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CAT - Caterpillar Inc Investor Meeting

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PRESENTATION

Jennifer K. Driscoll - *Caterpillar Inc. - Director of IR*

Good afternoon. Welcome to Caterpillar's Investor Day. We're excited to have you here with us, including those of you here in the room in Clayton, North Carolina, and everyone listening to us via webcast. We've provided slides to accompany the presentation. You can find the slides, along with this morning's news release on our website at the Investor relations section of the website under caterpillar.com. Click on Investors then Events &



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Presentations. A transcript of this session as soon as it's available will be posted in the same area of our website. I'll start with the usual reminders you see here. We plan to make forward-looking statements today, that are subject to risks and uncertainties and then a list of the factors that could cause our actual results to be different than the information discussed are described in our SEC filings. And for the list of the factors that individually or in aggregate could cause actual results to vary materially from our projections, please refer to our most recent SEC filings and those forward-looking statements in today's presentation material. Please keep in mind that this event is copyrighted by the company. Any use of any portion of the event without our expressed written consent is strictly prohibited. Here is our agenda for you today. We have 4 main speakers. First, Jim will provide his perspective on a progress since our last Investor Day in 2017, where we're headed next and our new margin targets. Then Bob will share how we intend to grow services within Caterpillar. And Denise will walk you through our progress and our vision for operational excellence and expanded offerings. Andrew will wrap up our Investor Day with our recent performance, the outlook and a refreshed capital deployment strategy. Some of these topics were highlighted in this morning's news release, which is available on our website. When our formal remarks conclude, we plan to conduct a Q&A session with the entire management team, including our speakers and the rest of the team. And I'll come back up at that point to give you some further instructions. Okay, that's it. So with that, we'll turn it over to Jim.

D. James Umpleby - *Caterpillar Inc. - Chairman of the Board & CEO*

Well, thanks, Jennifer, I'd like to add my welcome to our investors and analysts who are with us today. For those of you that are attending in person, I hope you enjoyed spending time with our building construction products employees. They are part of our diverse skilled workforce that designs and manufactures products that have made Caterpillar among the world's most widely recognized and respected brands for almost 100 years.

Along with our 1,000 plus colleagues around the world, they are dedicated to our customer's success. It's our customers that use our solutions to build a better world. Through projects that give people access to electricity, transportation, hospitals, schools, clean water, and so much more. As Jennifer mentioned, we're going to update you on our progress since we implemented our enterprise strategy in 2017. We have met or exceeded the targets we shared with you during our 2017 Investor Day, and we've profitably grown our company. This afternoon, we will share our new targets as you continue -- as we continue to execute our strategy for profitable growth and enhanced shareholder return.

As a reminder, Caterpillar is the world's leading manufacturer of construction and mining equipment, diesel and natural gas engines, industrial gas turbines and diesel-electric locomotives. Our 3 primary segments and financial product segments are shown on this slide, along with our services, distribution and digital organization that supports and enables all of these segments and our customers.

Last year's sales and revenues were approximately \$55 billion. We have a well earned reputation for best product lines, with the most productive equipment and superior product quality. Our competitive advantages include our independent Caterpillar dealer network. With 168 dealers and about 2,000 branches in 193 countries around the world, it's the most extensive sales and service network in our industry. When customers buy our products, they know they will be supported by the most capable and reliable global service network. As a result of our products and our dealers, we are a leader in almost all of our product classes in the markets in which we participate.

Caterpillar is well positioned for the future as our customers invest in infrastructure, energy and mining to meet the needs of a growing global population, an emerging middle class in the developing world and an increasingly urbanized society. And we have a clear strategy for profitable growth, which were introduced in 2017.

Next, let me introduce our talented senior leadership team. My colleagues in Caterpillar's Executive office are an experienced group of executives dedicated to execute in our strategy for profitable growth throughout the enterprise. It's a values-based team. Some of my colleagues have had long successful tenures at Caterpillar and some have deep and valuable experiences from other organizations. Before we discuss our plans for continued profitable growth, I'll remind everyone of the different components of our strategy. The core of our strategy is the overriding objective to grow profitably and the core is supported by 3 main pillars: operational excellence, expanded offerings and services. These are enabled by data and insight using the Operating & Execution model or O&E model and most importantly, all of this is underpinned by our long-standing code of conduct, our values in action, which define what we do everywhere we do business. They reflect how we behave with our customers, our partners and one another. We expect every employee to live our values every day in everything we do. I'll review each strategic pillar starting with operational excellence, which includes a safety-first culture, product quality reliability and durability, lean operations, and a competitive and flexible cost structure.



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Caterpillar has made great progress in improving safety during the last 15 years, but even one injury is one too many. We want everyone to return home safely every day. The same goes for quality. Our enterprise quality metrics don't mean a thing to a customer who experiences downtime because of a defect. We are striving for perfection in safety and quality in a continuous, never-ending journey. The same is true for lean. We are committed to continuing our lean manufacturing journey by synchronizing across our value chains, reducing lead times, optimizing working capital and increasing availability.

Our team has made incredible strides in lowering our cost structure in recent years and maintaining our cost discipline as we ramped up production during the last 2 years. We are firmly committed to maintaining a competitive and flexible cost structure. The next component of our strategy is expanded offerings. It's based on having the right products and solutions from various types of customers at the right value point to ensure an acceptable return for Caterpillar and our dealers, while always ensuring our customers are more successful using CAT products than they would be with the competition. We've introduced several life cycle value products that have been well received by our customers. Our new product strategy aligns investments and technologies across business units to ensure we are leveraging product enhancements across the enterprise. We also continue to focus on our entire product line. During the last 2 years, we invested about \$3.5 billion in R&D, resulting in a wide variety of new products across all of our segments. We have introduced hundreds of new products since the beginning of 2017.

Last month, I attended bauma, the construction industry's largest trade show held in Munich, Germany every 3 years. At bauma, we unveiled -- we unveiled a host of new expanded offerings. We showcased the entire line of next -- of new next-generation mini hydraulic excavators designed to provide the best performance and versatility in the smallest possible package. Also on the floor was the 988K XE, the company's first diesel-electric drive wheel loader, which improves fuel efficiency and productivity.

In addition, visitors had a chance to see our concept compact wheel loader, the 906, which provides customers a 0 emissions, battery-powered electric drivetrain. I used the opportunity at bauma to talk with customers as they toured new products at our exhibit, and they conveyed a great deal of excitement about what they saw and experienced at the show. Now turning to services. Services includes all the ways we help our customers succeed after they buy a piece of equipment. Services was part of our enterprise strategy that we introduced in 2017 and we are increasing our investments to enable Services growth. We are enhancing our digital capabilities by tapping into a talent pool in downtown Chicago, where our newly formed CAT Digital division has established a presence. We're also investing to upgrade our digital platform architecture. During the last 2 years, we've increased the number of connected machines and engines by 70% for approximately 850,000 connected assets. We've made it easier for customers to buy parts online. We are striving to continually provide more value to our customers. This includes allowing our customers to minimize downtime and maximize equipment availability through customer value agreements. The Operating & Execution model or O&E model is the methodology we use to provide the facts, data and insights to guide our strategic decision-making around profitable growth. We are using the O&E model across the enterprise and we have strengthened its governance. We're fixing areas of the business that are not producing acceptable returns and prioritizing to invest more resources in areas with the best opportunity for future possible growth. By creating value for our customers, each business should deliver a return above its cost of capital and generate the cash flow needed to continue to reinvest for profitable growth. Prioritization and reinvestment in those areas where we have or can develop a competitive advantage are keys to the continued success of Caterpillar and our dealers.

We've chosen to withdraw from some products where we did not have a line of sight to either a competitive advantage or acceptable returns. Examples include vocational trucks, some underground mining products and specialized forestry products. We'll continue to be disciplined in our capital allocation throughout the cycles and the laser focused on getting the return on our investments. We will use the O&E model to guide how we allocate resources and prioritize investments in areas like services and expanded offerings that represent the best opportunity for future profitable growth and shareholder return.

To summarize, we have made a great deal of progress since rolling out our enterprise strategy at our Investor Day in 2017. We have improved our operational performance but the pursuit of operational performance is a continuous, never-ending journey. We've introduced expanded offerings in response to customers and market needs and are investing to enable services growth. Through the execution of our enterprise strategy, we've improved our financial performance. We established various margin targets at our 2017 Investor Day for our 3 primary segments. Each target was specific to the segment based on our recent historical sales level. For each of the segments, we targeted a segment margin percentage point improvement. It ranged from a 5 to 7 point improvement for construction industries, to a 2 to the 6-point improvement for resource industries and a 1 to 3-point improvement for energy and transportation. We met or exceeded our performance targets across every segment. We finished



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at the top of the range for Resource Industries and we're slightly above the range for Construction Industries, but at a higher sales level. Energy & Transportation was in the middle of the target range. This stronger operating margin performance continued in our 2019 results -- first quarter 2019 results, which was another record first quarter profit per share after a record first quarter in 2018.

We set out similar targets for the company as a whole and also met or exceeded those targets. On \$55 billion of sales, our historical adjusted operating margin performance as presented at our 2017 Investor Day was about 12% and we targeted an improvement for the company of 2 to 5 percentage points. Putting it all together, our adjusted operating profit margin improved by about 4 percentage points compared to our historical demonstrated performance at \$55 billion sales and revenue level, which is at the high end of our target range. We achieved these targets by executing the elements of our enterprise strategy for profitable growth. We view these results as evidence that our strategy is working, and we still have plenty of future opportunity to continue to profitably grow our company. It also helps to put our recent performance in context by reviewing our results through the cycles of 2010 to 2016. We had a sales range from \$39 billion to \$66 billion. Our adjusted operating margins at lower levels of sales during these times has been as low as 7%, while our adjusted operating margins at higher levels of sales during this period have been in the low teens. During the last 2 years, we delivered much stronger financial performance. Our sales and revenues were approximately the same in 2014 and 2018, but we produced an operating margin of 16% in 2018 compared to 11% in 2014. In fact, margins last year were higher than they were in 2011 and 2012 despite the fact we had lower sales and revenue in 2018.

With that historical and recent performance in mind, I'd now like to share with you some new targets for adjusted operating margin performance as part of our profitable growth journey. But first, let's review our historical sales and adjusted operating margin performance from 2010 to 2016. During that time, we delivered an adjusted operating margin within a range of 7% to 15% with sales and revenues from \$39 billion to \$66 billion. Our best margin was 15% at the highest level of sales and revenues in 2018. Today, we are updating our company's adjusted operating margin targets. During our last Investor Day, we established margin targets based on a specific level of sales and revenue that we experienced in the recent past, \$55 billion. We are now targeting to be 3 to 6 percentage points above our historical performance to a range of sales and revenues. We are illustrating the improvement using our actual performance through 2010 to 2016. This elevates our future expected adjusted operating margin range from 10% to 21%. This target further raises the bar for our global team as we continue to execute our strategy and drive better long-term performance for our shareholders.

I'd also like to speak this morning about our plans for capital deployment. The enterprise strategy we introduced in 2017 has resulted in stronger profit performance, higher margins and improved free cash flow. The fact that we are managing the business differently gives us the confidence to continue targeting a mid-A credit rating to project even stronger operating margins and free cash flow throughout the cycles. As a result of our improved performance and philosophy of returning capital to shareholders on a more consistent basis, this morning we announced a significant dividend increase. We are raising the dividend 20% to \$4.12 per share on an annualized basis, effective with the dividends that will be paid in the third quarter. During the next 4 years, we anticipate increasing the dividend annually by at least a high single-digits percentage. For many years, we've been consistently growing the dividend. We were recently added to the S&P 500 Dividend Aristocrats index for 25 years of consecutive dividend growth.

In a few minutes, Bob will provide an update on services, one of the key elements of our enterprise strategy. After 2 years of executing our strategy utilizing the O&E model, we've gained valuable insights with a more granular understanding of the various elements of our business and our end markets. We validated the importance of growing services and intend to increase investment for services growth. Executed correctly, services create value for Caterpillar, our dealers and most importantly, our customers. Services increase value by minimizing downtime, maximizing the product availability, improving efficiency and asset utilization. By enhancing customer value, Caterpillar and our dealers create the opportunity to profitably grow our businesses while dampening the impact of market cycles. In 2016, the year before we launched our new enterprise strategy, services sales for Machinery, Energy & Transportation, or ME&T, was approximately \$14 billion. This included all aftermarket part sales and other Caterpillar services provided by all CAT divisions under our various brand names. The \$14 billion does not include Cat Financial or discontinued products. The percentage of sales represented by service varies at different points in the cycle. When market demand is high for new equipment, services tend to be roughly 30% of ME&T sales. During a market low, Services is closer to 40%. We believe tremendous opportunities exist to continue to grow Services revenue by working with our dealers to find new ways to increase the value we provide to customers.

Today, we are announcing an aspirational target to double our ME&T service sales to \$28 billion in 10 years from \$14 billion in 2016, the year prior to the introduction of our new enterprise strategy. As a reminder, the \$28 billion Services target for 2026 includes all the aftermarket part sales and



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other Caterpillar services provided by all Caterpillar divisions under our various brand names. The \$28 billion does not include CAT Financial. As you know, CAT Financial helps our customers purchase Caterpillar products. We do intend to increase the participation of CAT Financial as an enabler for customer value agreements to help grow Services sales. As you can see from the slide, we increased Services sales from \$14 billion in 2016 to \$18 billion in 2018. As we strive to reach \$28 billion in 2026, we don't anticipate Service sales will grow in a straight line. There are few primary reasons. During 2017 and 2018, we supported an influx of delayed rebuilds and maintenance in mining and oil and gas as these markets recovered. We also need to continue to invest in our service capabilities. This includes connecting more machines and engines, improving our digital capabilities and designing our components, machines and engines to provide increased customer value through enhanced service offerings. We also intend to enhance our analytical capabilities and develop new service offerings that leverage our deep engineering knowledge of our products. We anticipate these investments will accelerate services growth as we near the end of the 10-year period in 2026. Again, our Services strategy is based upon finding new ways to add value to our customers to ensure they're more successful using Caterpillar products than using our competitors' products. With that, I'd like to welcome Bob to the stage to provide additional detail on our strategy to grow services and why we believe it is ours to win. Thank you.

Bob De Lange - Caterpillar Inc. - Group President of Services, Distribution & Digital

Thank you, Jim. And another big thank you to all of you. We really appreciate the time you're spending with us today. So thank you very much. As Jim already mentioned, why do we focus on services? And in the end, it really all starts with our customers and our goal to make sure our customers can be more successful utilizing our products and our services than they could with any of our competitors. So that means being very easy to do business with, but then also beyond the point-of-sale, making sure we continue to add value throughout the life cycle of the equipment, helping our customers lowering their total owning and operating costs, reduce downtime helping them ultimately improve asset utilization. How are we going to do that? A number of things we have done traditionally in the past but also leveraging new capabilities like connectivity, utilizing our suite of new digital tools and making sure we package our offerings in such a way that helps our customers better manage their equipment fleets.

Second, growing services will help us reduce cyclicity. And yes, that will depend to some extent by segment, because you can imagine if you have a large gas turbine or a large engine, even in a downturn, chances are that utilization will remain pretty high even in a downturn, meaning the asset will continue to require the same level of services. Whereas on the other hand, if you think of mining applications, yes, we will see some applications whereas in a downturn, asset utilization will come down. But overall, for Caterpillar, it's clear. Growing services will help us reduce cyclicity. And then thirdly, profitability. Services have an attractive margin contribution for each of our 3 segments and there's plenty of opportunity for us to drive profitable growth. So you can say Bob, that is true for you but it might be true for a lot of other companies too. So what makes Caterpillar special? Why do you believe Caterpillar is well positioned to deliver those services to our customers? And here is where I listed some of the reasons, and it starts with our brand, a very strong brand, a legacy that is built over 90-plus years. Our customers don't just buy Caterpillar because we have robust products, they also buy Caterpillar when they need parts, when they need services. They know they can count on Caterpillar and our dealer network.

Secondly, we have a very large installed base, over 2 million active assets in the field. Old customers we know already, we sold them the prime product, so a great opportunity to now also increasingly offer them more services, an opportunity that continues to grow every day on top of it. We also have best-in-class field technology, whether it is to inspect, troubleshoot or repair equipment, services that are delivered by our worldwide network of Caterpillar dealers. Local entrepreneurs, you can find in pretty much all countries around the world who have many, many years of customer relationships know how to do business in their territory, a network that we believe has always been and will continue to be one of our strongest competitive differentiators. Just keep in mind that for certain businesses like Solar Turbines or Progress Rail, we also have direct service capabilities.

Then on the right, more recently connectivity. We are on track, we have close to 1 million connected assets by the end of this year, which is close to double the number of connected assets we had at the end of 2016 when we started our new strategy. So significant investment, significant progress in just 3 years. But here as well, you can say well there's a lot of companies that can -- that have the willingness to make the financial investment to invest and collect the data and do data analytics, predictive analytics. But really, what makes the difference is not just having the data but making sure you combine it with the domain expertise. Decades of experience our engineers have in our products and service in our applications, so that they can bind that data with the domain expertise and then apply data analytics to generate those useful insights. And then



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lastly, our customer tell us that they're now more than ever excited about the breadth and the depth of our products range. So in summary, this is why we are excited to grow services. This is why we believe Caterpillar is uniquely positioned to be the leading provider of services to our customers.

So why do we focus on services? Why do we believe we are well positioned? I guess the next logical question is how, what is our strategy to grow services? And I've shown here a number of the elements. It's really a comprehensive, multifaceted strategy. But it starts with what we call customer-focused design, which is very much upstream. It's well before we deliver services, it's even well before we delivered the prime product. It's all the way upstream when our engineers make the right design choices in developing our next generation of equipment. A good example of that is our sensor strategy. If you think for example of maintenance elements for filters, yes, you can try and find filters with a longer service interval, but the real key is also to build in sensors that tell us when the maintenance element needs to be replaced, so we can really maximize that service interval, help customers reduce downtime, reduce their operating costs, improve asset utilization. You can think of something similar too in a drivetrain, where we have sensors that gives us indications when a repair or an overhaul might be imminent. The only thing you have to keep in mind here is that some of the decisions we are making here today and the investments in design will take a number of years to be at full production and then to help us enable those services, which comes back to the point Jim made earlier that our services growth trajectory in the next years will not be linear.

Other areas we're investing in, digital enablers, and I will cover this in more detail in a minute, together with how we are transforming our go-to-market strategy for services, and I'll cover that right next. But very close linked to that is CAT Financial. And yes, we know CAT Financial as the provider of financial services for our customers. But in reality, CAT Financial is much more than that. It is actually one of the greatest marketing tools we have as well. Because you have to keep in mind in our industry where unit volumes are relatively low, CAT Financial has over 11,000 direct customer contacts per day with our customer base. Be it phone calls, can be face-to-face contact, it can by e-mail, can be online interaction, but you can very easily imagine how that makes CAT Finance the perfect marketing tool we have to build that relationship with our customers to identify opportunities for services, to offer services, do the follow-up of services to really build that loyalty with our customer base over time. Yet another area we're investing in is our parts distribution network. And here, you can think for example about a customer in Australia who just bought a new articulated truck and it needs the first set of maintenance elements. Or it could be a customer in Norway who has a 30-year-old track-type tractor that he wants to overhaul. Both those customers did not just buy Caterpillar because we have great products, but because they know when they need parts, they will be there and quickly, which is why we're continuing to invest in our parts distribution network to make it even more lean, cost-effective, but also further improve parts availability so that we can minimize customer downtime, help them improve asset utilization. Then we also continue to work with our dealers to make them even more efficient in delivery of the services, a number of projects to improve capability and capacity and with our dealers. And then lastly, even though it's not the primary driver of our growth, we do keep an open mind and an eye on adjacent services opportunities that we can invest in as another source of services growth.

With that, let's now dig a little bit deeper and first in our services go-to-market strategy. And here, there's 2 elements I would like to highlight. First one, comes back to our customers and having a deep understanding of what our customers value, what the services opportunity is and not just at the point-of-sale but throughout the life cycle of the equipment. And the picture I'm showing here is I would say, representative of construction industry-type machines and where you can see that, yes, there is initial opportunity at the point-of-sale but actually, the vast majority of the services opportunity, 95% is after the machine has already accumulated 5,000 hours which can be a few years, which then translates into our approach that is twofold. Number 1, at point-of-sale, making sure we build that relationship. If you do business with and get connected to the customer add value, but then also secondarily making sure we have a range of solutions, a range of services all throughout the life cycle of the equipment, which also if you think back to the customer in Norway, with a 30-year-old piece of equipment, he might very well be not even the second, but even the third owner. So you can imagine how investments like connectivity will help us throughout that long life cycle make sure we keep track of the equipment and the customer that owns it. Secondly is the transformation of how we package our services and how we go-to-market. Changing from service, our traditional approach with customer service agreements or CSAs, to service that's what we will call customer value agreements or CVAs. And it's really more than change -- just one change of a letter. It really is a different approach in being more customer-centric, more customer-focused than ever before, making sure we think of value offers that we can bring to the customer, being more creative, innovative and making sure we also leverage our new capabilities like connectivity, like our suite of digital tools and really bring it all together in such a way that will help our customers and manage our fleet. So might be a little bit theoretical, so let me show you a few examples of what that could mean in practice. First one here on the left is to build a relationship at the point-of-sale, relatively simple and straightforward. And the example here could be an electric power standby genset. Standby gensets, very low hours accumulation but that can vary pretty substantially, plus it can also be a mobile unit that's in different places, different points in time. Customer here is not as much interested in power generation but the important part is that



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what he does or she does need the genset, that it starts and that it's operating. This customer is going to be looking for peace of mind. At point-of-sale, customer might tell us well, we will do our own maintenance but where we can help with the CVA. They say fine with us but let us assemble for you a kit with all the required maintenance elements, we will include the instructions on how to do to the maintenance and then most importantly, we will utilize connectivity so that we can track the hour accumulation. We will know when the service is due, we know where the genset is located. So 2 weeks before, we will deliver to where the genset is, the maintenance kit ready to go so you have the peace of mind. Better example, in terms of extending the relationship, the one that's shown here is for Caterpillar Certified Used, actually a very interesting value alternative for our customers that don't require a new piece of equipment, maybe don't need that ultimate productivity but do want that guarantee from Caterpillar and are interested in Caterpillar Certified Used. Here, CVA, because it is not new, customers are looking for confidence and they help us manage their risk, might be interested in the CVA, that is included in the monthly payment through CAT Finance. That includes health and asset management, that includes maintenance when and where it is required. And because it's CAT Certified Used, we will also provide component protection for key components on that machine and develop a value offering that way. The last example I'll show you on the right is really relationships all throughout the life cycle. Think here, for example, about the mining industry where we will work with large mines or mining contractors and to really develop an end-to-end comprehensive solution where we take care of everything and help the customer manage their total cost of operation and of ownership, and help them manage their cost per ton or cost per hour, make sure we also provide assurances in terms of availability and machine asset utilization.

So just a few examples. With that, let's now switch gears and talk about digital for a minute. And for us, when it comes to digital, the key message is that digital is not a business in itself. For us, digital is an enabler to help us grow services. I'll try to explain and we call it a simplified digital model, which starts with connectivity, which is the investments we have made first in the optimized electronic architecture of the equipment. All of the electronic backbone, the ethernet that is built into the machine so that we can collect data from all the components around the asset. Then having ProductLink and telecommunications to bring that data on board. As I mentioned before, we are on track to have 1 million connected assets and by the end of this year and also for all new equipment pretty much all of our machines come now exit the factory fully connected, ready to go.

Second layer is then platform, our digital platform, which really you can see as the data architecture, the underlying architecture of how power we collect data. And this is where our digital team really gets excited because this is where they get to combine all the data we collect from our equipment in the field together with all other data sources we have from all around Caterpillar, bring it in all into 1 location, managed data security, managed data integrity and then start applying data analytics and machine learning so that we can provide useful insight and make sure it also becomes exciting for our customers so that we could provide those services, provide digital applications. Again, maybe to help bring it to life, let me show you a few examples. First for our customers, next I'll also talk about our dealerships. But first for our customers. The I have shown here on the left, the CAT app is a brand-new app that we just launched last month at the bauma trade show in Germany, which is really 1 application that allows customers to do a lot of different things. From that app, manager their fleet, see the location of the equipment, see the hours of the equipment to help management of the equipment, request parts and services direct with a local Caterpillar dealer. But also for some of our newer equipment like the next gen excavators, this app can also be used as an electronic key. Customers can use this to unlock the machine, to remotely start the machine or if the customer has multiple operators, he can program in there saying this operator can use out of my fleet of 5 machines; these 2 pieces of equipment, those you could not use between these hours of the day; my service technician is also allowed to start the equipment in the weekend or late at night. All of that power in the palm of the customer's hand. In the middle, I have shown a number of equipment management applications that we're developing. It starts simple like I've shown here in top, CAT Inspect, which is really an application to be able to do equipment inspections in the field in a modern way. Do inspections, report them, include visuals, the ability to highlight areas that need immediate attention and then be able to electronically upload it to the back office. Broader applications like VisionLink, which is really targeted at the construction industries segment, which again, allows customers a lot of possibilities. Whether to track the equipment, idle time, fuel consumption, productivity in a number of cases, location of the equipment as well. Customer can also install geofence. If you think, for example, of theft risk. Inside the geofence, the machine will operate. If somebody would transport the machine outside of the geofence, the equipment will no longer operate. And so a lot of possibilities continuously growing.

Below that, a number of segment-specific applications. MineStar for the mining industry, a lot of focus on productivity there as well. And that Solar InSight and Progress Rail Uptime specifically for those industries. Third area where we're investing for our customers is shown in the right, e-commerce. And here as well, we have a segmented approach. For our corporate accounts, we go as far as integrating our e-commerce capability into the ERP system of our customers. They don't need to use our system, we'll make it so that they can use their own ERP system to directly order services, order parts from us. Then we have data application for customers who are used to working with their Caterpillar dealer. They have a login experience,



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they can order parts, they can now also order equipment like the BCP equipment you saw this morning. And then thirdly, we also now developed an application for customers who don't have an experience at working with Caterpillar or with the dealer. Very easy, guest checkout, very convenient and easy to do business with. And that, just imagine in a number of countries around the world with their specific requirements, with their language, with their payment methods. So a growing suite of applications for our customers. In parallel, to that, we're also investing in applications for our dealers to make them even more efficient, more effective in delivering those services. First example, the top right, Service Information System, which is really aimed at the dealer service technician in the field. Making sure that in a modern way, at the tip of their fingers, they have all the instructions to troubleshoot the machine for when a repair is required, step-by-step repair instructions for that very wide range of equipment that we have both current and noncurrent.

Second one in the middle, Parts Inventory Optimization Tool, which comes back to maximizing parts availability where we analyze end to end parts inventories and our dealers who use data analytics and digital tools to optimize parts availability, making sure the repair gets done as quick as possible, help customers maximize their asset utilization. Third one, Remote Flash and Troubleshoot, another new one that we launched at the bauma fair in Germany last month, which allows an expert technician from a dealer who receives through connectivity, a health alert from a certain assets already who already in the back office, started doing remote troubleshooting on that asset from the back office. If needed, they can also upload new machine software to the asset or in case a field visit of a technician would be required, because they have done the troubleshooting, this can help make sure that when the technician goes out, he has the right tooling with him or with her and the right parts so he can do the repair right the first time. Again, minimizing up-time, helping our customers maximize asset utilization. The last one, again, this is where our digital team gets excited, Equipment Care Advisor, which is where we combine all that data, data with our domain expertise and data analytics, machine learning to help our dealers make the best maintenance and repair recommendations so that the customer can best manage their fleet.

So those were just a few examples of how our strategy is coming to life. But in summary, I would say it is 3 points: First of all, our primary focus of services is to help our customers succeed. Number two, we believe Caterpillar is uniquely positioned to be that provider of services to our customers. And #3, we have a comprehensive strategy and we are investing in growth. And all of that in support of the goal that Jim laid out to double our services revenue by 2026. So again, thank you and with that, I'll turn it over to Denise to talk about expanded offerings and operational excellence. Thank you.

Denise C. Johnson - Caterpillar Inc. - Group President of Resource Industries

Okay. Well, good afternoon. It's a pleasure to see all of you here in North Carolina. Today, I'm going to review 2 strategic areas of focus: operational excellence and expanded offerings. I'll also talk a bit about our products and technology and share a few examples with you.

But first, let me start with operational excellence. To be profitable and operate most efficiently through the cycles, we continue to leverage our foundational strengths, our competitive and flexible cost discipline, lean processes, a safety-first culture and quality, including product reliability and durability. These things collectively will help us build and maintain a competitive advantage. So let me share with you some of the ways that we've made sustainable improvement with our cost discipline.

All of you know that we have completed roughly \$1.8 billion in structural cost reduction since 2014. We've also reduced our fixed assets by more than \$3 billion. We have achieved these results by taking an enterprise view to cost management and announced closures and consolidations of 57 facilities. This reduced our manufacturing footprint by 25 million square feet, eliminating 29% of our manufacturing space. We also streamlined our manufacturing approach to become more agile and flexible and to better utilize existing floor space and assets. Even with the reduced footprint, our capacity utilization at the enterprise level is at approximately 70%. We are confident that we have sufficient capacity now and through the cycles. And let me repeat that, we are confident that we have sufficient capacity now and through the cycles.

A great example of the operational excellence that we've demonstrated can be shown right here in Clayton, North Carolina. If you were to go across the street and walk through the assembly plant, on the small wheel loader line, the number of small wheel loaders that are coming off the line in one day assembled on 1 shift would have required 2 shifts of workers just 4 years ago. So it's a great example of our operational excellence focus. Another key area focus for operational excellence is ensuring that we have a strong foundation and use lean principles to achieve results. Caterpillar has a strong foundation of lean, its routed in Six Sigma and the Caterpillar production system. Lean is a customer back approach, focused on understanding customer requirements and expands our entire value chain from supply chain to customer delivery. It's a culture of continuous



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improvement through which the entire enterprise and our value chain partners are aligned to stop defects, improve processes and eliminate waste. Caterpillar has leveraged lean methodologies and operations for decades.

Now we are extending the implementation through the value chain beyond operations into processes like product development, financial and HR, go-to-market and others. This optimizes our business end to end. Two leading indicators of successful lean implementation are safety and quality. We've seen significant improvement in safety, already achieving our 2020 goals. In fact, we have seen more than a 90% reduction in recordable entries since 2003. In the past 10 years, we've delivered more than 1,800 new or refreshed models. We have reduced defects found in the first 12 months of service by over 46%.

Ensuring lean benefits are achieved end-to-end means that we also must work with our supply base to optimize the value chain. Our enterprise strategy clearly articulates that our suppliers, who we also consider as partners, are key to our success. We have been working with suppliers to increase flexibility through the cycles. By together working with our suppliers to increase demand visibility and improve our sales and order planning processes, we're intentionally designing our value chains collaboratively. In the past year, we have taken a very focused approach to accelerating our production for both aftermarket parts and machines to meet the increased demand.

We have had challenges with constraints. Specifically, with our North America's supply of iron castings, machining and fabrications. We have made significant improvements for our product -- production output by utilizing an end-to-end approach. We are positioning our supply-side to respond with greater agility through the business cycles. Parts availability to our dealers and end customers had continued to show strong gains across all segments over the past 6 months now reaching optimal levels in almost all component classes.

Caterpillar continues to leverage lean principles to accelerate these results, while in parallel improving our inventory turns and our distribution networking efficiencies. As we work the engineered value chain, the goal is to increase response time, along with product and parts availability to our customers while running our value chain at optimal inventory levels and total cost through-the-cycle.

Next, I'd like to discuss how we are pursuing expanded offerings to fuel profitable growth, both by better serving existing customers as well as reaching new ones. We need to ensure that we have the right products and services to create greater customer value and drive profitable growth. We want to grow our current business, but we also want to expand that business to customers we did not previously reach. At the last Investor Day, we described our expanded offering approach. Today, I'm going to cover the key elements of the progress we've made. I'm also going to broaden the discussion to how we are thinking about the Cat product portfolio and how we are integrating technology to drive value for our customers.

Let me step you through how we segment our customers based on their application needs and value criteria to offer them solutions that are designed for their business [in mind.] This chart represents how we match our product offerings to the various customer business and economic requirements. The top right side of the chart in the dark yellow represents the life cycle performance customer segment where we traditionally have competed, heavy and medium duty applications. When you think of Caterpillar, you think of iconic machines. Products in this segment see heavy utilization and can run as much as 24 hours a day, 7 days a week in some applications. This is where customers value the total cost of ownership and measure success by cost per work done like cost per ton.

There are 2 life cycle performance models that are shown on this chart, the models with the highest levels of technology and expanded features are designated as XE. In addition to our core performance products, we are now offering specific solutions for customers where the value proposition is different. The life cycle of value segment is for customers who have lighter duty applications who are working less extreme conditions, they value simple tough machines that perform and provide Caterpillar quality and product support. Historically, we have either discounted our life cycle performance products or sold older models to attract these customers. This had limited success and put us in a position where in some cases, we were uncompetitive. Many customers perceive that we were too expensive.

Our current approach is to specifically design machines for the market needs and economics. The life cycle value segment, which is shown in the light yellow, is a Cat-branded product with a GC designation. An example of a product in this category is the 950 GC medium wheel loader. This machine delivers solid performance with the reliability and durability that Cat machines are known for.



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The utility segment, which is shown in gray is targeted at customers who most value acquisition costs, i.e. price and cost per hour. These customers operate primarily in emerging markets. These utility products carry our SEM brand and are supported by our SEM and/or Caterpillar dealers. They're straightforward machines with fewer features for light duty applications. Between 2016 and 2021, we will have introduced 24 new or refreshed models under the GC brand. In that same time frame, we will have introduced 27 new or refreshed models under the SEM brand. An example of how we are executing this strategy is with our wheel loader offerings. We have a wheel loader solution for every customer based on their application and the value proposition. We believe this specific approach to meeting customer needs by segment is a winning and profitable strategy. While expanding our product offerings, we use a modular design in order to leverage some common component across multiple models. This is lean in action.

Another key focus for Caterpillar is the use of technology to help our customers succeed. Caterpillar has invested \$5.5 billion in R&D since the beginning of 2016. I'd like to introduce a few examples of how we're leveraging these investments in technology to deliver customer value. We are using technology to improve safety, efficiency and productivity to drive lower maintenance costs and environmental impact and to address labor constraints. We are expanding our portfolio of electrified machines. From a standard mechanical drive to a hybrid to even battery applications. On the left-hand side of the screen you will see 1 example of our electrified products, with the D6 track-type tractor. This product will be available in both a fully automatic powertrain as shown on the D6 and with the switched reluctance electric drive technology as shown with the D6 XE. The base D6 transmission provides up to 20% better fuel efficiency and the D6 XE delivers up to 35% better fuel efficiency over conventional 3 speed transmissions. Both models feature the Caterpillar high drive design. Depending on the application and the performance required, the technology can provide the solution that the customer needs.

The next example demonstrates how we're leveraging technology directly on our core components. On the right-hand side of the screen you see the type 2 air filter, it is designed to have double the service life of the standard round radial style air cleaner to optimize customer total cost of ownership and reduce maintenance. The air cleaner body is equipped with temperature and pressure sensors to provide the operator with an accurate measurement of the remaining useful life of the filter element. And it does this in real-time. These sensors are just launching and will be available in full force on our next-generation machines in 2020.

Another example of how we create sustainable customer value is in the well services business. Oil and gas is an important end-market to Caterpillar, and we are well positioned to compete. When you think of a well site, you may think of the reciprocating engine side of our business. While this is true, there are many other pieces of Caterpillar equipment that are used to support the site, both upstream and downstream. We use construction products to clear and prep site and to install pipelines. Recip engines are used for drilling, well servicing and gas gathering. Our solar turbines are being utilized in midstream applications for interstate pipeline compression.

So let's talk a little more in detail on the well servicing side itself. We offer 65% to 70% of value of the well stimulation trailer and utilize technology in a number of ways. We have a pump electronic monitoring system to improve pump life and uptime. We offer an engine idle reduction system reducing non-value added run time. And new engine technologies like dynamic gas blending to allow the substitution of field gas in place of diesel fuel. Interestingly, Caterpillar is the only engine manufacturer with dual fuel options for well servicing that also meets EPA Tier 4 final emission standards for this application.

The key message that I'd like you to take away is that we are focused on delivering the right product. The right product for the right job by specifically designing offerings and leveraging technology to meet customer needs.

We're also investing in on board technology to enable growth. I have 3 short videos to show you some examples of what we already offer today. The first is remote control. This video shows one of our skid steer loaders, but we have similar systems available for our excavators, track-type tractors and a number of other products. This helps our customers succeed by keeping operators out of harsh environments while maintaining the same levels of efficiency and accuracy.

The second is semi-autonomy. This video shows Cat GRADE Assist on our next-generation excavators. We have similar systems available for our motor graders, track-type tractors and a number of other products. Cat GRADE assist will help inexperienced operators become efficient more quickly. In this application, the Cat GRADE Assist automates boom and bucket movement and helps the operator maintain grade. It also helps operators avoid digging too deep, hitting overhead objects or swinging into hazardous areas.



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The third technology that I'd like to demonstrate for you is autonomy. Caterpillar mining equipment leads the industry in mining automation with the world's largest autonomous fleet of haul trucks and proven solutions for drills, dozers, underground loaders and long wall systems. In fact, we have more than 200 autonomous trucks that have accumulated more than 47 million kilometers of autonomous driving, which interestingly is 2x the experience in autonomous operations of any car manufacturer. Autonomy will help our customers enhance safety and productivity and in fact, customers have experienced more than 30% improvement in productivity with our autonomous solutions. Implementation of these technologies allow efficiencies not only at the product level, but also at the full site level. And customer pull continues to expand.

So to wrap things up, we demonstrated our strategic focus on operational excellence and expanded offerings is paying off. The foundation is set to consistently deliver strong results now and into the future. We are growing our customer base with machines and solutions, including technology for the right job, the right application and the right customer value. Thank you for your time and attention today. And I'll turn it over to Andrew.

Andrew R. J. Bonfield - Caterpillar Inc. - CFO

Thank you, Denise, and just add my welcome to everybody else for coming here, down here today to see us. Now I'll walk you through our financial framework starting with our most recent results and outlook. Moving on to how we think about how we think about resource allocation, before finally talking about how we intend to deploy our capital going forward.

One of the reasons I joined Caterpillar in 2018 was that I love the focus on profitable growth at the heart of the strategy. Many companies chase growth while others concentrate on profits, focusing on profitable growth is much more challenging and the only sustainable way to build shareholder value. And that is exactly what we are doing.

Notwithstanding favorable macroeconomics, we are now in a stronger and much more profitable company than we were 2 years ago. Our focus on profitable growth is clearly illustrated by the improved margin performance over the past 2 years. As you know, operating margins fluctuate with revenues as operating leverage takes effect. It is clear in the last 2 years that more of the gain from operating leverage has gone through to the bottom line [against] our relative performance in previous periods. Let me remind you of that track record.

As we reported in January, sales and revenues in 2018 were \$54.7 billion, up 20% with gains across all 3 primary segments. We reported profit per share of \$10.26 and adjusted profit per share of \$11.22, a record for Caterpillar. And as Jim mentioned earlier, margins met or exceeded the 2017 Investor Day targets.

We continue to see strong first quarter results. As we reported last week, sales and revenues totaled \$13.5 billion, up 5%. Profit per share was \$3.25, up 19%, another new record for the first quarter on top of a record in the quarter of the previous year. We believe we are delivering benefits by executing our strategy and using the operating execution model, our O&E model, to allocate resources to the greatest profitable growth opportunities. And as we said last week, we expect profit per share for 2019 to \$12.06 to \$13.06, including \$0.31 from a discrete tax benefit in the first quarter. This guidance assumes modest sales growth, pricing that offsets manufacturing cost increases and the benefits of lower incentive compensation expense. That gives 18% to 27% growth in profit per share for this year.

As I mentioned a moment ago, Caterpillar is now a stronger and much more profitable company, so what can you expect our margins to look like going forward. Our new target is to improve adjusted operating margin by 300 to 600 basis points from the cycle from 2010 to 2016 being the base years against which we will measure this improvement.

Let's take a step back and see how this improvement could have impacted Caterpillar's historical performance. This chart shows our adjusted operating margin performance through the 2010-2016 cycle. Then it overlays the additional 300 basis points to 600 basis points target on a historical performance at any point in that time. At our Investor Day in 2017, we set a target to improve overall margins by 200 to 500 basis points. In 2018, we achieved margins of 16%, towards the high end of this range by some performance at a similar level of sales and revenues as in 2013 and 2014. This performance gives us confidence in the new target. Our new margin target of 300 to 600 basis points is 1 percentage point improvement at both ends of the range. And as I said, we aim to deliver this at all points in the cycle. This will give a targeted margin range of 10% to 21% over a cycle. If you think of this as 10% to 13% at lower levels of sales such as in [2016] and 16% to 21% at high levels of sales such as in 2011 and 2012.



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To be clear, this goal of 300 to 600 basis points margin improvement is versus the 2010 and 2016 baseline improvement, before we started to execute the new strategy. In other words, we are not projecting we'll add 300 to 600 basis points improvement to our adjusted operating margins for 2017 and 2018. How, we're delivering this. First by the cost actions the company has taken to reduce the cost base. And secondly, by not adding cost or capacity back into the business as we increase sales. This means that the improvement in the cost base we've already made leaves us with less cost to take out if sales decline. However, our lower cost structure means that we still expect absolute margins to be better than they would have been otherwise. Also, our being more disciplined in spending on capital, having added less new structural costs and by reducing future restructuring costs, we expect to deliver stronger cash flows in that environment, facts that I think are under-appreciated.

Our recent operational performance has been a big driver of our improved financial results. Through significant restructuring, we have reduced our period costs significantly to the tune of about \$1.8 billion over the last 5 years. Again, we've also been disciplined by not adding structural cost back as we move up the cycle, keeping a tight, yet flexible cost structure. Since 2014, we have reduced our manufacturing footprint by approximately 25 million square feet or 29%. Using lean manufacturing techniques that Denise described, we have sufficient capacity to meet increased demand at higher sales levels than we are currently experiencing. This means that even with this reduced footprint, we won't be adding to our capital expenditures. We, therefore, expect CapEx to remain below current depreciation and amortization levels. And normalized capital -- CapEx estimate is \$1.3 billion to \$1.5 billion, compared to depreciation and amortization of \$1.8 billion per annum. This is positive for cash flow conversion.

And we are still investing in R&D. Our spend is consistently around \$1.8 billion per year, we believe this is sufficient level of spend to drive our strategy and to continue to deliver long-term profitable growth. We have maintained a strong balance sheet. Our [current] debt-to-EBITDA range for machines, energy & transportation or ME&T is 0.5x to 1.7x to support an A credit rating. In 2018, the actual result was at the lower end of that range. Finally, improved operating margins and lower CapEx have been driving our improved free cash flow.

Companies that allocate the resources more effectively achieve higher returns for shareholders. The primary metric we use for resource allocation in the O&E model is operating profit after capital charge or OPACC. We calculate this metric quite literally as adjusted operating profit less capital charge. The capital charge is calculated as the average quarterly ME&T net assets multiplied by the pretax capital charge of 13%. As disclosed in our proxy statement, OPACC is one of the performance measures we use in compensation calculations. This metric means we can incentivize our leaders to properly balance our desire to grow with our desire to increase profits. Reminds us we have to achieve the minimum level of return to justify any investment in business and that capital has a cost. As you know, achieving returns above the cost of capital is the road map to create shareholder value. Our reliance on OPACC is not just as a metric we refer to, but the measurement we use to help run the business. We calculate the amount of OPACC for the company, the segments, by region, by division, all the way down to product level. We begin with facts and data, we include this data in business strategy reviews, which feed into our business and industry assessments. These insights guide us where to invest and how to allocate our resources, in particular, R&D and capital, which are critical to increasing OPACC. This is a dynamic process, which takes into account changes in the external marketplace, so we're not just making decisions based on a single point in time. We're seeing tremendous benefits. Our OPACC dollars in 2018 were about 3x, which we saw in 2014 on a similar sales and revenue cycle. We incorporate our OPACC into our thinking, our action plans, our core processes and our decisions, however we still have opportunities to deliver more benefits.

Last year, we evaluated the OPACC of about 40 product lines. This is an interesting exercise as 6 product line individually achieved an OPACC integration that was greater than the total of that bottom 13 in aggregate. Yet at the same time, these businesses in the bottom third consumed a disproportionate amount of our financial resources. We are now focusing on how to drive the more profitable product lines and allocate fewer resources to the lower performing parts of our business. Application of this metric at the product level has been driving decisions such as selling less profitable businesses. For example, we have recently agreed to divest our purpose-built forestry business to Weiler Forestry. Another example, will be we're going to take positive OPACC actions to improve the financial performance of a challenged business. We also applied our OPACC analysis to collections of businesses, such as hydraulic excavators when we invested to launch the nextgen excavator. Investments in new services is another example.

The next step is shifting resources amongst the segments aligning resources to the highest value creating businesses in turn creating even more value. We are early in the stage, and we would expect the decisions and outcomes to be more apparent in future years. This approach has been very effective for us. And we will continue to use the O&E model as a guide for resource allocation and investments going forward.



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If we look at the company's ME&T free cash flow history, which is defined ME&T operating cash flow less capital expenditure and discretionary pension or OPACC contributions, we've seen significant fluctuations based on working capital changes, capacity expansions and restructuring expenses. We've improved our ME&T free cash flow in 2017 and 2018, on increased sales and revenues due to our improved operational performance, commitment to a flexible and competitive cost structure and disciplined capital spending. Today we are introducing a new target for ME&T free cash flow as another part of our profitable growth journey. Let's briefly go back to our historical cash flow performance.

Looking at the year 2010 through 2016, we delivered a range of \$3 billion to \$6 billion. I have excluded 2012 when free cash flow was just \$1 billion, which is when we let working capital and CapEx creep up at the time of high demand. Given that confidence in our strategy, and using the O&E model to allocate resources to fund profitable growth, we are targeting ME&T free cash flow of an incremental \$1 billion to \$2 billion above our actual performance in 2010 through 2016. This brings our expected ME&T free cash flow range to between \$4 billion and \$8 billion per year.

Strong free cash flow leads us to the very good question of how best we can deploy our capital -- excess capital. In the last 9 years, the company has returned on average 65% of ME&T's free cash to shareholders. We have consistently increased our dividend and over the last 25 years leading to the recognition as a new member of the Dividend Aristocrat Index. The compound annual growth rate of our dividend in this period has been about 7%. While that's been steady, our dividend power ratio is at the lower end of where we think it should be. In addition, in recent years, we have not had a sustained share buyback program. Free cash flow paid out to shareholders has been inconsistent primarily because of the share buyback pattern. We paid out substantially all of our ME&T free cash flow only 4x in the last 9 years. Like our dividend payments, our deployment of free cash flow to shareholders has generally been lower than it could be. We now have much more flexibility from a cash perspective as we are now able to repatriate a greater proportion of our international earnings more cost-effectively. This change, along with the more disciplined approach to CapEx, higher margins and an expectation of lower restructuring costs in the future give us the opportunity to reconsider our dividend level, which I will discuss in a moment.

We expect to retain a mid A credit rating. We also expect to continue investing in appropriate levels of R&D and SG&A to support our strategy, examples in good investments in services, digital, or projects that enhance operational excellence. We closely monitor performance of these investments against using our OPACC goals with an eye towards profitable growth. I mentioned earlier, that we expect to invest about \$1.3 billion to \$1.5 billion per year in CapEx. We will characterize these investments typically being about 20% for growth and about 80% for running and maintaining the business. However, with the strong balance sheet position I referenced earlier, we will have significant free cash, which we can deploy. We, therefore, intend to return substantially all of our ME&T free cash flow to shareholders. We believe that a balanced approach with dividend growth and more consistent buybacks will create more -- the most value for our shareholders.

As Jim announced, we are increasing our dividend by 20% to \$1.03 per share per quarter from \$0.96 previously. This is a result of our execution against the O&E model and because of our confidence in our ability to perform well across all cycles. We also expect to increase the dividend in each of the following 4 years by at least high single digits percent, regardless of where we are in the cycle. This new 5-year plan to grow our quarterly dividend projects our confidence in the structural improvements we made in free cash flow. After the increases over the next 5 years, we would expect to pay out about 60% of ME&T free cash flow as dividends in a low sales period. Obviously, with higher revenues, the dividend payout ratio will be less. We also expect a sustained program of share buybacks based on residual free cash flow after paying the dividend. At a minimum, we're committed to repurchasing shares sufficient to offset dilution from equity-based compensation. Except for very -- periods of very low sales, we would expect the share repurchases will result in a reduction in the average annual share count. We will execute this in a disciplined way and be governed by our own assessment of the intrinsic value of our common shares. While funding the dividend and more consistent buybacks we would also expect to have sufficient resources to continuing investing in services and expanded offerings and to pursue M&A. We expect that we can fund any additional growth initiatives and M&A using our existing balance sheet capacity.

Before finishing, let me touch on our M&A framework. Our criteria naturally begins with OPACC as our primary financial metric, it tends to favor bolt-on acquisitions over more transformational transactions due to the way OPACC is calculated. Therefore, our focus has been on those sort of bolt-on acquisitions in adjacent areas that enhance our growth profile. Whilst we will continue to consider these and more transformational transactions, we are also focused on other growth areas, such as services, digital, and other opportunities that enhance our core business and take advantage of our size, scale and dealer networks. We believe we can pursue inorganic growth through our strong balance sheet. To that end, we continue to build our pipeline of potential M&A projects. However, we intend to remain disciplined in this pursuit, again with OPACC at the center



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of our decision-making as it is in the center of the decision-making of our business. Lastly, we do reserve the right and actually to suspend buybacks in the event of a substantial inorganic growth opportunity, which requires the use of free cash flow to fund it.

So let me leave you with 2 key points. First, thanks to the execution strategy, we are a much stronger company than we were 2 years ago. Second, by using OPACC at the heart of our decision-making, we are targeting more consistent and more effective capital deployment as part of our focus on driving long-term profitable growth. Let me hand it back to Jim.

D. James Umpleby - *Caterpillar Inc. - Chairman of the Board & CEO*

Well, thank you, Andrew. Now to conclude, I will share my thoughts on why you should be investing in Caterpillar.

The strategy we introduced in 2017 is working. We have achieved or exceeded the margin targets we shared with you during our 2017 Investor Day. We are a financially stronger company as evidenced by our recent results -- recent record results and our 3 to 6 percentage point improvement we are targeting in adjusted operating margins through the cycle. We are improving the operational performance of our company by accelerating our lean journey, striving to achieve world-class safety and quality standards, while continuously working to establish a more flexible and competitive cost structure. We are investing significant amounts of resources to grow services and we have established an aggressive, but achievable target to do that by 2026. We have also explained to you a more disciplined approach to more consistently return capital to shareholders, both through dividend increases and more consistent share repurchases.

And with that, I'll turn it back over to Jennifer to facilitate our question-and-answer session.

QUESTIONS AND ANSWERS

Jennifer K. Driscoll - *Caterpillar Inc. - Director of IR*

So let the fun begin, your favorite part Q&A. So thanks to everybody, who has presented so far. We're really proud of the things we have outlined here for you today and we are excited to continue with you deeper into our journey of our O&E model, delivering higher margins and increased level of cash flows, allowing us to return more value to shareholders. I'm seeing some hands come up while these chairs are brought up.

We will be fielding questions only from the live audience here in the room. So if you would like to ask a question, raise your hand. Rob and [Trent] and my team are going to be passing around mics. We would like you to announce your name and affiliation before asking your question for the benefit of those who are listening. Up on stage, we're welcoming the presenters you already heard from today along with 2 others, our group President Ramin Younessi of Construction Industries and Billy Ainsworth from Energy & Transportation. Okay, I think we are ready to go. Rob, have you got our first question?

Andrew Millard Casey - *Wells Fargo Securities, LLC, Research Division - Senior Machinery Analyst*

Andy Casey, Wells Fargo Securities. Thank you for the presentation. I was wondering if you could clarify whether the 300 to 600 basis points through-the-cycle margin improvement is based on what you have done up to this point or does that include future endeavors, such as the aspirational doubling of service?

D. James Umpleby - *Caterpillar Inc. - Chairman of the Board & CEO*

Yes, that 300 point to 600 basis point improvement is based again over and above what we accomplished in 2016, between 2010 and 2016, we're obviously going to continue to invest and within that, that framework gives us the ability to invest in services, to invest in organic growth opportunities and also provides opportunities for us to inorganically grow as well. So again, it's meant to be above and beyond 2010 to 2016.



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Andrew Millard Casey - Wells Fargo Securities, LLC, Research Division - Senior Machinery Analyst

I appreciate that. I'm just trying to probe as to whether that includes activities that you have not yet done or if it's what you have done to this point?

Andrew R. J. Bonfield - Caterpillar Inc. - CFO

Let me talk about that. I think what you're asking, Andy, if I -- correct me, is whether do you think there could be some incremental growth in the future as a result of the services [tracking against that.]

Andrew Millard Casey - Wells Fargo Securities, LLC, Research Division - Senior Machinery Analyst

Yes.

Andrew R. J. Bonfield - Caterpillar Inc. - CFO

So if you look at the way we looked at the margins of this, that was on the range of revenues between \$39 billion and \$66 billion, obviously that's depending on services, sales also prime product sales as well. So again, it depends a little bit about what that mix will be and it depends where you are on the cycle, but in that period of time, between \$39 billion and \$56 billion, you would expect margin to range between 10% and 21%, I think if you look today where we are today. Last year, we were just under 16%; first quarter this year just over 16%. That gives us quite a lot of headwind to grow into even with revenue growth on top of that.

Jennifer K. Driscoll - Caterpillar Inc. - Director of IR

There's a question in the third row near the middle.

Jerry David Revich - Goldman Sachs Group Inc., Research Division - VP

Jerry Revich, Goldman Sachs. Can you talk about the building blocks for the \$10 billion of incremental service sales, just give us a little bit more bite size? How much [of your] contribution can we expect from predictive analytics from doing some guaranteed buybacks and things like that, just a little bit more meat on the bone in terms of how you get to that \$28 billion from \$18 today.

D. James Umpleby - Caterpillar Inc. - Chairman of the Board & CEO

A combination of things, so it includes piece parts sales. It includes digitally-enabled solutions, it includes a number of things that we are doing. So we haven't broken down and we are not going to be communicating specifically within that \$10 billion the different components that make up the total, but that is, again, we'll be driving from a whole variety of perspectives, but we're not breaking it down further than that.

Jerry David Revich - Goldman Sachs Group Inc., Research Division - VP

Then maybe from a timing standpoint, you are very clear it's not going to be over the next year or 2. How back-end loaded is that or is a big chunk of that going to come from the last 3 years and recognize what you said about rebuild earlier, so clearly not a '19 or '20 event, but '21, '22 are we going to get a meaningful down payment?



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D. James Umpleby - *Caterpillar Inc. - Chairman of the Board & CEO*

Some of it depends on what happens to the market cycles between now and then, but it does require investments in our digital capabilities as I mentioned and we also talked about the fact that we have to invest in technology and our components and our machines to be -- to actually provide some of that service capability. If you stop and think about our NPI process when we invest in a product that takes a certain amount of time, then the product has to be delivered and often times it has to accumulate a certain number of hours before in fact we will see some of that parts opportunity. So it is a relative -- there is a process there. And as I mentioned in my prepared remarks, we expect it will not be a straight line, it will tend to increase and accelerate towards the end of that 10-year period, which ends in 2026.

Jamie Lyn Cook - *Crédit Suisse AG, Research Division - MD, Sector Head of United States Capital Goods Research, and Analyst*

Jamie Cook, Crédit Suisse. Andrew, the commentary you made on OPACC in terms of I think you said like 6 product lines, which generated greater than bottom quartile or whatever you said, that commentary was interesting to me. In terms of the product lines that are generating above average OPACC, is there anything common within those product lines? Is it specific to a certain segment geography. And then with the product lines that are underperforming, is the intention to fix all these or is there a certain percentage of the portfolio that could be up for conversation that it is not core to Cat? And then my other question is just as you think about returns, you talk about OPACC in dollars, is there any consideration to talk -- think about returns sort of as a percent and targeting a certain return sort of based on where you are in the cycle and sort of improving that over time?

D. James Umpleby - *Caterpillar Inc. - Chairman of the Board & CEO*

Jim here. I'll take that one on. There's 3 questions there, so I'll do the first 2, and if I forget the last one, you can remind me. So in the first one, there really isn't any kind of criteria or characteristic that we would use to explain why a product line is underperforming. There's a whole variety of reasons for that. And this isn't just about divestment. One of the things that we've shown over the last couple of years is, by really using the O&E Model to shine a light on our performance, we've been able to focus our teams on fixing businesses. So we have a number of products and a number of businesses that have not been acceptably returning -- giving us an acceptable return, and we'd be able to fix those businesses. So obviously, our primary desire is to fix and not to divest.

But as we mentioned earlier, if in fact, we don't see a clear line of sight to either an acceptable return or a competitive advantage, we are willing to divest in businesses. So again, there's no real characteristics -- single characteristic that I would apply to those that are underperforming. Sometimes, it's a change in footprint, or sometimes it's a change in technology. In some cases, we just had the wrong structural cost in that product line, and that's supporting that business that we'd had -- that we had to rightsize.

Jamie Lyn Cook - *Crédit Suisse AG, Research Division - MD, Sector Head of United States Capital Goods Research, and Analyst*

Okay.

Andrew R. J. Bonfield - *Caterpillar Inc. - CFO*

Yes, and on the other part your questions, regarding resource allocation. I mean the interesting thing that often happens, as we know, with businesses is you look at the characteristics of them. But obviously, large scale helps. So obviously, our larger businesses obviously produce more OPACC that would -- and you tend to expect that. And so that obviously is one advantage they had. So obviously, some of the more small businesses have a little bit more challenge from that perspective. And that obviously is always the norm you would expect. They actually trying then to make sure, though, that you allocate your resource dollars across them all in a relatively balanced way to make sure that you do make the right of investments to protect that OPACC pull is also important, and that's part of that process of resource allocation we've been talking through.

With regards to percent targets, actually, I mean if you grow OPACC dollars effectively, that actually is actually excess return, effectively over and above the cost of capital. I think for our people, as we manage the organization, rather than setting percent targets, actually just making -- it's a



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very clear and easy way for people to understand they have their operating profit performance, there's the capital charge, they know what the asset base is, they know they have to manage that. That gives them a simpler way of managing it, and it's actually more measurable across the whole of the organization. So for most sort of capital-intensive-type businesses, I think it does work pretty well, rather than actually setting a particular hurdle rate. Problem with hurdle rates, as we all know, is once you set a hurdle rate, that becomes the norm for everything you get from an investment level, rather than actually a real level of return that you're going to be able to achieve.

Jamie Lyn Cook - *Crédit Suisse AG, Research Division - MD, Sector Head of United States Capital Goods Research, and Analyst*

Okay.

D. James Umpleby - *Caterpillar Inc. - Chairman of the Board & CEO*

And one more follow-up answer there. We have certainly demonstrated the ability over the last few years to improve underperforming businesses. We had some businesses that had not been acceptably profitable for many, many years, and by really using the O&E Model and focusing on it and actually telling our teams, "Here is the goal, and we need to get to this point or we may, in fact, elect to divest this business," it really has provided clarity and the initiative in our teams to really go after it and make it happen. So I think that's one of the differences as opposed to just looking for incremental improvements every year to actually -- again, shining a light on those businesses that aren't performing acceptably, saying, "This is the minimum if we're going to stay in this business," we've seen that have a major impact on the performance of our teams.

Jennifer K. Driscoll - *Caterpillar Inc. - Director of IR*

Thanks, Jamie. Question over here.

Robert Cameron Wertheimer - *Melius Research LLC - Founding Partner, Director of Research & Research Analyst of Global Machinery*

This is Rob Wertheimer, Melius Research. Questions for Bob. I mean the services disclosures is great. It's obviously far higher than a lot of other companies in the industrial world. It should provide some stability, but last cycle, there was a bit more volatility in the downside than maybe some of us expected. And so my question is whether the next 5 and 10 years look a little bit more -- if there's more factors in stability embedded within the services stream that you can point to.

Bob De Lange - *Caterpillar Inc. - Group President of Services, Distribution & Digital*

I think it comes back to the point I -- thank you for the question, Robert. I think it comes back to the point I listed as to why we focus on services growth. Definitely, I think clearly, it will help us reduce cyclicalities over the cycles, but that does not mean it will eliminate all cyclicalities. And I gave some examples of different segments. So we will continue to see some cyclicalities, which is also why Jim mentioned it's one of the factors that our growth trajectory will not be fully linear. But by focusing on services, clearly, throughout the cycle, we will bring that cyclicalities down to lower levels. So in any case, it'll be a positive trend, I would say. I don't know if there's anything...

D. James Umpleby - *Caterpillar Inc. - Chairman of the Board & CEO*

That's a good answer.

Jennifer K. Driscoll - *Caterpillar Inc. - Director of IR*

Our next question is on the front row in the left here.



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Mircea Dobre - *Robert W. Baird & Co. Incorporated, Research Division - Associate Director of Research and Senior Research Analyst*

Yes. Mig Dobre with Baird. So my question, I think I heard this stat from you, Bob, you were talking about the service business being between 30% and 40% of overall revenue depending on where you are in the cycle. And obviously, you have a target to double this business. So I'm wondering, as you approach that target, do you see this business eventually being closer to 50% of the overall mix? Is that the goal? And what are the long-term implications for margin and investment as a result?

D. James Umpleby - *Caterpillar Inc. - Chairman of the Board & CEO*

Yes. Maybe I'll take that. I think it was my comments where I said it tends to vary, depends on the market cycle, 30% to 40%. So our goal here is to drive absolute services sales increase in Machinery, Energy & Transportation. So that is the goal. Again, that percentage will vary at different points of the market cycle. As Bob mentioned earlier, by doing that, we will, in fact, dampen cyclical somewhat in terms of the impact on our bottom line. But again, what we're really focused on is just growing that absolute services sale.

Mircea Dobre - *Robert W. Baird & Co. Incorporated, Research Division - Associate Director of Research and Senior Research Analyst*

So you're not thinking of it in terms of a percentage of revenue target, it's just an absolute dollar goal?

D. James Umpleby - *Caterpillar Inc. - Chairman of the Board & CEO*

Yes, I think that percentage of revenue target really will be determined primarily by the market cycle, frankly, in terms of -- as opposed to anything that we do. So what we want to do is increase the absolute sales number. And again, in periods of low market demand, that percentage will be -- tend to be higher. And then when the market is very hot and we're selling lots of new equipment, the percentage will be lower, just by definition. So rather than worry about the percentage, what we really focused on is increasing absolute services dollar. It's kind of like OPACC. We've got our teams focused on increasing absolute OPACC dollars as our measure of profitable growth. It's really the same kind of philosophy.

Mircea Dobre - *Robert W. Baird & Co. Incorporated, Research Division - Associate Director of Research and Senior Research Analyst*

Got it. Then my follow-up. You raised your margin range, if you would, by a 100 basis points. But as I was looking through your 2017 presentation, it seems to me that the starting point is a little bit different than it was in 2017. So I'm wondering if you could talk a little bit about this adjustment and if it's truly an apples-to-apples comparison. And then maybe give us a sense for exactly where this 100 basis points of improvement is coming from.

Andrew R. J. Bonfield - *Caterpillar Inc. - CFO*

Yes, so I'll start with the change -- actually, there's an accounting change. There's a -- [imposed on] OPEB, effectively, which went -- actually, we had an adjustment at the beginning 2018. So the operating margin on a like-for-like basis to what we reported in 2018 was 11% at that time period in time. So that was the adjustment which caused the change. So actually, it is a -- on a comparable basis, the baseline for 2017 should have been adjusted down from 12% to 11%.

D. James Umpleby - *Caterpillar Inc. - Chairman of the Board & CEO*

So the comparison we gave you between actual 2018 performance and 2011 was an apples-to-apples comparison on the chart. But because of an accounting methodology change, again, the earlier number was restated. But it is in apples-to-apples on our charts.



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Mircea Dobre - *Robert W. Baird & Co. Incorporated, Research Division - Associate Director of Research and Senior Research Analyst*

[Why the change?]

Andrew R. J. Bonfield - *Caterpillar Inc. - CFO*

Where does it come from? Obviously, factors such as operating leverage will still obviously play a part, making sure that we drop as much of [sales], obviously, as sales and revenues drive through to the bottom line; continue focus on operational excellence, just making sure we continue to drive cost out of the business; and discipline. So that's all part of those factors where we expect an additional margin improvement.

Jennifer K. Driscoll - *Caterpillar Inc. - Director of IR*

Okay, and our next question here in the third row.

Ross Paul Gilardi - *BofA Merrill Lynch, Research Division - Director*

Ross Gilardi from Bank of America Merrill Lynch. So you guys gave some color on how the dealers are going to be involved with selling these services. But I'm wondering if you can go into that a little bit more in-depth because it would seem they're just a critical partner in driving all this? And how do you really establish accountability and motivate to hit that number, that \$28 billion number? Is it going to be something that goes on the scorecard that you review frequently along with all the other key metrics?

Bob De Lange - *Caterpillar Inc. - Group President of Services, Distribution & Digital*

Thank you, Ross. It's a really good question and one that, of course, we discuss a lot with our dealers as well. But I think it comes back to the point I made earlier, that one thing that our focus on services does not change is the fact that our worldwide network of Caterpillar dealers has been and will continue to be one of our strong competitive advantages. And one of the main reasons, that is, because together with our dealers, we share that focus, that passion for our customers. And services will help our customers be more successful, similar for the dealers. As for us, it'll help build loyalty over a long time. Services provide for each of the 3 segments an attractive margin contribution, and so does it for our dealers. So in terms of strategy and the objectives that we want to achieve, we are very well aligned with our dealer network.

We have the separate discussion on about some of the businesses mentioned, like Progress Rail or Solar Turbines, where we have direct service capabilities as well that's specific to our dealers and the alignment is very natural, which makes focusing on services a very obvious area that we can work on together to grow, meaning that, yes, we want to, on our end, continue to invest in a number of projects we outlined. One of them was also working with our dealers to make them even more efficient, raise their capability and capacity. So I think, very close to the core of the dealership relationships we have for many, many decades, and I don't really see that changing with this strategy. If anything, it will reinforce that focus.

D. James Umpleby - *Caterpillar Inc. - Chairman of the Board & CEO*

On services is very important to dealers. And so there's a natural alignment there, but it's good for them, and it's good for us. And it's good for our customers.

Ross Paul Gilardi - *BofA Merrill Lynch, Research Division - Director*

Okay. And then I just wanted to ask you an unrelated question you didn't really discuss so much today. But it was really about China. And certainly, under your predecessor, Jim, Doug Oberhelman, winning in China was always one of the key strategies for Caterpillar. I'm wondering how you define winning in China over the next 5 years, how you would measure that and how you balance that with your effort to drive profitable growth.



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D. James Umpleby - *Caterpillar Inc. - Chairman of the Board & CEO*

Yes, China has been important to Caterpillar for many decades, and I'm -- or we're very fortunate that our predecessors invested in China. We have over 20 manufacturing facilities, more than 10,000 employees. Our market share over the last 2 years has improved year-to-year, and it's an important market that we've been successful in. We intend to continue to successfully -- to profitably grow in China. We continue to develop in -- our dealer network. We continue to invest in new products that are appropriate for that market. We have vertically integrated our value chain in China to ensure our competitiveness. And again, that continues to be an important market that we're confident that we'll be successful in.

Stephen Edward Volkmann - *Jefferies LLC, Research Division - Equity Analyst*

I think I have the mic. Steve Volkmann with Jefferies. Just a couple of quick follow-ups, if I could, somewhat unrelated but back to the sort of services drive here. I'm guessing probably 80% of the \$18 billion that you're showing us now has to be kind of parts. And I'm wondering, as we grow -- feel free to disagree with that. But I'm wondering, as we grow toward 2026, do you see this as a way to capture more of the parts stream through the life cycle of the different Cat equipment? Or do you actually think we're going to add a significant amount of sort of a non-parts revenue there? And the reason I'm asking is that it sounds like so far, most of the services costs that you have talked about are fairly small, some small monthly fee that only somebody pays for monitoring, seems like that's going to be a real stretch to grow that super aggressively. So I'm trying to figure out this is mostly a focus on growing parts penetration or whether there's a lot of other opportunities there as well.

D. James Umpleby - *Caterpillar Inc. - Chairman of the Board & CEO*

So we won't comment on the percentage, but thank you for offering that up. So certainly, what we're doing is looking at growing services across the spectrum. Certainly, parts is an important part of that, but there are other elements as well. And we're investing in our digital capabilities, as we mentioned. We are investing in serviceability in our components, our engines, our machines to help facilitate services growth while always providing more customer value. But it'll come from a variety of areas. Parts is certainly an important one. .

One of the things that we did when we laid out that goal is we looked at what we perceived the opportunity at a fairly granular level, and we are confident that if we are aggressive here and invest in the right way that we can, in fact, grow and double that from 2016 to 2026. So we have actually evaluated what we view as the pools of opportunity in various areas to go after.

Stephen Edward Volkmann - *Jefferies LLC, Research Division - Equity Analyst*

Okay. Fair enough. And then somewhat unrelated, Andrew. We talked about sort of more share repurchase over the next few years, and it sounded for a while like we were talking about kind of doing that regardless of sort of where we are in the cycle. And then you kind of added on subject to kind of intrinsic value calculations. And so I guess I'm trying to figure out whether the message is we're going to kind of do this regularly regardless or whether we're going to sort of -- maybe more timing the market.

Andrew R. J. Bonfield - *Caterpillar Inc. - CFO*

No, we're not going to try and time the market. I think we're going to be doing it more regularly. I think the point that we're trying to make is, obviously, intrinsic value has to be part of the discipline we look at. So if we believe that we're in a situation where we would be destroying value by buying back shares at that point in time in the market cycle, we would, obviously, look at this as a hold at that point. We're not at that stage of the moment.

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D. James Umpleby - *Caterpillar Inc. - Chairman of the Board & CEO*

But you should expect us, again, in normal circumstances to be in the market on a more regular basis. That's our intent, including at the -- again, during lower levels of the cycle, making sure that we hit a minimum offset dilution, which we haven't always done in the past.

Jennifer K. Driscoll - *Caterpillar Inc. - Director of IR*

We have a question in the front row.

Ivan Philip Feinseth - *Tigress Financial Partners LLC, Research Division - Director of Research*

Ivan Feinseth, Tigress Financial Partners. Do you feel there's some opportunity to be able to mine your service data or in-the-field feedback to help save off credit default. For example, if you see machine dropping off in serviceability or a customer dropping off in maintenance, you could predict the default and, conversely using that data, to extend better credit because your ability to extend credit to your customers could enable them to pursue more business and make them a better customer.

Andrew R. J. Bonfield - *Caterpillar Inc. - CFO*

Yes. So one of the benefits of connectivity for Cat Finance is actually the ability to shut off a machine and actually stop it, so -- which is if you are in default, that is one of the advantages. So from an overall perspective, yes, connectivity is key for that as well. And then obviously, it does enable us to take not necessarily a little bit more risk but actually have that ability to have the collateral of the machine in all cases, which is important.

Ivan Philip Feinseth - *Tigress Financial Partners LLC, Research Division - Director of Research*

And my second question is, it's being talked about that the U.S. is very close to a trade deal with China, and how much do you think that, that headwind will turn into our tailwind? Also, it's being proposed that both Trump and Pelosi are discussing that any infrastructure bill should be a minimum of \$2 trillion, which should also be a significant tailwind as well.

D. James Umpleby - *Caterpillar Inc. - Chairman of the Board & CEO*

Caterpillar for many, many years has been an advocate of free trade and so we think that it's not a zero-sum game. We think that free trade between countries helps everyone. So that's a positive thing. I think the thing that's most important is if, in fact, there was a free trade agreement. And in fact, that helps increase global economic growth. That's a very good thing for us. So probably the most important thing in terms of our performance is that global economic growth. That's good for our business.

In terms of infrastructure, we have seen a certain amount of spending at the state and local level, which has certainly helped. But if we had a national infrastructure bill, I think that would be obviously a positive thing for Caterpillar, and we would very much welcome and support that kind of a bill. We believe that the nation's infrastructure needs it. I think you all -- would all agree.

Ivan Philip Feinseth - *Tigress Financial Partners LLC, Research Division - Director of Research*

Yes. Absolutely.

Jennifer K. Driscoll - *Caterpillar Inc. - Director of IR*

In the first row.



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Clifford F. Ransom - *Ransom Research, Inc. - Founder and President*

Cliff Ransom, Ransom Research. I'm a little confused as I often am. When you talk about these beefing up the service offerings, whose revenue is that, the dealers or yours?

D. James Umpleby - *Caterpillar Inc. - Chairman of the Board & CEO*

Both.

Clifford F. Ransom - *Ransom Research, Inc. - Founder and President*

Okay. And how is there a general way we should think about how to split that revenue between the 2 of you?

Denise C. Johnson - *Caterpillar Inc. - Group President of Resource Industries*

[What the targets are.]

Andrew R. J. Bonfield - *Caterpillar Inc. - CFO*

Yes, wouldn't really give you percentage. Again, we showed you on the chart -- our Caterpillar's services sales growth over the last couple of years. So we've demonstrated the fact -- and that's not dealers. That's Caterpillar sales. So again, we're not going to split it out. And it varies by application, it varies by dealer and it varies by segment. But again, growing services sales is a good thing for the dealer, it's a good thing for us. And again, it's always rooted in providing more customer value. So it's a win-win.

Clifford F. Ransom - *Ransom Research, Inc. - Founder and President*

Are all those services billed through the dealer or some billed directly from you?

Andrew R. J. Bonfield - *Caterpillar Inc. - CFO*

The services target is the Caterpillar Inc. services number. So to be clear, that has nothing -- that is the services revenue we recognize within our books.

D. James Umpleby - *Caterpillar Inc. - Chairman of the Board & CEO*

Now I understand your question. So the majority of services revenue for Cat-branded products is, in fact, goes to the dealer. We also have some direct distribution business as well so I'm sure the trail on those are invoiced by Caterpillar directly.

Clifford F. Ransom - *Ransom Research, Inc. - Founder and President*

I got that. Sure. Denise, I have a question for you. We've heard 2 -- Caterpillar helped me 10 years ago to understand that the first lean measurement should be safety. And I commend you on making that the highest priority both times it was discussed. But what we heard today was 2 different metrics: One started with safety, went to, I think, quality. And I can't remember the third one. But the second one was safety and went to velocity. It's different, I would say, than those others. But in any event, is that just difference of attitude about how to define them? Or my bigger question is, to me, the #2 metric ought to be employee engagement, and where does that fit in? And how do you measure it?



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D. James Umpleby - *Caterpillar Inc. - Chairman of the Board & CEO*

Give me a second, and I'll give it to you.

Denise C. Johnson - *Caterpillar Inc. - Group President of Resource Industries*

Go ahead.

D. James Umpleby - *Caterpillar Inc. - Chairman of the Board & CEO*

So I think what we defined is operational excellence for us. Operational excellence means 4 primary things: safety, quality, lean and competitive and flexible cost structure. So if you got confused about the definitions, we were using those, and we did that in our 2017 Investor Day as well. Those are the main criteria we use to describe operational excellence. Now within lean, there's a whole variety of other measures, and I'll kick it over to Denise.

Denise C. Johnson - *Caterpillar Inc. - Group President of Resource Industries*

Right. So within lean, we're also looking at velocity -- things like velocity. Inventory turns, obviously, is key to us. Making sure that we're efficiently and effectively synchronizing the value chain. So really, looking at where we're holding inventory and making sure that we're most able to meet customer demand. So safety, without a doubt, is up there as well as quality. And I would say, from an employee engagement perspective, that is something we track very carefully and closely. And it is something that's on all of our scorecards. And it is something that we take very seriously as the people in our factories and our workplace are really the key to our success overall. And so ensuring that they are actively engaged and also being as productive as they can be is something that we take very seriously and measure also on our scorecard. But I would say, those are the key metrics that we track. And then certainly, there's a lot of other metrics within the operational scorecard, specifically, that we're tracking on an ongoing basis.

Jennifer K. Driscoll - *Caterpillar Inc. - Director of IR*

Thank you. We have a question in the back.

Noah Duke Kaye - *Oppenheimer & Co. Inc., Research Division - Executive Director and Senior Analyst*

Noah Kaye with Oppenheimer. A lot of good discussion about how you work with the dealers to grow the service to this revenue. And my question is really about the role of the digital platform in that. I think the idea that the dealers can benefit from real-time customer data, communicating with each other, offering more and consistent e-commerce, that all makes sense. How long does it take, do you think, for the dealers to kind of get that digital modernization, if you will, to build up that digital platform? What is sort of your plan for that? And how does that factor into the timing for a back-end-weighted revenue growth?

Bob De Lange - *Caterpillar Inc. - Group President of Services, Distribution & Digital*

Yes, I think it comes back to the average, and our age of our dealers is well over 50 years. It's not like we got to know them yesterday and having to start working with them. This strategy, we started at the end of '16, and we've started heavily investing in it, but we do so on a daily basis together with our dealers. As we mentioned before, we believe our objective to grow services is very well naturally aligned with our dealers. So just as we are investing in new services, capabilities and new digital capabilities, our dealers equally see the opportunity. So they're equally investing in that area. And of course, one of the elements that I shown in our strategy was to work with the dealers, to work with them on capability and capacity.



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So we also give them a helping hand where we can and to make sure that we can have simultaneous lift and we progress at the same speed. But as I said that, it's really rooted in the long-standing partnerships we have with our dealers which makes alignment of investments very easy.

Noah Duke Kaye - *Oppenheimer & Co. Inc., Research Division - Executive Director and Senior Analyst*

I guess I could follow that up with just trying to understand the more specific timetables or milestones how should be judging the pace of your rollout here with the digital platform to the dealers.

Bob De Lange - *Caterpillar Inc. - Group President of Services, Distribution & Digital*

Yes, I mean digital platform is one of our -- one of the investments that we are currently making. But one of the things we want to be careful of is making sure we don't measure progress by the enablers. As Jim had laid out, our ultimate goal is to double services revenue by 2026, and that will be the ultimate performance metric that we have for our dealers, for us. And all the enabling projects we have will be measured by that single measure. But in the meantime, we can assure you that both us and the dealers are making significant short-term investments in digital in the platform.

Jim also mentioned that, as one example, that we have established a digital head office in Chicago. We've recruited quite a bit of new digital talent. So that is all happening as we speak.

Jennifer K. Driscoll - *Caterpillar Inc. - Director of IR*

Okay, we have a question in the fourth row.

Jairam Nathan - *Daiwa Securities Co. Ltd., Research Division - Research Analyst*

Jairam Nathan with Daiwa. I understand your point about giving 100% of your ME&T cash flow back to shareholders. But given that you're expecting \$1 billion to \$2 billion in additional free cash flow going forward, doesn't that -- shouldn't that increase your debt capacity? And -- so can we argue that you can do more than that in terms of returning?

Andrew R. J. Bonfield - *Caterpillar Inc. - CFO*

Yes. So what we've tried to do, and this is one of the things that -- one of the things when you go back to the history and part of the reason why we went back to the history, we showed that only 65% payout of the free cash flow over the past period -- decade or so. If you look at that, only 4 times over that period of time has Caterpillar even paid close to this full cash flow.

If you look at -- one of the things we could have done was say, "Okay, we'll pay out a percentage of free cash flow but, obviously, keep M&A as always our criteria and so forth." What we're saying is M&A is not a reason -- we're paying out substantially all of our free cash flow after dividends. It's not including M&A transactions. So basically, what that means is the balance sheet, and the balance sheet capacity is being kept for that. So rather than have -- it's actually from a measurement perspective and for you guys, actually, to be able to model it and actually see where the real return is, actually, we tried to simplify it in that way and use the balance sheet as the -- as a sort of lever for M&A transactions and so forth and other growth opportunities.

Yes, we do have significant balance sheet capacity as we showed. I mean, if you look at it, we're at the low end of the debt-to-EBITDA range. And obviously, if EBITDA rises, obviously, you could grow that debt capacity. But we do think it's important to keep that strength in balance sheet because one of the things as well that we want to be able to do is take opportunity in organic growth opportunity. And we can't -- we don't always know when those are going to be time. So giving the cash back now and then finding later on that we would have to come back or cut back share

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buybacks at some point in time because we have an M&A opportunity just creates more uncertainties. So we're trying to give a very simple framework but one you can actually measure against on a consistent basis.

Jairam Nathan - *Daiwa Securities Co. Ltd., Research Division - Research Analyst*

On the services side, the 30% to 40% of revenue, does that differ significantly between regions and business? And if you could, where's the biggest opportunity?

D. James Umpleby - *Caterpillar Inc. - Chairman of the Board & CEO*

Yes, there is a certain amount of variation, but I'd say the biggest differentiator of just -- in estimating is really where we are in the market cycle. That's probably a bigger determinant. But yes, are there differences between, let's say, with product line a skid steer and mining truck? Certainly. There's more services opportunities in that mining truck or that gas generator or that locomotive than there would be a skid steer that you might hopefully purchase today for your backyard.

Jennifer K. Driscoll - *Caterpillar Inc. - Director of IR*

Okay, back here in the corner.

Joseph O'Dea - *Vertical Research Partners, LLC - Principal*

Joe O'Dea with Vertical Research. First, Andrew, I just wanted to revisit, I think, a comment you made about the dividend is on top of the 20% increase the plan over the next 4 years for at least high single-digit increases and that you have that in place regardless of what we may see from a cycle perspective. And depending on whatever the cycle has in store for us, if that -- if we were to see some challenges nearer term rather than later, that could potentially push the dividend as a percent of free cash flow above that 60% you talked about. So I just wanted to kind of understand your comfort level with that, our comfort level with the idea that we are firmly set in this high single-digit dividend growth over the next several years.

Andrew R. J. Bonfield - *Caterpillar Inc. - CFO*

Yes, so let me -- so yes, absolutely. This 4 years -- after this year's 20% growth, our aim is to grow dividend by high single digits the 4 years that follow that. At that time, even in what we think in a low-sales environment, as we said, we estimate our free cash flow to be between 60 -- between \$4 billion and \$8 billion through the cycle, we think that actually will only be 60% of free cash flow at that point of time in the cycle, so even at the end of that 5-year period.

Joseph O'Dea - *Vertical Research Partners, LLC - Principal*

And if we're facing some kind of draconian situation in a year and you're looking at a 65% of free cash flow, that's not going to change?

Andrew R. J. Bonfield - *Caterpillar Inc. - CFO*

That's not going to change our policy, no.



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Joseph O'Dea - Vertical Research Partners, LLC - Principal

Second question just related to the framework. I think you've kind of reiterated that framework, the \$55 billion of revenue and 14% to 17% margins this year. It seems like it's on track for the high end of that margin range. And what's happened since the 2017 Investor Day is tariffs, a materials inflation and all the supply chain challenges, and you're doing that and still delivering the margin that you're delivering, which seems like if we get some relief from that and some of the mitigating actions you've discussed, there's upside to this margin range. But you haven't actually given that to us today. So maybe the offsets to that or you've talked a lot about investments, should we be thinking about R&D has a nice step-up coming?

Andrew R. J. Bonfield - Caterpillar Inc. - CFO

Yes. So I mean, at the moment -- obviously, at the moment, we are facing tariffs, and tariffs are we estimate for this year between 250 -- \$300 million and \$350 million. Obviously, in the event -- that's direct tariffs. Obviously, in the event that those are reversed, obviously, that would be an opportunity. Obviously, at this stage, it's far too early. And also, the other thing we do also have to think about is it often takes quite a long time for those to come back through the system. So the timing of that, we can't be certain of in the event they were reversed, if they are reversed. And then secondly also, on top of that, because we put through price increases, partly because, obviously, of increased costs, one of the things we may get pressured back is from a revenue perspective from customers, which is -- should they get further discounts. So can't be certain that, that actually naturally feeds through into the bottom line.

D. James Umpleby - Caterpillar Inc. - Chairman of the Board & CEO

But we would welcome lifting of the tariffs. Bottom line, it would be -- seriously, it'd be a positive thing for Caterpillar. There's no question. Net, net, net, Andrew's points are very valid, but net, net, net, it'd be a positive thing for us. There's no question.

Ben Cherniavsky - Raymond James Ltd., Research Division - MD of Industrial Research

Ben Cherniavsky with Raymond James. I'm wondering if you guys would be willing to talk a little more about your decision today to divest the forestry line just as an example of an area where you went down that pathway. To me, it seemed like that was a market -- a product where you had deep roots, pardon the pun, you had a lot of large machinery in the resource sector, not terribly crowded, good parts consumption. So what was it in that market that made it so difficult for you to compete and where you said -- felt like you couldn't fix it?

D. James Umpleby - Caterpillar Inc. - Chairman of the Board & CEO

Yes. So we are still very involved in serving forestry customers, just to be clear. It's an important market for us, which we continue to participate. What we did is to divest a limited number of specialized forestry products. We're just, again, going back to our strategy, the O&E Model: We evaluate our competitive position, we evaluate the return we're getting on the investment, and most importantly, we evaluate looking forward what are the best areas for us to invest for future profitable growth. And we, based on all of those factors, we made a decision to divest some products in forestry. We are still very involved in the forestry business and to a large extent, but we did divest some products for those reasons.

Ben Cherniavsky - Raymond James Ltd., Research Division - MD of Industrial Research

But as part of the whole product catalog for forestry, wasn't strategically important to have them in the group?

D. James Umpleby - Caterpillar Inc. - Chairman of the Board & CEO

Our forestry customers are very important to us. We continue to support them. But yes, we did conclude that it was appropriate for us for the reasons I outlined to divest some of those products.



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Ben Cherniavsky - *Raymond James Ltd., Research Division - MD of Industrial Research*

Okay. And if I could just have one quick follow-up. A number of years ago, you guys also talked about the Across the Table initiative with your dealers. Where are you with that strategy right now? And are you still sort of going through that process of having those kind of discussions with the dealers and looking their performance that way?

Bob De Lange - *Caterpillar Inc. - Group President of Services, Distribution & Digital*

I think we definitely work with -- we definitely work with our dealers on an ongoing basis to help them continuously improve performance. So that has not changed. But overall, our discussions with the dealers are very much aligned with the strategic framework that Jim outlined, where we work together with our dealers on operational excellence, on expanded offerings and on growing services. So that is the primary focus in line with our new strategy in terms of our discussion with our dealers.

Courtney Yakavonis - *Morgan Stanley, Research Division - Research Associate*

Courtney Yakavonis from Morgan Stanley. Earlier today, you guys gave us some good examples of the expanded offerings that you have from the retail customers, customers that typically have 1 to 3 units in their fleet. Can you just address the opportunity within that customer base, really, for services and/or if you're typically just going after some of those more traditional Caterpillar customers? And then secondly, if you can just address if there's any reason why we didn't get updated segment targets under the new framework, or should we just assume that all of those targets kind of grew up by 1%?

D. James Umpleby - *Caterpillar Inc. - Chairman of the Board & CEO*

Getting to the first question, so we're after services for all of our products. So as I mentioned earlier, there's arguably more opportunity with a mining truck, a gas generator or a locomotive than there is a skid steer. But there are still service opportunities for that skid steer. And we have dealers that -- and we have in Europe that has a very high percentage of what we're now calling customer value agreements for every piece of the equipment they sell, including the smallest skid steer that, and that includes our expanded offerings in our GC product line. So again, there are opportunities everywhere. The opportunity does vary based on application and product, but we're after all of it. Service isn't all of it.

And we -- on your last question, we decided really to focus on profitably growing the company, and we've decided to focus on the margin improvement for total Caterpillar. We decided not to go back and give it by segment. I don't know if you want elaborate. I don't know...

Andrew R. J. Bonfield - *Caterpillar Inc. - CFO*

Yes, this is because -- partly because, obviously, segments go through different cycles at different parts of -- in different parts of the cycle at different points in time. We're spending all our time updating. This is the target through the whole cycle. So that gives you a broader base to work with and, therefore, does reflect the fact that different businesses will be in different places at different time.

Jennifer K. Driscoll - *Caterpillar Inc. - Director of IR*

We had a question on the left-side fourth row.

Ashish Ravi Gupta - *Stephens Inc., Research Division - Research Associate*

Ashish Gupta from Stephens. Just trying to get a sense from where you are on lean in terms of ultimate margin opportunity. Made significant progress over the last several years, obviously, but where -- what inning or however you want to describe? And then I'll have a quick follow-up.



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Denise C. Johnson - Caterpillar Inc. - Group President of Resource Industries

Sure. So we have been very focused and have had a long journey in really getting lean implemented. I think the big change that we've had on that, that I really tried to speak to, is probably didn't do as good of a job in aligning with our supply base from an end-to-end perspective. So we went through our downcycle and had a lot of opportunity to pull cost out, and as our supply base actually got constricted, there were a number of those suppliers, especially North America, that went out of business. And I would say, as we've gone back through the upturn it's really saying let's, first of all, look at our strategic supply base as part of -- as an extension of us and make sure that we're really synchronizing how we think of capacity with our supply base as we go through those cycles and set up very strategic supply agreements with them and really rationalize our supply base such that we're able to more responsive. Part of that is giving them more visibility to our demand. And in the past, we had fairly short signals of what we would give them for our demand, so it's giving them a longer signal so that they can plan better for that and then aligning that with the dealer process because a lot of the WIPs are -- of the cycle came from dealers anticipating they couldn't get our equipment and then ordering it in advance of that and then, obviously, them being stuck with it when the cycle turns.

So it's being able shorter cycles so you can respond faster, so you don't have to hold as much inventory and be more responsive end to end. So it's in every range of that. I would say there are definitely, from an operational excellence perspective, more opportunity as we move forward to get even leaner in our factories, and we are working to do that. So we're still in the early recovery days of the upcycle, and we're working to become even more lean.

Ashish Ravi Gupta - Stephens Inc., Research Division - Research Associate

And if you were to think about it from the perspective of a segment, I mean I think in the 2017 meeting, you'd focused on BCP being pretty far along. Would you say that RI and E&T are sort of at that similar levels BCP was back then?

Denise C. Johnson - Caterpillar Inc. - Group President of Resource Industries

From what perspective? From a lean perspective?

Ashish Ravi Gupta - Stephens Inc., Research Division - Research Associate

Yes.

Denise C. Johnson - Caterpillar Inc. - Group President of Resource Industries

I would say I think as we've looked at the consolidation across the segment, I wouldn't say there's any segment that's specifically ahead of any others. I think, certainly, where we've been more constrained has been in the larger, more complex products, so some of the E&T and mining products have had more of a challenge in ramping up just because of the sheer complexity and size where there's much more standardization in the construction area and perhaps because of the global footprint was a little broader. But Ramin, why don't you speak to that a little more?

Ramin Younessi - Caterpillar Inc. - Group President of Construction Industries

I'll just give you one example on CI's perspective now versus a couple of years ago. From like an inventory perspective, as a measure of lean performance, we used to hold a whole bunch of finished machines and finished goods in the PDCs or at our plants. They cost a lot of money. It doesn't have -- help our cash flow, turns, et cetera. Now we work with our partners, like in the engine group or the transmission group. They hold inventory for us. They can quickly respond to us. Sometimes, we have to ship engines or machines across the world. It really helps to hold the inventory where the amount, the dollar value is the least. We do a lot of that today, and it's really helped us in a big way from a responsive perspective. So...



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D. James Umpleby - *Caterpillar Inc. - Chairman of the Board & CEO*

But it's a never-ending journey. So if the question is, do we have room for improvement across the Caterpillar? Absolutely, right? So I won't give you an inning on that one. But it's a never-ending journey, and we have room to get better. There's no question.

Ashish Ravi Gupta - *Stephens Inc., Research Division - Research Associate*

Just a really quick unrelated follow-up. In terms of the expanded offerings, GC, mini excavators, et cetera, SEM, how do you think about the opportunity there? I mean I know I've heard you guys say it's large or significant, but could you provide any other context?

Unidentified Company Representative

So as Denise showed very nicely earlier today. So when you think about our construction products, we have this 4-tier product range, if you would. So the kind of the standard model is what we are -- were traditionally known for. Now we are going up from that with the XE model. We go below that with the GC model. And then in some offerings, in some cases, in some regions, depending on market requirements and such, we have the SEM brand. In the case, we looked at wheel loader. So we're doing that regionally or across the board depending on what the market requirements are, but we have a -- basically, we have a long-range harmonized product line across the world, and we're basically executing against that.

Joel Gifford Tiss - *BMO Capital Markets Equity Research - MD & Senior Research Analyst*

Joel Tiss from Bank of Montréal. I wonder if you can share with us a characterization of what percent of businesses are in the bottom end of that 80-20 as you look through that, that are never really going to get to the return levels that you guys are targeting.

D. James Umpleby - *Caterpillar Inc. - Chairman of the Board & CEO*

Yes, it's very tough to just determine or disclose that. We've had some surprises. As an example, in our small engine business, for many, many years, that business was not heavily profitable. And we brought in some new leadership. We had the courage to do the right thing from our footprint perspective, from a cost perspective, and now that business is very heavily profitable. So it's tough for us to judge until we actually, again, shine our light on it, get the right leadership, get the right focus to say a certain percentage will or won't make it.

Andrew R. J. Bonfield - *Caterpillar Inc. - CFO*

I think the other thing you should always remember is this is the home of the O&E model BCP, and BCP was one of the most troubled divisions in Cat many years ago. When they used O&E and OPACC as a starting point, that actually has driven and actually has become one of the best-performing divisions within the company. So anybody can turn around.

Joel Gifford Tiss - *BMO Capital Markets Equity Research - MD & Senior Research Analyst*

Then I just wonder, in sort of the bigger framework of margin improvement, can you give us a sense of what percent is from the existing businesses and what percent is from the incremental services, [Ed]?

Andrew R. J. Bonfield - *Caterpillar Inc. - CFO*

Yes, I mean, I think as -- we manage the businesses by segments. So segment includes services as part of that. So that's all integrated. I think as we look across the businesses as a whole, it's about making sure we manage as much of the operating leverage as revenues rise and pull that through

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to the bottom line as we can. That is where we can do a good job. As far as actually avoiding building structural costs, and actually, last year, obviously, SG&A, R&D were very flat year-on-year, and avoiding those increases as much as we can, reallocate resource as well [and pop-up]. So actually, that's the best way of making sure we actually deliver that margin improvement.

Joel Gifford Tiss - *BMO Capital Markets Equity Research - MD & Senior Research Analyst*

No one is taking the mic from me. Can -- is there a larger acquisition that could really accelerate your services strategy? But that's not the preferred way to go about it.

D. James Umpleby - *Caterpillar Inc. - Chairman of the Board & CEO*

Everything is on the table. So we're looking at organic growth opportunities, inorganic. And I won't say something's likely or not likely, but everything is on the table, and we're evaluating all of our options to accelerate services growth.

Chad Dillard - *Deutsche Bank AG, Research Division - Research Associate*

This is Chad Dillard from Deutsche Bank. So with the \$28 billion target for services, how should we think about the mid-single sales potential for Caterpillar? And then secondly, if you can think about what the mid-cycle sales part is for the individual segments, so 85% below for mining, 45% for construction, any framework would be very helpful.

Andrew R. J. Bonfield - *Caterpillar Inc. - CFO*

Yes, so I mean, obviously, we did update you at the end of the first call just to give you an indication of where we thought the different end markets where. Obviously, construction in North America is strong but still continues to grow. So that's been a key market for us. China obviously is still another opportunity for us in construction. Lat Am is very slow. So actually, when we look at where we are today, the \$55 billion last year, Construction Industries probably was reasonably strong overall. In Energy & Transportation, we still have businesses like rail business, which we are still -- obviously, got a lot of opportunity. Offshore oil and gas still hasn't grown yet. Marine still got an opportunity. Onshore oil and gas is very strong. But obviously, there is still further opportunity with the Permian takeaway issues are resolved.

Then looking, obviously, at mining, we're clearly early on in the mining cycle, and there's a lot of replacement that's going to happen. So overall, we sort of sit there, and we got actually -- there's -- we're only 2 years -- we keep having to remind people we're only 2 years into our recovery. And so still, actually, it's hard -- we tried to avoid characterizing whether we're mid-cycle or so forth, but key for us is actually to focus on continuing to grow profitably. So that's what we're trying to do. Obviously, we have to manage the cycles, we have to look around and see what's happening outside. But generally, we do actually see more demand opportunities than negatives out there at the moment.

Steven Fisher - *UBS Investment Bank, Research Division - Executive Director and Senior Analyst*

Steve Fisher, UBS. Just following up first on the services. Jim, you mentioned that you've looked at the revenue opportunity and what you have with some degree of granularity, and I'm wondering if you could just give us some general sense of how many revenue generating streams you actually have today and then how that number will look when you get to that \$28 billion? I mean, is it 20 today, and it becomes 40 different streams or to some general magnitude?

D. James Umpleby - *Caterpillar Inc. - Chairman of the Board & CEO*

Yes, the way we really look at it, we don't categorize them by revenue stream. We really look at the total opportunity, and much of the opportunity, frankly, that we see is with our existing revenue streams. We think even with just the revenue streams that we have today, there's plenty of



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opportunity for us to grow services. Now when we look at other opportunities as well, we will, but even with those existing avenues today, there's good opportunity.

Steven Fisher - *UBS Investment Bank, Research Division - Executive Director and Senior Analyst*

Okay. And then just as a follow-up. I didn't hear much today about increasing demand for rental services. Because it does seem like that is increasingly important to your dealers and customers and so curious how the expansion of the rental demand plays into, number one, your margin opportunity and, number two, the services opportunity?

Unidentified Company Representative

I'll start and then...

D. James Umpleby - *Caterpillar Inc. - Chairman of the Board & CEO*

Go ahead.

Unidentified Company Representative

So rental is very important to us. We have 1,500 rental stores around the world, especially in North America and Europe is a big deal. Last year, we grew that by about 5%, and we're going to continue to invest in rental. Rental is a huge enabler for us for not only getting our products out there but also growing our services. So...

D. James Umpleby - *Caterpillar Inc. - Chairman of the Board & CEO*

Yes, and thinking about it from a utilization perspective, one of the things that's very positive for us is if there's more equipment utilization, and rental gives an opportunity for customers to, in fact -- for there to be more utilization of our products in the field, and that's a positive thing, obviously, for services. So we -- it's an important element of our business. We are working with our dealers. We have some dealers that are very, very good in rentals. Some of them are not as good. But it's a big area of focus for us. And I already said we're excited about it. But again, thinking about it from an equipment utilization perspective, it is important.

Jennifer K. Driscoll - *Caterpillar Inc. - Director of IR*

Right here, third row.

Charles Harris - *ClearBridge Investments, LLC - MD, Director of Research & Senior Research Analyst for Industrials*

Chuck Harris from ClearBridge. You mentioned earlier about fixing some businesses, and you feel you've been pretty successful at that. If you look at the all -- all the businesses on a distribution for -- relative to OPACC, I assume it's not an even distribution across the curve and that there are -- it's not just a 25-25-25 (sic) [25-25-25-25] evenly distributed. If you're able to bring up the bottom 25 by some amount, whatever that number is, what do you think that translates into either in terms of OPACC dollars or margin or something along those lines, considering that this is something you guys have said out loud that you're pretty focused on?



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D. James Umpleby - *Caterpillar Inc. - Chairman of the Board & CEO*

Yes, we're not going to quantify it, but certainly, there is an opportunity there, right, and we've seen it and that we've mentioned the examples already here today. We've had a number of businesses like our BCP business, like our small engine business, our IPSD business, whereby shining the spotlight, using the right kind of measures, right leaders, the willingness to make tough cost structure and footprint decisions, we've been able to turn businesses around. At the same time, again, there are some where we decide just based on the reality of where we are, where the market is, where the competitors are, that it makes sense to divest.

One additional comment about OPACC. We talk about looking at the OPACC performance of our businesses using the O&E Model today. A part of what goes into our thinking, of course, is not just looking at today, but we are always making an assessment of where the market's going, where the competitors are going. So that's key as well. So we are not just doing this via spreadsheet. We really do look at and really do evaluate where the market is going, and we want to skate to where the puck is going to be, to use a hockey analogy, not just look at how things are today.

Charles Harris - *ClearBridge Investments, LLC - MD, Director of Research & Senior Research Analyst for Industrials*

No, and I would assume that you're not going to look at rail today and say, "Oh, it's low OPACC, but we got to get rid of it because this a low business." But if I look at that analysis, relative to the improvement in overall margin that you guys have given us, what do you think -- how would it translate sort of how you've done in terms of lower OPACC businesses that you brought up to some level translating into that improved margin expectation? Can you give us a bridge there a little bit?

Andrew R. J. Bonfield - *Caterpillar Inc. - CFO*

Yes, so if you look at these charts when I talked about OPACC, I said if you looked at it between 2014 and 2018, it had tripled. There's 2 elements of that: One which is the margin improvement, so the \$1.8 billion structural cost taken out, a big chunk of it; the other thing \$3 billion of assets we've reduced there to [baseline]. So you shrinking the asset base at the same time as growing absolute margins, basically, that grows your OPACC because your capital charge is lower. So it's a bit of both. It's asset utilization, which is a [key net] part of that as well. So we can't just always be drilling to margins.

And back to your point about one of the things I would say is, we go through a process where we have -- we are doing what we call OPACC improvement agendas for our business which we actually set out each year for them to actually go and deliver again. And that's part of the planning process of how this gets integrated into the day-to-day operation of the business.

Jennifer K. Driscoll - *Caterpillar Inc. - Director of IR*

And we have a question here in the second row.

Timothy Thein - *Citigroup Inc, Research Division - Director and U.S. Machinery Analyst*

Tim Thein from Citigroup. First one for Ramin. I'm curious you've grown and continue to grow the number of connected machines. Have you seen a -- and the dealers, therefore, have more and better visibility just in terms of the usage and the -- just the status of the machines. Have you seen a commensurate improvement in terms of their ability, the dealer's ability, to order just in terms of as they think about stocking models? Does it -- has it resulted in maybe greater accuracy in terms of them knowing how many machines and when?

Unidentified Company Representative

I'll start talking and then maybe Bob. So the answer is yes. And let me also say one thing here. Not only that new machines that are leaving the plants are leaving the plants connected and the dealers are helping us with that, but also, if you were at bauma here 2 weeks ago, we launched a



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new product. We called it PL161. So it's a standalone piece of electronics that allows us to go back and activate machines or attachment that were -- that did not leave the plant in the past connected. There are many, many units out there today. Maybe be estimated at, I don't know how many, 800,000 units or so that we are connected. So we're going to go back and try and connect as many of those units also and kind of be tethered back to the machines. But the answer to your question is yes. The machines that are connected, we definitely see a service benefits to that.

Jennifer K. Driscoll - Caterpillar Inc. - Director of IR

In the fourth row here.

Unidentified Analyst

[Steve Zammitti] from [Azora Asset Management]. You mentioned that you are only running at 70% capacity utilization, but then you said that 20% of your CapEx is for growth. So can you talk about where you're constrained? And how much of that 20% is for other things like digitization, et cetera?

Andrew R. J. Bonfield - Caterpillar Inc. - CFO

Yes, so a chunk of that will be things like digital because, obviously, it will be things like IT assets, which are capitalized on the balance sheet, so that will be part of it. There will be individual businesses, and that 70% is an aggregate, that is a whole. So there will always be individual plants which may be actually constrained, which are running 3 shifts 7 days a week and, therefore, actually running in capacity -- at capacity. So there will be at times when we'll be adding capacity on an individual plant level we'll just make those decisions. And then there is also some of the factory reconfiguration that we're doing as well as part of that process.

Jennifer K. Driscoll - Caterpillar Inc. - Director of IR

I think we have time for one more question.

Unidentified Analyst

Just [splitting in]. It's almost 3:30, and I want to hear what Billy's voice sounds like. So I'm wondering if you can give us a sense -- we don't get to talk about rail too much. Where -- what do you think -- where do you think we are in the cycle? What are you seeing over the next couple of years? I know there's some regulatory changes. There's been some changes in some of your big competitors' ownership structure. How are you feeling about rail over the next few years? And kind of what are you looking at?

William P. Ainsworth - Caterpillar Inc. - Group President of Energy & Transportation

So we like the market segment long term. If you look at North America, precision schedule railroading, all the railroads are implementing it now, which is really asset utilization. It's like our O&E Model. So they've -- most of them except one have parked a lot of locomotives, and you can look at that as a negative. And probably, new locomotive sales won't be too robust the next few years, but they're doing a lot of modernizations to up the utilization on their existing locomotives so that's creating good businesses for us. And utilization is really what service is all about. The more they utilize in locomotives, the more they want the product, the more services you get to sell to them. So we view that as a positive.

And then I would say another thing when you think about rail, we're not just locomotives. The Progress Rail, the original business that was acquired by Caterpillar, is a very robust service business, serving the railroad in a broad way. And then international, there's a lot of activity on new locomotive clones. So if you look at the sector, we like it. It's the most sustainable way to move people and goods over land so we think it's a good market to be in.



MAY 02, 2019 / 5:00PM, CAT - Caterpillar Inc Investor Meeting

Jennifer K. Driscoll - *Caterpillar Inc. - Director of IR*

How about around of our applause for the management team?

At this time, I'll turn it over to Jim for closing remarks.

D. James Umpleby - *Caterpillar Inc. - Chairman of the Board & CEO*

Yes, just a few comments. I want to thank everyone again for taking the time to travel to be here or participating by telephone. I hope you came away feeling the sense of excitement that we have for the opportunity to profitably grow our business. We communicated some -- what at the time were viewed as quite challenging targets to you all in our 2017 Investor Day. There was a bit of skepticism, and of course, we have met or exceeded all of those targets.

We are very confident in our ability to continue to grow our business. We talked about our investment in services and the opportunity that represents. We've also shared with you our intent to be much more consistent in terms of returning capital to shareholders, both through dividends and share repurchases, again, having the right balance, as Andrew mentioned, to ensure that we have the balance sheet capacity to go after opportunities that will help us profitably grow. And we very much appreciate the faith you have in our business, and I'm absolutely convinced that Caterpillar best days lie ahead. Travel safe. Thank you.

Jennifer K. Driscoll - *Caterpillar Inc. - Director of IR*

Thanks, Jim. Thanks, everyone.

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