	1,678	2,438
Customer advances	1,610	1,697
Dividends payable	—	424
Other current liabilities	1,698	1,754
Long-term debt due within one year:		
Machinery, Energy & Transportation	516	510
Financial Products	5,739	6,283
Total current liabilities	25,833	27,877
Long-term debt due after one year:		
Machinery, Energy & Transportation	8,997	9,493
Financial Products	16,211	18,291
Liability for postemployment benefits	8,638	8,963
Other liabilities	3,322	3,231
Total liabilities	63,001	67,855

Commitments and contingencies (Notes 10 and 13)		
Stockholders' equity		
Common stock of $1.00 par value:		
Authorized shares: 2,000,000,000 Issued shares: (9/30/15 and 12/31/14 – 814,894,624) at paid-in amount	5,190	5,016
Treasury stock (9/30/15 – 232,660,823 shares; 12/31/14 – 208,728,065 shares) at cost	(17,642)	(15,726)
Profit employed in the business	35,191	33,887
Accumulated other comprehensive income (loss)	(6,843)	(6,431)
Noncontrolling interests	72	80
Total stockholders' equity	15,968	16,826
Total liabilities and stockholders' equity	$78,969	$84,681

See accompanying notes to Consolidated Financial Statements.

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

	Common stock	Treasury stock	Profit employed in the business	Accumulated other comprehensive income (loss)	Noncontrolling interests	Total
Nine Months Ended September 30, 2014						
Balance at December 31, 2013	$4,709	$(11,854)	$31,854	$(3,898)	$67	$20,878
Profit of consolidated and affiliated companies	—	—	2,938	—	10	2,948
Foreign currency translation, net of tax	—	—	—	(642)	(1)	(643)
Pension and other postretirement benefits, net of tax	—	—	—	255	—	255
Derivative financial instruments, net of tax	—	—	—	(67)	—	(67)
Available-for-sale securities, net of tax	—	—	—	(5)	—	(5)
Change in ownership from noncontrolling interests	—	—	—	—	4	4
Dividends declared	—	—	(815)	—	—	(815)
Distribution to noncontrolling interests	—	—	—	—	(7)	(7)
Common shares issued from treasury stock for stock-based compensation: 9,338,857	(109)	327	—	—	—	218
Stock-based compensation expense	207	—	—	—	—	207
Net excess tax benefits from stock-based compensation	161	—	—	—	—	161
Common shares repurchased: 41,762,325 [1]	—	(4,238)	—	—	—	(4,238)
Balance at September 30, 2014	$4,968	$(15,765)	$33,977	$(4,357)	$73	$18,896
Nine Months Ended September 30, 2015						
Balance at December 31, 2014	$5,016	$(15,726)	$33,887	$(6,431)	$80	$16,826
Profit of consolidated and affiliated companies	—	—	2,189	—	7	2,196
Foreign currency translation, net of tax	—	—	—	(801)	(9)	(810)
Pension and other postretirement benefits, net of tax	—	—	—	369	—	369
Derivative financial instruments, net of tax	—	—	—	54	—	54
Available-for-sale securities, net of tax	—	—	—	(34)	—	(34)
Dividends declared	—	—	(885)	—	—	(885)
Distribution to noncontrolling interests	—	—	—	—	(7)	(7)
Common shares issued from treasury stock for stock-based compensation: 2,843,506	(75)	109	—	—	—	34
Stock-based compensation expense	240	—	—	—	—	240
Net excess tax benefits from stock-based compensation	7	—	—	—	—	7
Common shares repurchased: 25,841,608 [1]	—	(2,025)	—	—	—	(2,025)
Other	2	—	—	—	1	3
Balance at September 30, 2015	$5,190	$(17,642)	$35,191	$(6,843)	$72	$15,968

[1] See Note 11 regarding shares repurchased.

See accompanying notes to Consolidated Financial Statements.

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

	Nine Months Ended September 30, 2015	2014
Cash flow from operating activities:		
Profit of consolidated and affiliated companies	$2,196	$2,948
Adjustments for non-cash items:		
Depreciation and amortization	2,272	2,368
Other	354	327
Changes in assets and liabilities, net of acquisitions and divestitures:		
Receivables – trade and other	614	393
Inventories	840	(859)
Accounts payable	(893)	518
Accrued expenses	(25)	(44)
Accrued wages, salaries and employee benefits	(704)	648
Customer advances	(36)	(132)
Other assets – net	(108)	(104)
Other liabilities – net	354	123
Net cash provided by (used for) operating activities	4,864	6,186
Cash flow from investing activities:		
Capital expenditures – excluding equipment leased to others	(946)	(1,072)
Expenditures for equipment leased to others	(1,251)	(1,310)
Proceeds from disposals of leased assets and property, plant and equipment	473	681
Additions to finance receivables	(7,099)	(8,464)
Collections of finance receivables	6,849	7,264
Proceeds from sale of finance receivables	101	154
Investments and acquisitions (net of cash acquired)	(140)	(18)
Proceeds from sale of businesses and investments (net of cash sold)	174	196
Proceeds from sale of securities	238	347
Investments in securities	(296)	(769)
Other – net	(76)	(12)
Net cash provided by (used for) investing activities	(1,973)	(3,003)
Cash flow from financing activities:		
Dividends paid	(1,309)	(1,197)
Distribution to noncontrolling interests	(7)	(7)
Contribution from noncontrolling interests	—	2
Common stock issued, including treasury shares reissued	34	218
Treasury shares purchased	(2,025)	(4,238)
Excess tax benefit from stock-based compensation	20	162
Proceeds from debt issued (original maturities greater than three months):		
Machinery, Energy & Transportation	3	1,991
Financial Products	4,079	7,112
Payments on debt (original maturities greater than three months):		

Machinery, Energy & Transportation	(513)	(779)
Financial Products	(6,259)	(7,114)
Short-term borrowings – net (original maturities three months or less)	1,922	791
Net cash provided by (used for) financing activities	(4,055)	(3,059)
Effect of exchange rate changes on cash	(131)	(123)
Increase (decrease) in cash and short-term investments	(1,295)	1
Cash and short-term investments at beginning of period	7,341	6,081
Cash and short-term investments at end of period	$6,046	$6,082

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

See accompanying notes to Consolidated Financial Statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. A. Nature of operations

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

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

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

B. Basis of presentation

In the opinion of management, the accompanying unaudited financial statements include all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of (a) the consolidated results of operations for the three and nine month periods ended September 30, 2015 and 2014, (b) the consolidated comprehensive income for the three and nine month periods ended September 30, 2015 and 2014, (c) the consolidated financial position at September 30, 2015 and December 31, 2014, (d) the consolidated changes in stockholders' equity for the nine month periods ended September 30, 2015 and 2014 and (e) the consolidated cash flow for the nine month periods ended September 30, 2015 and 2014. The financial statements have been prepared in conformity with generally accepted accounting principles in the United States of America (U.S. GAAP) and pursuant to the rules and regulations of the Securities and Exchange Commission. Certain amounts for prior periods have been reclassified to conform to the current period financial statement presentation.

As previously disclosed, in connection with the preparation of our Quarterly Report on Form 10-Q for the quarter ended June 30, 2014, we concluded that certain non-cash transactions should be excluded from both changes in Receivables-trade and other and Accounts payable when preparing our Consolidated Statement of Cash Flow. Accordingly, we prepared our Consolidated Statement of Cash Flow for the nine months ended September 30, 2014 on that basis. We subsequently concluded that our prior policy of including those transactions in the changes in Receivables-trade and other and Accounts payable is acceptable. Accordingly, we prepared our Consolidated Statement of Cash Flow for the year ended December 31, 2014 using our prior policy. We have revised our Consolidated Statement of Cash Flow to increase Receivables-trade and other and decrease Accounts payable by $149 million for the nine months ended September 30, 2014. The revisions did not impact net cash provided by operating activities.

Interim results are not necessarily indicative of results for a full year. The information included in this Form 10-Q should be read in conjunction with the audited financial statements and notes thereto included in our Company's annual report on Form 10-K for the year ended December 31, 2014 (2014 Form 10-K).

The December 31, 2014 financial position data included herein is derived from the audited consolidated financial statements included in the 2014 Form 10-K but does not include all disclosures required by U.S. GAAP.

Unconsolidated Variable Interest Entities (VIEs)

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

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

(Millions of dollars)	September 30, 2015	December 31, 2014
Receivables - trade and other	$48	$36
Receivables - finance	492	216
Long-term receivables - finance	63	285
Investments in unconsolidated affiliated companies	28	83
Guarantees	98	129
Total	$729	$749

2. New accounting guidance

Reporting discontinued operations and disclosures of disposals of components of an entity – In April 2014, the Financial Accounting Standards Board (FASB) issued accounting guidance for determining which disposals can be presented as discontinued operations and modifies related disclosure requirements. The guidance defines a discontinued operation as a disposal of a component or group of components that is disposed of or is classified as held for sale and represents a strategic shift that has (or will have) a major effect on an entity's operations and financial results. This guidance was effective January 1, 2015 and did not have a material impact on our financial statements.

Revenue recognition – In May 2014, the FASB issued new revenue recognition guidance to provide a single, comprehensive revenue recognition model for all contracts with customers. Under the new guidance, an entity will recognize revenue to depict the transfer of promised goods or services to customers at an amount that the entity expects to be entitled to in exchange for those goods or services. A five step model has been introduced for an entity to apply when recognizing revenue. The new guidance also includes enhanced disclosure requirements, and is effective January 1, 2018, with early adoption permitted for January 1, 2017. Entities have the option to apply the new guidance under a retrospective approach to each prior reporting period presented, or a modified retrospective approach with the cumulative effect of initially applying the new guidance recognized at the date of initial application within the Consolidated Statement of Changes in Stockholders' Equity. We are in the process of evaluating the application and implementation of the new guidance.

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

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

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

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

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

3. Stock-based compensation

Accounting for stock-based compensation requires that the cost resulting from all stock-based payments be recognized in the financial statements based on the grant date fair value of the award. Stock-based compensation primarily consists of stock options, restricted stock units (RSUs) and stock-settled stock appreciation rights (SARs). Stock-based compensation awards granted prior to 2015 will vest three years after the date of grant (cliff vesting). The awards granted in 2015 will vest according to a three-year graded vesting schedule. One-third of the award will become vested on the first anniversary of the grant date, one-third of the award will become vested on the second anniversary of the grant date and one-third of the award will become vested on the third anniversary of the grant date. Stock-based compensation expense will be recognized on a straight-line basis over the requisite service period for awards with terms that specify cliff or graded vesting and contain only service conditions.

Upon separation from service, if the participant is 55 years of age or older with more than five years of service, the participant meets the criteria for a "Long Service Separation". Prior to 2015, our stock-based compensation award terms allowed for the immediate vesting upon separation for employees who met the criteria for a "Long Service Separation" and fulfilled a requisite service period of six months. For these employees, compensation expense was recognized over the period from the grant date to the end date of the six-month requisite service period. Our stock-based compensation award terms for the 2015 grant allowed for the immediate vesting upon separation for employees who met the criteria for a "Long Service Separation" with no requisite service period. For these employees, compensation expense for the 2015 grant was recognized immediately on the grant date. For employees who become eligible for immediate vesting under a "Long Service Separation" subsequent to the grant date and prior to the completion of the vesting period, compensation expense is recognized over the period from grant date to the date eligibility is achieved. If the "Long Service Separation" criteria are met, the vested options/SARs will have a life that is the lesser of ten years from the original grant date or five years from the separation date.

We recognized pretax stock-based compensation expense in the amount of $48 million and $240 million for the three and nine months ended September 30, 2015, respectively; and $70 million and $207 million for the three and nine months ended September 30, 2014, respectively. The change in stock-based compensation expense for the third quarter was primarily due to the change in award terms for participants that met the criteria for a "Long Service Separation", as the removal of the six-month requisite service period results in higher expense in the first quarter (period of grant) and lower expense over the following two quarters.

The following table illustrates the type and fair value of the stock-based compensation awards granted during the nine month periods ended September 30, 2015 and 2014, respectively:

2015	2014

	Shares Granted	Weighted-Average Fair Value Per Share	Weighted-Average Grant Date Stock Price	Shares Granted	Weighted-Average Fair Value Per Share	Weighted-Average Grant Date Stock Price
Stock options	7,939,497	$ 23.61	$ 83.34	4,448,218	$ 29.52	$ 96.31
RSUs	1,822,729	$ 77.54	$ 83.01	1,429,512	$ 89.18	$ 96.31

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The following table provides the assumptions used in determining the fair value of the stock-based awards for the nine month periods ended September 30, 2015 and 2014, respectively:

	Grant Year	
	2015	2014
Weighted-average dividend yield	2.27%	2.15%
Weighted-average volatility	28.4%	28.2%
Range of volatilities	19.9-35.9%	18.4-36.2%
Range of risk-free interest rates	0.22-2.08%	0.12-2.60%
Weighted-average expected lives	8 years	8 years

As of September 30, 2015, the total remaining unrecognized compensation expense related to nonvested stock-based compensation awards was $261 million, which will be amortized over the weighted-average remaining requisite service periods of approximately 2.0 years.

4. Derivative financial instruments and risk management

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

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

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

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

Foreign Currency Exchange Rate Risk

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

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Our Machinery, Energy & Transportation operations purchase, manufacture and sell products in many locations around the world. As we have a diversified revenue and cost base, we manage our future foreign currency cash flow exposure on a net basis. We use foreign currency forward and option contracts to manage unmatched foreign currency cash inflow and outflow. Our objective is to minimize the risk of exchange rate movements that would reduce the U.S. dollar value of our foreign currency cash flow. Our policy allows for managing anticipated foreign currency cash flow for up to five years. As of September 30, 2015, the maximum term of these outstanding contracts was approximately 15 months.

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

As of September 30, 2015, $19 million of deferred net losses, net of tax, included in equity (AOCI in the Consolidated Statement of Financial Position), are expected to be reclassified to current earnings (Other income (expense) in the Consolidated Statement of Results of Operations) over the next twelve months when earnings are affected by the hedged transactions. The actual amount recorded in Other income (expense) will vary based on exchange rates at the time the hedged transactions impact earnings.

In managing foreign currency risk for our Financial Products operations, our objective is to minimize earnings volatility resulting from conversion and the remeasurement of net foreign currency balance sheet positions, and future transactions denominated in foreign currencies. Our policy allows the use of foreign currency forward, option and cross currency contracts to offset the risk of currency mismatch between our receivables and debt, and exchange rate risk associated with future transactions denominated in foreign currencies. Substantially all such foreign currency forward, option and cross currency contracts are undesignated.

Interest Rate Risk

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

Our Machinery, Energy & Transportation operations generally use fixed-rate debt as a source of funding. Our objective is to minimize the cost of borrowed funds. Our policy allows us to enter into fixed-to-floating interest rate swaps and forward rate agreements to meet that objective. We designate fixed-to-floating interest rate swaps as fair value hedges at inception of the contract, and we designate certain forward rate agreements as cash flow hedges at inception of the contract.

As of September 30, 2015, $4 million of deferred net losses, net of tax, included in equity (AOCI in the Consolidated Statement of Financial Position), related to Machinery, Energy & Transportation forward rate agreements, are expected to be reclassified to current earnings (Interest expense excluding Financial Products in the Consolidated Statement of Results of Operations) over the next twelve months.

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

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

As of September 30, 2015, $1 million of deferred net losses, net of tax, included in equity (AOCI in the Consolidated Statement of Financial Position), related to Financial Products floating-to-fixed interest rate swaps, are expected to be reclassified to current earnings (Interest expense of Financial Products in the Consolidated Statement of Results of

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Operations) over the next twelve months. The actual amount recorded in Interest expense of Financial Products will vary based on interest rates at the time the hedged transactions impact earnings.

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

Commodity Price Risk

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

Our Machinery, Energy & Transportation operations purchase base and precious metals embedded in the components we purchase from suppliers. Our suppliers pass on to us price changes in the commodity portion of the component cost. In addition, we are subject to price changes on energy products such as natural gas and diesel fuel purchased for operational use.

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

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

(Millions of dollars)	Consolidated Statement of Financial Position Location	Asset (Liability) Fair Value	
		September 30, 2015	December 31, 2014
Designated derivatives			
Foreign exchange contracts			
Machinery, Energy & Transportation	Receivables – trade and other	$16	$25
Machinery, Energy & Transportation	Accrued expenses	(47)	(134)
Machinery, Energy & Transportation	Other liabilities	(2)	—
Interest rate contracts			
Financial Products	Receivables – trade and other	1	6
Financial Products	Long-term receivables – trade and other	65	73
Financial Products	Accrued expenses	(4)	(8)
		$29	$(38)
Undesignated derivatives			
Foreign exchange contracts			
Machinery, Energy & Transportation	Receivables – trade and other	$6	$2
Machinery, Energy & Transportation	Accrued expenses	(11)	(43)
Financial Products	Receivables – trade and other	3	5
Financial Products	Long-term receivables – trade and other	35	17
Financial Products	Accrued expenses	(5)	(15)
Commodity contracts			
Machinery, Energy & Transportation	Accrued expenses	(12)	(14)

	$16	$(48)

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

(Millions of dollars)	September 30, 2015	December 31, 2014
Machinery, Energy & Transportation	$2,198	$3,128
Financial Products	$3,785	$5,249

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

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

Fair Value Hedges

(Millions of dollars)	Classification	Three Months Ended September 30, 2015		Three Months Ended September 30, 2014	
		Gains (Losses) on Derivatives	Gains (Losses) on Borrowings	Gains (Losses) on Derivatives	Gains (Losses) on Borrowings
Interest rate contracts					
Financial Products	Other income (expense)	$3	$(3)	$(19)	$1
		$3	$(3)	$(19)	$1

	Classification	Nine Months Ended September 30, 2015		Nine Months Ended September 30, 2014	
		Gains (Losses) on Derivatives	Gains (Losses) on Borrowings	Gains (Losses) on Derivatives	Gains (Losses) on Borrowings
Interest rate contracts					
Financial Products	Other income (expense)	$(11)			