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EDITED TRANSCRIPT

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PRESENTATION

Operator

Good afternoon, ladies and gentlemen, and welcome to the Caterpillar conference call on Cat Financial. It is now my pleasure to turn the floor over to your host, Rich Moore, Caterpillar Director of Investor Relations. Sir, the floor is yours.

Rich Moore - *Caterpillar Inc. - Director of IR*

Thank you, Paul. Good afternoon, and welcome everyone, to our conference call on Cat Financial. Thank you all for joining us today. I'm Rich Moore, Caterpillar's Director of Investor Relations. On the call today I'm pleased to have Kent Adams, President of Cat Financial and Vice President of Caterpillar Inc. with responsibility for the financial products division. Along with Kent, we also have Jim Duensing, Cat Financial's CFO, and Mike DeWalt, Caterpillar Vice President of Finance Services Division.

I have a few housekeeping items before we get started. This call is copyrighted by Caterpillar Inc. Any use, recording or transmission of any portion of the call without the express written consent of Caterpillar is strictly prohibited. There is a copy of today's presentation posted in the investor section of our Caterpillar.com website, in the section labeled events and presentations. We will also post a copy of today's call transcript in the same location on our website.

Today, we'll be discussing forward-looking information that involves risks, uncertainties, and assumptions that could cause actual results to differ materially from the forward-looking information. Additional information concerning factors that could cause results to materially differ can be found in the risk factors section of Caterpillar's Form 10-K filed with the SEC in February of this year, and also in the forward-looking statements section in today's presentation.

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So today's call is the second in a series of conference calls that we started in August, when we provided an update on our Across the Table initiative. After that call in August, we thought about what to highlight next, and it became clear that Cat Financial would be an excellent topic. As you will learn during the call, Cat Financial is an integral part of Caterpillar's enterprise strategy and business plan. They've been around for a long time, and have deep expertise with Caterpillar equipment, and in working closely with customers and the industries we serve. In addition, their portfolio is quite diverse, and their risks are very well-managed. So with that brief introduction, I'll turn the call over to Kent Adams.

Kent Adams - *Caterpillar Inc. - VP and President of Caterpillar Financial Services Corporation*

Good afternoon. This is Kent Adams, as Rich said, I'm the President of Caterpillar Financial Services Corporation, and with me today, who will also do some of the presenting is Jim Duensing, our Executive Vice President and Chief Financial Officer for Cat Financial Services Corporation.

If you would, turn to the next page, and I really have four key messages for you today. First, we create value for Caterpillar customers. Second, how Cat Financial creates value for Caterpillar. Third, that we are a globally diverse group. And fourth, that we are very well managed. And I'll go over examples of all of these over the next few minutes.

If you would turn to the next page, please. Speaking about customer value and creating value, and how we support our customers globally, we do that in more than 115 countries, either through our local presence, by cross border financing, or through the various types of alliances. We provide Caterpillar customers financial alternatives and options to support their purchase of Caterpillar products in 115 countries, in 23 languages across 18 time zones, with over 2,000 employees--unmatched by any of our competitors.

If you would turn to the next page, please, we also create value with our customers in many different ways, and you can see two quotes from our customer listening surveys. We've been in business over 35 years, and we have deep industry knowledge, and these quotes really summarize in many ways the values that our customers see in financing with Caterpillar Financial. The quotes, and I'll read them to you:

The deal is always there. It's a first class operation. They helped us 26 years ago, when no one else would. My Cat Financial experience is why I bought another Caterpillar machine. They are extremely understanding, and work well with clients. That really speaks to the value that Caterpillar customers see when they finance with Caterpillar Financial. And finally, from a quote and credit process determination and the various ways we touch customers on a daily basis, we touch customers, Caterpillar customers, more than 10,000 times on a daily basis, driving the positive Caterpillar customer experience.

If you turn to the next page, please, we offer Caterpillar customers diverse and consistent financial products. You can see on this chart the various types of financial products we offer from non-tax leases to tax leases, to wholesale financing, to installment sales contracts, a small amount of government financing, and various types of notes receivable. And you can see the mix hasn't changed much between 2014 and 2015, and this has been fairly consistent over the last several years. Our finance lease and tax lease portfolio has dropped slightly from 2014 from 34% to 31%, all other areas are stable, and the offsetting increase was in our installment sales contracts increasing from 18% to 21%. And, I mentioned this mix of financial products has been consistent for several years.

Our next chart, please. Another way we create value, this is really creating value for Caterpillar, is the loyalty we drive with customers, and this chart depicts loyalty created by captive finance companies including Caterpillar Financial, compared to third parties or independents.

And you can see since 2009, and we have tracked this for several years, in every year, a customer has a higher sense of loyalty to the manufacturer when they finance with a captive finance company. And when we ask Caterpillar customers about their overall machine satisfaction, those customers that finance with Caterpillar Financial actually have a higher level of satisfaction with their machine, than those that finance with a third party. Finally, customer loyalty is one of the few indicators that suggests and predicts what future share of market will be.

If you turn to the next page, please, we spend a lot of time thinking about residual values and our ability to resell equipment when a machine comes off lease. Our residual value, again, depending on our deep industry knowledge, goes back over 35 years. When we create a residual value, we look at the machine application. We look at the number of hours that machine will be used, and we consider how we will remarket that machine.

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This chart depicts the cascade for remarketing of off-lease or repossessed equipment. Almost 90% of the machines that we have from a lease, off of a lease conversion, or from a repossession, will be remarketed and sold through the Caterpillar channel. That means specifically when a machine comes off lease, our first choice is for the customer that is leasing the equipment to convert the equipment and purchase the equipment. If that customer doesn't take the machine, we then offer it through CatUsed.com to Caterpillar customers globally, and they have the opportunity to buy that machine and the sale is directed to the Caterpillar dealer.

Third, if it's not sold directly to a Caterpillar customer, the machine is sold to a Caterpillar dealer through our online services. And finally, and this is about 10% area, machines are sold, if they don't go through the first part of the cascade, will go through the auction channel. And auction channel machines are typically competitive equipment or older Caterpillar equipment that hasn't obviously sold through the Caterpillar channel.

By selling through the Caterpillar channel, as I said, almost 90% is sold through that channel. It creates a higher price point. That higher price point enables us to offer better residuals and more aggressive payment terms than you might see from a third party. It also creates greater parts and service revenue for Caterpillar and the Caterpillar dealer.

If you go to the next chart, please, I'm only going to speak today about our global leader goal within our strategy, because it's targeted specifically to driving PINS, POPS, and PODD, and I'm sure all of you are familiar with those three acronyms. Our global leader strategy has been developed to support the sale of Cat equipment, and grow with Caterpillar. Our top tier metrics include PINS, POPS, and PODD.

We have four critical success factors, and I'll read them to you: Marketing competitive intelligence to beat our competition. Know how to beat the competition, and understand what our competitors want to do. So we're targeting specifically our intelligence to make sure we understand what competition is doing, and how do we put plans in place to beat our competition.

Second are business unit and dealer alignment and engagement. Aligning with our business unit partners and our dealers to drive the sale of Caterpillar equipment. Third, sales excellence, help sell Caterpillar products and services through financial services and insurance solutions. That's really focused on our sales force and our ability to acquire new customers. And fourth, creating a customer experience to retain customers.

I'll cover the next few of these in the next few slides. If you think about those earlier quotes, it really demonstrates the importance of the last two, CSFs, in terms of the customer acquisition aspect, in terms of ease of doing business, and finally, the customer experience and why customers come back to Caterpillar.

If you go to the next chart, please, I'll talk about market and competitive intelligence, the value that brings to Caterpillar. We use what we call a global hub and spoke model. What that means is we use more than 280 sales professionals globally providing input. It's coordinated by 25 regional process owners, focused specifically on funneling competitive intelligence to our two global process owners. They provide that to our Global Leader Council, which is again focused on driving PINS, POPS, and PODD. The information is analyzed and shared with the Caterpillar MBDs and the Caterpillar dealers, and used to proactively and at times react to competitive pressures.

The next chart, please. Chart 11. Every dealer, where we have a presence, we have a specific action plan deployed globally for that dealer. This annual process is specific to driving plans in their territories, focused on PINS, POPS, and PODD, using financial solutions to drive Caterpillar business. And you can see the level of detail we go through, and these are done with the key decision makers at each dealer.

Finally, by managing the business model well we create value for Caterpillar through the stable earnings that our business model creates. You can tell as part of our mission, when we close today, our mission is to grow with Caterpillar, support the sale of Caterpillar equipment, and create stable earnings. We have thousands of customers paying us monthly, quarterly, or semiannually, generating profit for Caterpillar as an offset to the cycles that Caterpillar sometimes goes through. With that, I'll turn it over to Jim Duensing.

Jim Duensing - *Caterpillar Inc. - EVP and CFO of Caterpillar Financial Services Corporation*

Thank you, Ken. It's a pleasure to be with all of you today. We want to share some additional details on our portfolio composition, which are depicted on slide 13. Our portfolio is very well diversified, with broad distribution of exposure across the key industry segments Caterpillar serves.

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Our largest segment, Cat dealers and wholesale, represents about 25% of our portfolio, mostly comprised of dealer trade payables on new machine shipments from our factories, dealer term loans and rental fleet financing with our dealers. Our second largest industry segment, but comprising only 13% of our portfolio and down from 15% at year end 2014, is mining, which also includes the small amount of oil and gas exposure we currently have in our portfolio. We consider our exposure to mining to be very manageable, and we are fully reserved for any expected losses in this segment. Highway and heavy construction is next at 11% of the industry exposure, with the remaining industries at or below this percentage concentration.

We also have broad distribution of risk across our 143,000 customer base globally. Nearly 80% of our customers have outstanding balances with us of less than $100,000, and 98% of our customers have balances of less than $1 million. Geographically, North America represents our largest segment at 59% of our total portfolio exposure, followed by Asia-Pacific at 14%, Europe at 13%, and Latin America at 11%.

If you move to slide 14, you'll find a summary of Cat Financial's past dues and credit losses over the last 25 years. As you're all aware, this is a cyclical business, and there's certainly a level of cyclicality as you look at our past dues and allowance losses. But our performance has been comparatively good through the cycles, when you look at the extent of industry decline in some of the key businesses that we serve. Today, despite weakness in many of our key end markets, at September 30 our past dues over 30 days were 2.68%, and in line with our historical averages.

Our write-offs also continue to perform well, given the current macroeconomic environment we're operating in, and are in the range of our historical average at 59 basis points annualized, based on our third-quarter 2015 year-to-date results. Maintaining good portfolio health is something that's been very important to us, and is supported by a very robust process around communication with our customers, collection processes. We also maintain a good overall collateral position in the equipment we finance, and we have the ability, as Ken mentioned earlier, to sell machines through our dealer network to help minimize credit losses.

If you move to slide 15, we have provided a summary of our global funding mix in recent years, an area where we've assigned a great deal of importance to funding diversity, to maintain access to liquidity through all economic cycles. Today, we maintain access to 10 global term debt funding platforms, across nine different currencies, and an additional five global commercial paper programs. On average, medium term notes comprise 55% to 60% of our capital structure, providing a deep source of liquidity, and allowing us to cover most of our matched funding needs from a loan duration, fixed and floating rate profile, and currency perspective.

Commercial paper typically averages 12% to 15% of our capital structure, and is used along with our cash balances to fund day-to-day new business needs. Bank loans, around 4% of our capital structure are utilized for some of the smaller global portfolios we have, where a capital market solution either isn't available or isn't economical given the scope of our funding needs. Finally, through our national-based capital markets group, we also maintain the ability to syndicate excess customer risk exposures, which we do on an ongoing basis, and this represents around 1% of our total capital structure.

Kent Adams - *Caterpillar Inc. - VP and President of Caterpillar Financial Services Corporation*

To close, before we take questions, in terms of what's ahead, we're very focused on executing our strategy and that strategic focus really resides around three key principles: One, as a captive finance company, to support the sale of Caterpillar equipment. I speak regularly with our employees, and with customers, as Caterpillar's captive finance company, we aren't financing refrigerators, we aren't financing computer software. Our focus is to finance Caterpillar customers and help Caterpillar customers through the various cycles they're in. And second is to grow with Caterpillar. We grow where Caterpillar grows. And third, by managing the business well, creating stable earnings.

We have three strategic goals: Best team, global leader and superior results. With five CSFs and the best team goal, four critical success factors in global leader, and three critical success factors in superior results, supported by hundreds of action items to support the sale of Cat equipment, to grow with Caterpillar, and to create those stable earnings that you've seen through the previous cycles. With that, we'll close and take questions.

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QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Your first question is coming from Ann Duignan. Ann, please announce your affiliation and pose your question.

Mike Conlon - *JPMorgan - Analyst*

This is Mike Conlon on for Ann. With JPMorgan.

The question that I have is with respect to what trends you're seeing in your loss provisions. It looked like they had moved up earlier on in the year, but have since come back down a bit. Can you just talk about what you're seeing there?

Kent Adams - *Caterpillar Inc. - VP and President of Caterpillar Financial Services Corporation*

The way our provision process works is, as a part of a standard repeatable process we go through several times a quarter, we look at the overall risk that is apparent in the portfolio, based on past dues, the macroeconomic factors at play in the various industries and geographical areas we serve. And in addition, we will provide specific reserves for specific named accounts, where we see greater than 50% loss potential.

As those accounts are written off, the specific reserve comes out of our allowance. You will have seen some of that in the third quarter. And those amounts not being replaced by equal numbers of new potential credit loss accounts.

So you saw at the end of September, our allowance down slightly, ending the quarter at 1.26%. So that's how we go about it. Those are some of the larger moving pieces in the allowance process and reflected in that final number of 1.26%.

Mike DeWalt - *Caterpillar Inc. - VP of Finance Services Division*

This is Mike. Did that answer your question?

Mike Conlon - *JPMorgan - Analyst*

I think that's a helpful introduction. I was hoping to hear a little bit more about what's actually driving some of those underlying components?

Kent Adams - *Caterpillar Inc. - VP and President of Caterpillar Financial Services Corporation*

So this is Kent. The way to think about it, with our global footprint, we're seeing softness in the developing markets. We're obviously seeing some softness in the mining space.

But when you look at the cycles we've seen since 1991, it's nothing extraordinary. And as Jim mentioned in the process, we're very systematic in not just our upfront underwriting, but also very systematic in our allowance, and our potential credit losses implication. So you're seeing the global softness, but it's not extraordinary in any way.

Mike Conlon - *JPMorgan - Analyst*

Could you just talk quickly about mining, given how that portfolio looks different now versus in past cycles, with the inclusion of Bucyrus?

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Kent Adams - *Caterpillar Inc. - VP and President of Caterpillar Financial Services Corporation*

Yes, this is Kent again.

So our credit underwriting is a pretty consistent approach, and so the mining portfolio is, as Jim said, it's about 13% of the total portfolio. Within that, it's a global footprint, within that, you have various commodities. We don't talk specifically about any one commodity. We had some softness, but nothing of a material nature. It's just not that big.

Mike DeWalt - *Caterpillar Inc. - VP of Finance Services Division*

This is Mike. Is it dramatically different than it would have been 10 years ago, the mix?

Kent Adams - *Caterpillar Inc. - VP and President of Caterpillar Financial Services Corporation*

The mining mix is actually probably a little smaller today than it was over the last few years.

Mike Conlon - *JPMorgan - Analyst*

Thank you.

Operator

And the next question is coming from Ted Grace. Please announce your affiliation and pose your question.

Ted Grace - *Susquehanna Financial Group / SIG - Analyst*

It's Ted Grace from Susquehanna. Thanks for hosting the call.

Kent, or maybe Jim, could you talk to what -- domestically, what the lease term environment's like, in terms of how aggressive some of your competitors are using lease terms to win business? And then on a related basis, could you just talk about what you're seeing on the used equipment pricing side for Cat equipment, we're able to see the Rouse data, both retail and auction, I was wondering if you could just maybe talk about what you're seeing across your own portfolio of leases?

Kent Adams - *Caterpillar Inc. - VP and President of Caterpillar Financial Services Corporation*

Sure, this is Kent.

Let me talk a little about -- I mentioned earlier in a broad way, so when we think about leases, and we think about residual setting, we think specifically, first of all, about how a machine will be used, whether it's in logging or landfills or agricultural or mining, road construction. We think about how many hours it will be used, whether it's two, three, four, five years. And then we think about how we'll remarket it, and we look at usually a three- to five-year moving average, in terms of historical prices of machines, based on our database, and how we set that residual and we set those residuals annually.

So when you talk about mining specifically, you've got to talk -- or the US lease market, you have to think about, so are you talking about a 936 on a construction site, or are you talking about a 936 being used in an agricultural application? So that's a broad view. I mentioned how we remarket

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through our distribution system, to really maximize the resale values when they come off the lease, if they do come back from conversion. And we actually have historically a high conversion percentage. And so, and a lot of our leases typically convert.

Certainly competition at times uses financial products to sell product, as we do also. But having said that, the process we use to set those residuals, how we remarket those machines that come off lease, it's not -- we haven't really seen any significant change at all. In fact, we've seen a little bit of reduction in our overall operating lease fleet.

Ted Grace - *Susquehanna Financial Group / SIG - Analyst*

Okay. That's helpful.

One of the questions we often get from investors is how does Cat mitigate risk in places like China, and in mining markets, whether it's leased or on the loan side? Could you maybe walk you through whether it's a function of the equity contribution the client's making, or amortization schedule, the various steps you take in those markets that would be different than probably what you do in the US?

Kent Adams - *Caterpillar Inc. - VP and President of Caterpillar Financial Services Corporation*

So I'll talk about China a little bit, and it may be sort of a surprise. So as an example, in China, the machines we finance are equipped with Product Link, so we know physically where the machine is. It's interesting in China, because of the technology there, we often communicate with our customers in China through SMS text messages. If a customer falls behind, we have the ability to derate the engine or turn the engine off, and we've set up a legal presence in all of the provinces in China.

Finally, we have fairly conservative payment terms in China because it's still a developing market from a rule of law standpoint. And our results in China have actually been very, very acceptable. There's an example of how we manage it to mitigate the risk there.

Ted Grace - *Susquehanna Financial Group / SIG - Analyst*

Okay. That's super helpful. Thanks for the call again. I'll get back in queue, and let other people ask some questions.

Operator

And your next question is coming from Ross Gilardi. Ross, please announce your affiliation and pose your question.

Ross Gilardi - *BofA Merrill Lynch - Analyst*

Bank of America-Merrill Lynch. Good afternoon. I just had a couple of questions. I'm trying to just understand a bit better the cadence between Cat machinery operating profit and the trends you see there versus Cat Financial.

If you look at Cat machinery, operating profits have more than halved off the peak. If you look at Cat Financial, I think they're down about 20% or so from the peak. But maybe there's a lag. But is it inevitable the declines for Cat Financial should eventually track what you're seeing in the machinery business? And if not, why not?

Kent Adams - *Caterpillar Inc. - VP and President of Caterpillar Financial Services Corporation*

So this is Kent again. The first part of the answer was it depends. The first thing you hit on is the difference in the volatility of the operating profits, and that's really because you have two different business models.

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You think about the Cat Financial side of the business, as Jim mentioned, the portfolio's over $30 billion. We have 143,000 customers. Our average origination runs over four years, and so that portfolio, as it amortizes, you recognize the profits and associated expenses over the life of that loan.

And so those 143,000 customers paying every month, you have a much more stable source of earnings. You are going to see a decline in earnings, as the size of the portfolio shrinks, but it's going to be a slower decline, and as Caterpillar's profits recover, then our average earnings of our portfolio would grow back up, and you'll see the earnings recover more quickly.

Mike DeWalt - *Caterpillar Inc. - VP of Finance Services Division*

Ross, this is Mike.

I'll just give you another little perspective on that. The way I always think of Cat Financial when I talk to investors is, it's a four-year moving average of Caterpillar sales, because each year, you have business that was written three or four years ago roll off, and new business comes on. So it's a moving average.

And I think, if you think about probably thinking about sales volume, it might be a better indicator than thinking about our operating profit at the machinery company, because we're fairly capital-intensive and profit for the machinery Company moves more significantly than sales. I mean, we have 25% to 30% decrementals and similar incrementals, and Cat Financial is not capital intensive like that. I think their results are probably, if you look at them over time, I would think they would be a little bit more aligned with a three, or four, or five year moving average of Cat sales.

Ross Gilardi - *BofA Merrill Lynch - Analyst*

Got it. Thanks, Mike. That's helpful.

And then I just had a follow-up question more on China, and wanting to understand what type of captive finance capability some of your Chinese competitors have, and what trends are you seeing there? Are they willing to underwrite much riskier deals in this environment? And Cat has clearly been taking share in a down market for a couple of years now, and what role, if any, has Cat Financial played in that?

Kent Adams - *Caterpillar Inc. - VP and President of Caterpillar Financial Services Corporation*

This is Kent again. It's hard for me to speak about our competition. What I can say is, our typical customer profile has two to six machines. They tend to be, obviously, small as a result of that, entrepreneurial.

We tend not to lend to large groups where payment could be an issue and remedy would be a problem if there's lack of payment. So I can talk about what we do and how we do it and the success we've had, and we obviously haven't had the headlines that some of our competition has. But I can't say specifically what they do or how they underwrite it.

Ross Gilardi - *BofA Merrill Lynch - Analyst*

Okay. Thanks very much.

Operator

Thank you. And the next question is coming from David Raso. Sir, please announce your affiliation and pose your question.

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David Raso - *Evercore ISI - Analyst*

Evercore ISI. Just a couple quick questions on areas of some concern in the portfolio, just so we understand the comfort level we should have. In LatAm, you took a pretty big write-off in the third quarter. I would have figured the past dues there would have come down.

If you look at LatAm, it looks like almost 13% of all LatAm receivables at the customer level are past due, with a large percent of them actually over 91 days past due. Can you give us a little comfort in understanding the past due situation in LatAm, and why doesn't it become more of an issue? 13% of the total LatAm receivables are past due.

Definitionally, can you help us understand, if you have a mining customer in LatAm, is there double counting there, or is it completely separate? A mining customer regardless of geography, is in mining? Just wanted to understand the LatAm mining overlap issue.

Jim Duensing - *Caterpillar Inc. - EVP and CFO of Caterpillar Financial Services Corporation*

This is Jim Duensing, I'll take your question.

The first thing that we say, and as you recognized and going through our past due aging details in our public filings, there is a lot of focus today on Latin America. There is portfolio stress there. We're working through the accounts, especially the aged accounts, to get to a point of final resolution.

There are a lot of economies not doing well in Latin America today, and that's clearly reflected in our numbers. So we have, as we typically do during periods of portfolio stress, we've moved some of our origination staff to portfolio health-related activities, we call it, collections, repossessions, to make sure as we work our way through the current difficult conditions in many of the key markets and industries in Latin America, that we come out as well as we possibly can. And as you've seen in our historic results, we tend to do reasonably well. Again as you look at our business model, we try to get a down payment, or many times there's a trade-in on the machine.

So we go in after the transaction with a reasonably good collateral position. Higher risk customers will receive shorter credit terms, so we tend to get even more quickly into a collateral position and maintain that through the contract, the finance lease, installment sale, contract, whatever it is. So that's how we're approaching Latin America. There is a lot of activity there with our teams, and we're assigning it a high degree of priority. So that's the broad response as you look at Latin America.

Mike DeWalt - *Caterpillar Inc. - VP of Finance Services Division*

Talk about the geography and the mining.

Jim Duensing - *Caterpillar Inc. - EVP and CFO of Caterpillar Financial Services Corporation*

On the mining side, if you look at our segment reporting, and the description that we have around the mining sector, that covers the large majority of our mining exposure, large corporate accounts in the mining sector are captured there. There is some level of smaller contract miners, or junior miners, where we would have exposure within individual Latin America countries, but it's a relatively small percentage of the total portfolio. Most of it, the large majority of it shows up in the mining segment, as broken out in our public filings with the SEC.

David Raso - *Evercore ISI - Analyst*

So to be clear, a miner is going to be in that mining section, generally speaking. If it's a LatAm miner, that's not in the LatAm number. Basically what we're trying to figure out, you've got $204 million past due over 91 days in LatAm. And I'm just trying to understand how much further can we go before we start to see that flow through in a negative way to the financials?

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It's not just past due 30 days. It's a couple hundred million dollars over 91 days. I'm just trying to make sure we have some comfort on when is that going to manifest itself over the next quarter or so? How much further can you go with that?

Kent Adams - *Caterpillar Inc. - VP and President of Caterpillar Financial Services Corporation*

This is Kent. The question about is it going to flow through, Jim mentioned during the allowance process, and how we think about it, we have really three approaches to creating our allowance for credit losses. One, we have a general reserve, where we look at statistical process, just the overall health of the portfolio.

Then we have specific reserves, where each of our offices report specific customers are in trouble and we rank those in terms of how much trouble they're in, in terms of the likelihood of potential loss. Then we have the qualitative piece. And so when we look at our past due trends, that fits into that qualitative piece. So we should already be reserved for losses that might occur from those past dues.

David Raso - *Evercore ISI - Analyst*

So have you stepped up the reserves? Like the reserves for the total company are not necessarily that high, but have you set reserves higher, provisioning already a lot higher for the LatAm business? Again, these are now over 91 days due. I'm just making sure we understand.

Jim Duensing - *Caterpillar Inc. - EVP and CFO of Caterpillar Financial Services Corporation*

Yes, this is Jim Duensing again. We have. Those that you see in the 91 and higher category would have specific credit reserves set aside, potential credit loss additions to our allowance account. Unless we are in a collateral position, and that as we repossess, we have determined that we very likely would not experience a loss, and we're just going through the process in the court system.

The other thing you may be aware of, but going through the court system in some of these Latin American countries takes a longer period of time, certainly, than many Western countries, and more -- better developed, I guess, legal systems. That's what you're seeing, some of that 91 and above. We're just working through the court process.

We've got potential credit loss amounts set aside for those expected losses, again, unless we have a good collateral position on those. So the financial statement impact of what you see in those past dues is already reflected, based on our current estimates in our P&L, and our financial results through the end of September.

Mike DeWalt - *Caterpillar Inc. - VP of Finance Services Division*

This is Mike.

I'm not in Cat Financial, so I have to think about this much more simply. But just because something is past due doesn't mean that it's going to be a loss. I mean, we have the ability to repossess equipment, and I don't know what the average is, but if it's more than a year old, it's probably not under water.

Kent Adams - *Caterpillar Inc. - VP and President of Caterpillar Financial Services Corporation*

This is Kent again.

I'll come back to Jim's point. If you think about a transaction, let's say you have a $100 financing that shows up as being over 90 days past due. That financing may have a down payment, will likely have a down payment against it, and we also likely have lien on the machinery, because a very,

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very high percentage of our financing is secured. An ultimate loss would be well less than that $100 that shows up as past due. That's the part that's reserved, as Jim mentioned.

David Raso - *Evercore ISI - Analyst*

That's helpful. And on the impaired receivables, Cat Power finances about 50% of them. Cat power finance, I know the basic definition of basically, if has a Cat engine in it, marine vessel, power gen, it's still in the purview of Cat Financial financing it. A little more current up-to-date view of what actually is in Cat Power Finance, those impaired receivables? Is it more marine? Is it small power plants that you've gotten involved in? I'm trying to understand the sensitivity there on that.

Kent Adams - *Caterpillar Inc. - VP and President of Caterpillar Financial Services Corporation*

Sure. This is Kent.

Cat Power finance is both electrical power generation and marine. The bulk of what you're seeing there is specific to our marine market in Europe, and it's been challenging for us for about the last three years, and we actually feel like we're pretty well through it. But that's what that is.

David Raso - *Evercore ISI - Analyst*

That's not a new development. It keeps moving around. Kind of the same issues, marine and Europe.

Kent Adams - *Caterpillar Inc. - VP and President of Caterpillar Financial Services Corporation*

That's right.

David Raso - *Evercore ISI - Analyst*

Really helpful. Appreciate the call. Thank you.

Operator

Thank you. And the next question is coming from Joe O'Dea. Please announce your affiliation and pose your question.

Joe O'Dea - *Vertical Research - Analyst*

It's Vertical Research. Slide 13 gives a helpful breakdown, I think, of the portfolio by end markets, but just wondering if you could marry up the finance exposure with how the equipment side is reported to talk to it, in terms of what that exposure looks like on a construction or resources or E&T side of things, because it seems like there's a skew towards the construction side, and naturally toward North America. So that would help some of the trending recently, and why receivables haven't moved down as sharply as they would have back in 2009 with declines then.

Jim Duensing - *Caterpillar Inc. - EVP and CFO of Caterpillar Financial Services Corporation*

If you look at the industry breakdown, on slide 13, I think it's the one you're referring to, the top pie graph, and go down the list, highway and heavy construction would be largely construction. A lot of manufacturing, industrial, likewise. You go into building construction, certainly our BCP product

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line, very active in that segment. Special trade contractors, again, you'd find a lot of construction equipment. Those would be utility contractors, landscapers, companies involved in that activity.

So to your point, as you look at those industry segmentations, and you also measure that or marry that up with the North American geographic segment, you can see that nearly 60%, as I said earlier, is in the North American geographic area, a lot of it construction. There's some mining, but a lot of it's construction, which is why we continue to have comparatively good performance, despite, again, weakness in some of our key end markets.

Joe O'Dea - *Vertical Research - Analyst*

Okay. Thank you.

And then could you talk about complications when it comes to the remarketing side of things with emission standards, and what that means for when equipment comes offlease. Maybe your ability to move it around more easily in prior periods versus today, and how you address that?

Kent Adams - *Caterpillar Inc. - VP and President of Caterpillar Financial Services Corporation*

I think you're referring to Tier 4, and the ability to use it outside of the developed markets. This is Kent speaking.

You referred to that cascade. To date, we really haven't seen any impact in our ability to remarket. If we were to see that trend, we would obviously adjust our residual values on a forward basis. But to date, that hasn't been the case.

Mike DeWalt - *Caterpillar Inc. - VP of Finance Services Division*

I think the idea is to keep it as close to where it is --

Kent Adams - *Caterpillar Inc. - VP and President of Caterpillar Financial Services Corporation*

That's a good point, Mike. Back to -- our real focus, as I mentioned, we have a very high conversion rate on our leases. That's our first choice, is that the customer that's leasing it also convert the machine. Second, it's to customers in that local market, and so typically we see a high percentage there, and third is the Cat dealer, and also a lot of that is in the geographic market.

A very small percentage goes the auction channel. It's actually the poorest price point. We work specifically to try to keep products out of the auction channel. And as I said, if we did see it, a differentiation in ultimate resale prices and we match that trend, we would adjust our residual values accordingly.

Joe O'Dea - *Vertical Research - Analyst*

Okay. Thank you.

Operator

Thank you.

And the next question is coming from Chad Dillard. Chad, please announce your affiliation and pose your question.

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Chad Dillard - *Deutsche Bank - Analyst*

It's Deutsche Bank. So assuming we enter a rising interest rate environment next year, how should we think about the impact of higher interest expenses on the FinCo margins. Is it the case that this margin pressure will actually be formed by the equipment biz, or if you could just talk about that? And then is that contemplated in your guidance for 2016?

Kent Adams - *Caterpillar Inc. - VP and President of Caterpillar Financial Services Corporation*

This is Kent. I'll turn it over to Jim.

Mike DeWalt - *Caterpillar Inc. - VP of Finance Services Division*

Actually, this is Mike. Before he answers, we don't have any profit guidance for 2016.

Kent Adams - *Caterpillar Inc. - VP and President of Caterpillar Financial Services Corporation*

Yes, I wasn't going to -- I was going to talk about separating margin from spread. And Jim works very hard to really eliminate interest rate risks and foreign exchange risk to our matched funding approaches. When Jim went through our various funding platforms, besides giving us access to multiple markets, it's also a means for us to match fund and eliminate currency interest rate risk, and we do that through our borrowing basis, but also through our derivatives.

And so a rising interest environment has some impact on the margin on the existing portfolio, but it's more of a question about the impact competitively on spread on future new business. That's more of a clarification point. Jim, I don't know if you want to talk more about interest rates and currency, or not.

Jim Duensing - *Caterpillar Inc. - EVP and CFO of Caterpillar Financial Services Corporation*

So our match funding policy is to work to match fund all interest rate risk in the portfolio. So we have a very, very high percentage of our current portfolio match funded to protect against rate rises. So we have locked in already the net interest spread, and have good line of sight then to the margin that will be delivered from our business, based on that match funding.

As we get into 2016, and if we were to see a rising rate environment, which seems more likely in the US, we have, as typically has been the case in the past, we will work to adjust standard rates in a timely manner to make sure that we don't see any material deterioration in new interest spreads, to again protect margin, and we don't anticipate any material impact from rising rates as we look at our profit in 2016, or any year, for that matter.

Chad Dillard - *Deutsche Bank - Analyst*

That's helpful.

And then how much has the mining downturn impacted residual values for mining equipment? What's the delta between now versus the peak, or now versus 2014?

Kent Adams - *Caterpillar Inc. - VP and President of Caterpillar Financial Services Corporation*

This is Kent again.

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Let me talk about residual values, because when you think about the mining segment, we set residual values based on all the various segments, whether it's construction, whether it's ag, whether it's mining, logging, all those segments. And so, when we look at the small percentage of our operating lease portfolio as a part of total portfolio, when we look at the small percentage of the mining of the total portfolio, it really hasn't had an impact.

Mike DeWalt - *Caterpillar Inc. - VP of Finance Services Division*

Kent, that's a point I think that sometimes, particularly when I talk to investors, that sometimes they don't get. The vast majority of the financing that we do is on retail contracts, not leases.

Kent Adams - *Caterpillar Inc. - VP and President of Caterpillar Financial Services Corporation*

So 13% of our portfolio is operating leases. And so you'd have to ask -- so within that, you've got a portion in mining, a portion in construction, a portion in logging, a portion in ag. And then as I mentioned, we set our residuals using a three- to five-year moving average. So we eliminate peaks of used equipment prices. We don't really use high spot prices to set a residual value. And so we really haven't seen a significant impact from the slowdown in mining.

Chad Dillard - *Deutsche Bank - Analyst*

Great. Thanks. I'll jump back in queue.

Operator

Thank you. And your next question is coming from Eli Lustgarten. Eli, please announce your affiliation and pose your question.

Eli Lustgarten - *Longbow Research - Analyst*

Longbow Securities. Could we get a little more clarity on your match funding in currency? Was there a currency effect in the first nine months that we've seen this year? And I guess you can offset some of the transactional stuff, I don't think you can do the translational side. So can you give us some idea of how that's playing through?

Jim Duensing - *Caterpillar Inc. - EVP and CFO of Caterpillar Financial Services Corporation*

The match funding that I referenced earlier is really, to the extent possible, we try to fund, as an example, Aussie dollar assets with Aussie dollar funding, both term debt and short-term commercial paper. So the local portfolios are match funded. We work to eliminate basically 100%, or very close to 100% of the non-functional currency exposure on each of our subsidiary balance sheets.

Similar to other global banks' finance companies, we don't hedge the entire asset portfolio. As we translate back to a US dollar functional company, in this case Cat Financial Services here in the US, we will see the impact of the stronger dollar, the weaker international currencies on our asset level, margin and profit. So that, as you look at the movement in the dollar the past year, that's had some effect, and you've seen that in our quarterly financial results.

Eli Lustgarten - *Longbow Research - Analyst*

Do you have what the nine-month impact of the currency has been?

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Jim Duensing - *Caterpillar Inc. - EVP and CFO of Caterpillar Financial Services Corporation*

We haven't broken that out publicly, so I don't have that number for you today.

Eli Lustgarten - *Longbow Research - Analyst*

Mike was referring to a four-year moving average for sales, best way to look at that. If that's true, then I mean are we looking at a much more material decline as we go forward for Cat Financial and revenue, than we've seen in the last 9 to 12 months, based on the fact that volume continues to soften? Is that a fair observation that we're seeing?

Kent Adams - *Caterpillar Inc. - VP and President of Caterpillar Financial Services Corporation*

So the revenue -- this is Kent speaking. The revenue's really driven by two factors. One is the nominal interest rate, and the other is the size of the portfolio. If the size of the portfolio decreases as a result of Caterpillar sales dropping, and our opportunity dropping, you would see a decline in profit. Nominal revenues could be impacted positively by an increase in interest rates, with no impact on profit. That's the mathematics of.

Eli Lustgarten - *Longbow Research - Analyst*

I'm just saying, from where we are today at this point, we've got the sales decline flowing through. We've got the portfolio decline going through, and we haven't had much change in interest rates. I'm just asking at this point should we expect that as we look forward, the decline that we see out of Cat Financial will probably be somewhat larger than what we've seen so far?

Mike DeWalt - *Caterpillar Inc. - VP of Finance Services Division*

Eli, this is Mike. I don't know if it will be larger, but if you just think about it, of the 2012 business four years ago, three and-a-half years ago, that's being fully paid for by customers is coming out of the portfolio, and the new things that are going in, in 2015, were certainly less than 2015.

So I think all else being equal, yes, I think you'd see some decline in the portfolio. But to Kent's point, if we're in a rising interest rate environment, just the reported revenues could end up maybe not being affected as much.

Kent Adams - *Caterpillar Inc. - VP and President of Caterpillar Financial Services Corporation*

The other thing I would point out, if you look at our current portfolio, we amortize a little less than $1 billion a month. So if you take our first nine months of new business, you annualize that, that gives you a proxy as to how much relative movement in the portfolio you would see. And if you marry up that amortization rate and the new business levels that we're currently booking, we're seeing some decline, but not a significant decline in portfolio size.

Eli Lustgarten - *Longbow Research - Analyst*

And one final question. The percentage of business through Latin America and Asia-Pacific hasn't changed a lot. But given the current big decline this year, are you expecting the percentage of business from those parts to be sharply lower next year versus the current year, and that pie chart will change a bit, as opposed to just modest movement?

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Kent Adams - *Caterpillar Inc. - VP and President of Caterpillar Financial Services Corporation*

Eli, is Kent. I don't know if you could say sharply lower. You might see some decline. It's also impacted by our share of market, in terms of how much business we write of total opportunity. That also factors into it.

Eli Lustgarten - *Longbow Research - Analyst*

All right. Thank you.

Operator

Thank you. And your next question is coming from Sameer Rathod. Please announce your affiliation and pose your question.

Sameer Rathod - *Macquarie Securities - Analyst*

Macquarie. We touched on this a little earlier. Given the slowdown we are seeing, how much do you expect residual values to decline by end market, and if you stress test that, how much do residual values need to fall, and what do we need to see before it becomes concerning to the portfolio? Thank you.

Kent Adams - *Caterpillar Inc. - VP and President of Caterpillar Financial Services Corporation*

This is Kent again.

We may not see any decline in residual values, because of how we actually look at the applications, the hours a machine will be used, and the three- to five-year moving average used, in terms of setting residuals. Used equipment prices can fluctuate a fair amount without having an impact on our residual values, because we're looking at what the value will be over the next three to four to five years.

Sameer Rathod - *Macquarie Securities - Analyst*

Okay. So the second part of my question, obviously, you are taking three or four or five-year averages, but obviously we're witnessing some unprecedented slowdowns. In terms of the sensitivity to the portfolio, how do you think about the sensitivity of residual values if your assumptions of residual values fall 5%, 6%, 10%? What kind impact will that have on the portfolio or potential losses?

Jim Duensing - *Caterpillar Inc. - EVP and CFO of Caterpillar Financial Services Corporation*

Well, what you would likely see is more likely a reduction in the conversion rate than you would see in terms of any types of losses or of that nature. And frankly we have -- because the way we structure our leases, and because of how the product is used, and the types of customers that we lease to, our conversion rates are still very good.

Kent Adams - *Caterpillar Inc. - VP and President of Caterpillar Financial Services Corporation*

We naturally have a little bit of cushion. If you think about residuals that were established three, four and five years ago in a lower price environment, you've got some benefit from that, so in absolute dollars, the residual amount would be less, taking into account some level of inflation that's occurred since then.

So at this point, we feel pretty comfortable with our overall residual exposure. We look at it on a regular basis. It's not something that we take for granted and we'll continue to look at it. At this point we're pretty comfortable.

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Jim Duensing - *Caterpillar Inc. - EVP and CFO of Caterpillar Financial Services Corporation*

And again, remember that those operating leases are offered across all the various segments. It's not just solely mining.

Mike DeWalt - *Caterpillar Inc. - VP of Finance Services Division*

And again, as Kent said earlier, operating leases are 13% of the portfolio.

Sameer Rathod - *Macquarie Securities - Analyst*

Right. Okay. Thank you.

Operator

Your next question is coming from Steven Fisher. Steven, please announce your affiliation and pose your question.

Steven Fisher - *UBS - Analyst*

It's UBS.

Can you talk about what the rise of the equipment rental business in North America has meant to Cat Financial, and how should we think about whether there's added risk to Cat Financial from dealers that now have more leverage to accommodate a rental fleet, compared to what they've had in the past?

Kent Adams - *Caterpillar Inc. - VP and President of Caterpillar Financial Services Corporation*

I need to think about that question a little bit. So we've actually looked at the mix of rental, rent to rent, rent to sell, and retail transactions back to 1981. And when you look at that mix between those three, it's not surprising that the mix changes, depending on where customers' confidence levels are, in terms of their longer-term outlook or short-term outlook, I guess.

In terms of rollouts from dealer rental fleets, they remarket much the way we do, and trying to keep product in channel and in territory to maximize the resale price. So I don't see it really as a direct competition to Cat Financial. We actually provide financing to dealers to support their dealer rental fleet, and that's part of the dealer financing you see on the bottom of chart 13.

Mike DeWalt - *Caterpillar Inc. - VP of Finance Services Division*

Let me clarify the question. Was your question around are we worried about financing dealers, and has that grown because of rental? Is that the crux of the question?

Steven Fisher - *UBS - Analyst*

There's a couple aspects to it. One, has the purple wedge on that pie chart that dealer has gotten meaningfully bigger over the last several years because you have more rental equipment going into their fleets? And then second, as you think about just the inherent risk in the dealers' business, as you extend them credit, they're more leveraged businesses now, so does that create a potential need for higher reserves over time?

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Jim Duensing - *Caterpillar Inc. - EVP and CFO of Caterpillar Financial Services Corporation*

So the pie chart, let me clarify. The dealer financing, there's different types of dealer financing. There's dealer rental fleet financing. There may be dealer acquisition financing. But there also would be the receivables that we factor or purchase from Caterpillar, that drives that number also.

There's different types of dealer financing within that purple part of that pie chart. And our history with Caterpillar dealers has been outstanding from a performance standpoint. So no, I wouldn't expect any impact on our reserving or losses at all from the percentage of financing we do with Caterpillar dealers. It's been an outstanding part of the portfolio.

Steven Fisher - *UBS - Analyst*

Okay. Thanks a lot.

Operator

Thank you. And the next question is coming from Seth Weber. Seth, please announce your affiliation and pose your question.

Seth Weber - *RBC Capital Markets - Analyst*

It's RBC.

To the extent you're willing to talk about it, can you give us any color what you're seeing out of extended payment terms out of the Middle East? We've heard recently from some companies that liquidity out of places like Saudi Arabia is getting -- DSOs are getting extended, things like that. Can you comment anything there?

Jim Duensing - *Caterpillar Inc. - EVP and CFO of Caterpillar Financial Services Corporation*

First, we have a very small portfolio in Saudi Arabia. We have seen some impact, and, again, it's typically with customers that are well capitalized, good collateral positions, so we don't have any specific concern with regard to Saudi Arabia at this point. But we are aware of some of the slowdown of payment by the Saudi Arabian government.

Seth Weber - *RBC Capital Markets - Analyst*

Okay. Is it possible to give any context for how much the Middle East represents as a percentage of the EAME bucket?

Jim Duensing - *Caterpillar Inc. - EVP and CFO of Caterpillar Financial Services Corporation*

It's very small.

Kent Adams - *Caterpillar Inc. - VP and President of Caterpillar Financial Services Corporation*

Really, really small.

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Seth Weber - *RBC Capital Markets - Analyst*

Really small. Okay. That's all I had. Thank you.

Rich Moore - *Caterpillar Inc. - Director of IR*

Okay. I think we're at the top of the hour, so with that, we'll go ahead and conclude the call, and thanks everyone for calling in, and we'll speak with everyone soon.

Operator

Thank you, ladies and gentlemen. This does conclude today's conference call. You may disconnect your phone lines at this time, and have a wonderful day. Thank you for your participation.

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