

Caterpillar

111423-01 Virtual HQ Visit Jefferies, Umpleby and De Lange

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>> STEVE VOLKMANN: All right. Good morning, everybody. This is Steve Volkmann with Jefferies. And thank you so much for joining us for the Caterpillar virtual headquarters visit, and very pleased to be hosting two of CAT's senior managers. We have Jim Umpleby, Chairman and CEO. Jim and I will have a conversation for about 45 minutes or so. We will have a quick break, and then we will switch over to Bob De Lange, who is the Group President for Services, Distribution and Digital.

So, before we dive into that, the lawyers have a little bit for us here from our side. And I would just like to remind people that members of the press are not authorized to be on this call. And, if you are from the media or the press, please disconnect from the call now. The content presented on this conference call is proprietary to and/or subject to copyrights of Jefferies or third parties.

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So that's it for us. And I will turn it over to Ryan Fiedler from the CAT side.

>> RYAN FIEDLER: Thanks, Steve. Appreciate it. During today's meeting, we will also make some forward-looking statements which are subject to risks and uncertainties, also make assumptions that could cause our actual results to differ from the information we are sharing with you on this call. Please refer to our recent SEC filings in the forward-looking statements reminder and releases for details on factors that individually or in aggregate could cause our actual results to vary materially from our forecast. A detailed discussion of the many factors that we believe may have a material effect on the business on an ongoing basis is contained in our SEC filings.

In today's call we will also refer to non-GAAP numbers. For a reconciliation of any non-GAAP numbers to the appropriate U.S. GAAP numbers, please see the appendix of our earnings call slides.

Additionally, please note that Caterpillar policy does not allow for meetings to be recorded with smartphones or other devices unless specific approvals have been sought and granted prior to the beginning of this meeting. And, lastly, we will be posting a transcript on our website as soon as we can.

With that, I will turn the call over to Steve.

>> STEVE VOLKMANN: Great. Thanks, Ryan. And, Jim, welcome. Thank you for joining us.

>> JIM UMPLEBY: Well, thanks, Steve. Great to be with you.

>> STEVE VOLKMANN: Great. So, thanks for joining us again. And I would like to kick off with sort of a broad question. And you have been with CAT now, I think, for over 40 years, I think CEO since 2017. Can you just talk about how your career has progressed at CAT and how CAT is a different company today versus the past and sort of how you're positioning yourself for the future?

>> JIM UMPLEBY: Well, thanks, Steve. And the years certainly do go quickly. I have a bit of an unusual background for a CAT CEO, although I've been with the company for 40 years. I actually started my career at Solar Turbines a year before Caterpillar acquired them. And I've spent many years at Solar. And one of the things that it allowed me to do is see how important services were. For a while after the Caterpillar acquisition of Solar, Solar wasn't doing that well financially in the '80s. And then we really started the services culture and really started to focus on that. And, always adding more value to our customers and doing it in a way that was also good for Solar and learned a lot during that process. So, I have a bit of an unusual background. But I spent time in the old product support division, in the mid-2000s in Peoria. Then, before I took my current role, I was Group President of Energy & Transportation. So, again, did that as well.

Maybe just a couple comments here. You know, we just came off the best year in our 98-year history. So really proud of our team. Record sales and revenues, record operating profit, record adjusted PPS, record ME&T free cash flow. So, we feel good about that.

We introduced a new strategy in 2017, and that strategy was based on a few core elements. One was Operational Excellence, which is Safety, Quality, Lean, and competitive flexible cost structure. Services, everything we do for our customers after the initial sale. Again, always striving to add value to our customers and we have to do it in a way that makes sense for the customer, makes sense for our CAT dealer and makes sense for us. And Expanded Offerings, making sure that we have the right products to meet customers at various price points. And we utilized the O&E model. That really has been a key, I believe. It allows us to really understand in a much more granular way by product, by market, by application, where we are creating shareholder value and where we are not. And that really has helped us over the last few years allocate our resources to those areas. They represent the best opportunities for future profitable growth. And our measure of success is what we call OPACC dollars. That is Operating Profit After Capital Charge. And so, again, we have been working at it here hard for seven years and really proud at what the team has accomplished.

>> STEVE VOLKMANN: Great. Okay. So, as you said, last week you reported a strong finish to 2023. Can you talk about what trends you are seeing in your important

end markets and, you know, current conditions relative to supply chain maybe and any commentary relative to where you think your various businesses are in their respective cycles?

>> JIM UMPLEBY: We do expect continued strength in most of the end markets that we serve. And, as you know, we told our investors that we expected 2024 to be broadly similar to 2023 in terms of sales and revenues. And just to kind of run through some of the major, major markets. In Construction Industries, we expect our sales to users to be roughly similar to 2023. We expect no significant change in machine dealer inventory in the year. North America, we expect it to remain healthy and had quite a strong 2023. We expect that to remain the case. We expect non-residential to remain at similar demand levels. And, of course, a lot of it is supported by infrastructure by the various government bills that have passed. But we expect residential, to be healthy as well relative to historical levels, so we feel good about that.

China, we expect to remain relatively weak [in the greater than 10-ton excavator industry] (company clarified after the discussion). If you look at a long period of time, China, that is 5 to 10% of the company sales. And we had a couple really strong years in 2020 and 2021. Then we started to see a decline in the market in 2022, a further decline in 2023. And then we told investors last year that we expect it to be below that bottom end of that 5 to 10% range, and we expect that again this year. So, we expect China to remain relatively weak. A bit of softening, we believe, in the economic condition in Asia Pacific outside of China.

And EAME it's a bit of a mixed bag. Continuing strong, construction activity in the Middle East, particularly in places like Saudi Arabia. But we expect Europe to be down slightly due to some uncertainty there. And Latin America up a bit due to some easing financial conditions.

Resource Industries. We entered last year, 2023, with an elevated backlog in a couple of products, off-highway trucks and articulated trucks. And so, they worked through that backlog last year. And so, we expect to see the machine volumes to be a bit lower in Resource Industries in 2023 because of those two products. However, quotation activity remains high, particularly in mining. We see a low number of parked trucks. The average age of the fleet is relatively high. But our mining customers, are displaying capital discipline. And we expect to see that throughout [2024] (company corrected after the discussion). But, because the utilization of the product is high, we expect good services revenues in Resource Industries.

And, as we've talked about previously, Steve, we do expect that the energy transition will drive increased demand for commodities that our customers use our products to produce, all the battery materials for EVs and all the rest. We are quite bullish about the medium and long-term in mining. But we expect, again, to see capital discipline from our customers this year.

>> STEVE VOLKMANN: Great. And I get the question quite a bit from investors around: Where are you in your respective cycles? And I think people mostly are focused on mining and energy. You know, where do you think we are in those cycles?

>> JIM UMPLEBY: So, again, talked about mining. We expect really that our total adjustable market will improve over time. Just because if you believe in some form of the energy transition, or not, we can have a debate as to how quickly that will occur. But there are very few people that don't believe there will be more EVs on the road, that don't believe in more electrification, and that requires the minerals that our customers use our products to produce. So, we think that is a significant opportunity for the long haul for profitable growth.

Energy & Transportation, haven't talked about that yet. In Power Generation, that is another really unique opportunity that we are quite excited about. We are seeing very strong demand in Power Generation. We expect that to continue. A lot of that, of course, is being driven by data centers. Our customers use our generator sets as backup for those data centers. And, because of the cloud and generative AI, we believe there is a secular growth trend there that is increasing our total addressable market. So, we told our investors in our earnings call recently that we are making a multi-year capital investment to increase our manufacturing capacity for both new engines and parts to increase our ability to produce those engines. So, quite frankly, we struggled to keep up with demand for large engines.

In Oil and Gas, we expect reciprocating engines and services to be up slightly in the year in 2024. Well servicing is showing some short-term moderation. And we talked about that, I think, in our last couple of calls. But gas compression order backlog remains healthy, and we remain optimistic about the future demand. Solar has a strong backlog and continues to have robust quoting activity. Industrial, a bit of softening in the near term after quite a strong 2023. And then in high-speed marine we expect that to be up slightly as our customers continue to upgrade their aging fleets.

>> JIM UMPLEBY: So, we have seen improvement, which certainly has helped our availability, which has allowed our dealers and our customers to wait a bit longer before placing orders. The exception is the one I talked about around large engines, that is still a challenge. We are still making those investments. But, for the most part, supply chain has certainly gotten better.

>> STEVE VOLKMANN: Great. So, you mentioned energy transition; but, sort of more broadly, do you think you're seeing signs yet that some of these global mega trends, I guess energy transitions is one, but I might add reshoring or infrastructure, are you seeing signs that these are starting to impact any of your markets yet?

>> JIM UMPLEBY: Certainly, in North America we are seeing some of the demand that was driven this year and last year, comes from some of the legislation that's passed over the last couple years. So, the IIJA, certainly, we have seen an impact of that. That is infrastructure, which is non-residential construction.

In terms of reshoring, hard to really pinpoint any activity associated with that. Again, it's more around infrastructure. And, of course, I've talked about data centers and energy transition, so that is happening. But in a place like Saudi Arabia, as an example, very strong construction growth. And I think most people are aware of the investments that the Saudi government is making around some of these mega projects that are going on. And that, of course, drives demand for a lot of construction equipment, which is quite positive.

>> STEVE VOLKMANN: Okay, great. So last week you also updated your progress on growing your services revenues. And we will spend some time with Bob on this as well. But, just curious, sort of where you think you are in that process and kind of where it goes from here?

>> JIM UMPLEBY: Well, we are still driving to meet that goal of doubling services revenues starting in 2016 over a ten-year period. We've increased over time. We've seen a good increase and still driving for our goal to double services revenues. And I know Bob will get in a bit more detail on a lot of things that are driving that.

>> STEVE VOLKMANN: Okay. We will leave more of that with him, I guess.

But let's switch a little bit. You guys in recent years have been increasingly focused on autonomy, electrification, alternative drive trains, et cetera. Maybe starting with autonomy, can you just update us on sort of where you are in that journey and where that goes from here?

>> JIM UMPLEBY: It's been very exciting. Certainly, autonomy was applied first, of course, in mining, large mining trucks, for a whole variety of reasons, just in terms of our customers see value in it. We have more than 630 trucks online now. And I think we've really have passed a tipping point where if there is a new greenfield mine going in, there is always a conversation around autonomy. We have been able to reduce the price of the capital investment required to put autonomy in. It used to be that a mine needed around 50 trucks or more to have it. Now as low as 10 to 12 trucks is good enough. And we got an order, quite excited, from a quarry and aggregates company, a family-owned business in the U.S. called Luck Stone, and then so we are seeing autonomy go into quarry and aggregates as well. It's an area where we believe we have the best solution. And we feel strongly about that. And we've had customers publicly state that they have seen up to a 30% productivity increase over the best manned sites. Stop and think about a mine, a big capital investment. If, in fact, you can produce 30% more product, that's a game changer for a mining company. So, again, we are very focused on that.

And one of the things that gives us an opportunity to do that is be closer to our customers as well, because we are there every day. We and our dealers are there every day with them, helping them find ways to become more productive. And I had the opportunity last year to visit a site in Western Australia, a large autonomous site that had more than 60 trucks. And it's just fascinating to watch the trucks at work and to see

the teams really focusing on continuing to find ways to make those trucks productive. So, it's not a situation where you put them in and you are done. It continually gets better all the time by taking out waste. It's really a lean process and getting the trucks to move more quickly and produce more product. So, we are very excited about that. And we are starting now. And the next step, of course, is starting to put autonomous operation in other areas of the business as well. We already have drills and we have semi-autonomous dozers. So, an example is a user can sit in any part of the world in an office and control four dozers semi autonomously at the same time. So, as we continue to put that new technology into our products, and particularly now when a lot of our customers are struggling with having enough qualified operators because a lot of young people don't want to have a career operating a machine. So, it's a way to take less experienced operators. It's a way to allow people to sit in offices and still do work. So, again, one of our elements of our strategy is to continue to incorporate leading-edge technologies into our products to allow us to have a competitive edge.

>> STEVE VOLKMANN: Okay, great. And when I think about those autonomy options, is a lot of that aftermarket or is it mostly people buying new equipment and using it autonomously?

>> JIM UMPLEBY: So, it's both. So, think about mining customers. It's certainly new equipment as well, but we also retrofit. We retrofit our trucks as well, so it's both.

>> STEVE VOLKMANN: Okay, great. And maybe just finally on this, like, what's in it for CAT in the sense that you mentioned closer relations with customers? Obviously, that's important; but is there sort of a recurring revenue piece to this as well?

>> JIM UMPLEBY: There is an element of that. There is a hardware and a software element to it. But, again, one of the main opportunities for us is getting close to our customers. It helps us capture more sales. And it allows us by being there every day, to capture additional services, make our customers more successful, find ways to add value. I saw this in my days in Solar Turbines where we had embedded fleet managers in connectivity by being with our customers and being their partner as opposed to a supplier. It changes the relationship. Now, we have to earn that trust every day. We have to get better every day. We have to get all our customers to be more productive every day. But, if we do that right, it really does help us become more of a partner with our customer, so it's really important.

>> STEVE VOLKMANN: Okay, let's switch to electrification, and maybe other alternative power, if you want to talk about, I don't know, hydrogen, or something else. But can you just talk about where you are sort of in adopting some of these new technologies for kind of power and where you think this goes, kind of, through the end of the decade?

>> JIM UMPLEBY: So, we are doing a variety of things. One is we are, just as we think about our traditional product line, we are investing to help customers that still need and will need diesel-powered equipment, lower the carbon footprint by improving the

efficiency of our products to allow them to, again, even though they still have a diesel-powered machine, allow them to reduce their fuel efficiency and lower their carbon footprint. So, we do a lot of that. There are a lot of things in Oil and Gas I can talk about as well in terms of dynamic gas blending, substituting up to 85% of diesel fuel with natural gas, e-frac, all those kinds of things. And, yes, we are also developing electric-powered machines. And I think some of the ones that got the most visibility were the big mining trucks. And so, a lot of our big mining customers are very focused on reducing their Scope 1 and Scope 2 emissions. And so, we demonstrated, in late 2022, our first ever prototype, battery-electric large mining truck with diesel-like performance. It's fully loaded. And so, we have a number of customers that have signed on with us, what we call early learner customers. And we will be deploying trucks with them as early learners throughout the year so they can learn how to operate those battery-powered machines. We are also introducing construction machines as well, which we had a number of them at the recent ConExpo. So, again, a lot going on there, also.

>> STEVE VOLKMANN: Do you expect hydrogen combustion to be a meaningful part of this pie?

>> JIM UMPLEBY: Not on the short term. I mean, we certainly have the ability to burn hydrogen and hydrogen blends in our gas turbines and our reciprocating engines for Power Generation. So that is certainly something that we have now and will continue to enhance. We are working on hydrogen. Our view is that's going to take longer.

And, maybe just a few words about electrification. A lot of people think that, okay, it's kind of like an electric car, like a Tesla. But, of course, the power requirements for a piece of construction equipment are much more significant than an automobile. And oftentimes construction equipment operates or mining equipment operates 24 hours a day, 7 days a week. And you are on locations where there isn't a grid to plug it in, so it can be quite challenging. So, you know, our view, my view is that this transition will take some time to occur. And it will occur at different rates, in different geographies, in different parts of the world, and by application as well. So, if you're in Manhattan and you've got small construction equipment on a building site, one would think those are probably the first that would probably convert. And probably due to government regulation, you can see the government saying, all right, someday saying no more diesel engines on the island of Manhattan, whether it's an automobile or construction equipment or anything else. But if you are in upstate New York and you are building a highway in the middle of nowhere, or in Nebraska or in Angola or in India, and you are out there doing something where there is no infrastructure, there is no grid, it's much more challenging for battery-powered machines. So, again, what do you do when the battery runs down after six hours, four, eight hours? Do you have an extra machine which doubles your capital costs? You don't want to power up a diesel generator set

because that negates the whole reason for having batteries in the first place. So, in my view, this is going to take time. So, I think the vast majority of construction equipment by all manufacturers that will be sold in the world for the next ten years will be diesel powered, in my opinion.

>> STEVE VOLKMANN: Okay. It does seem like you should have sort of a competitive advantage here in that you have a Power Generation business. And maybe you can help provide sort of a full solution?

>> JIM UMPLEBY: Completely agree. And one of the areas where I do think it will move more quickly is mining because, again, our mining customers are very, very focused on reducing their carbon footprint. So, again, we are working closely with those mining customers. And we do believe that we are uniquely positioned to help our mining customers electrify their mines. Because of our Energy & Transportation business, we can provide reciprocating engines and gas turbines that burn a whole variety of fuels, natural gas, biofuels, hydrogen blends, and all the rest. We have expertise in micro grids. We have energy storage systems, which is a fancy way to say large batteries. So, we believe we are really uniquely positioned to help our customers do that. And our competitors don't have that Energy & Transportation portfolio. But I think the area that is moving first is mining for electrification.

>> STEVE VOLKMANN: All right. So, let's switch gears a little bit to the financials. And one thing I find is investors are very focused on inventory levels both at CAT and at the dealer network. How are inventory levels from your perspective and are there any trends either at CAT or the dealers that we should be aware of?

>> JIM UMPLEBY: Yeah, maybe start with dealer inventory. And, of course, I always start with a reminder that dealers are independent businesses and manage their own inventory. Overall, we are comfortable with the total level of machine dealer inventory that is out there. In the fourth quarter we saw a total dealer inventory decrease of almost a billion dollars, \$900 million. And a lot of that was driven by Construction Industries, a lot of that in Excavation. So, we knew that because of the downturn in China, there was quite a bit of excavator inventory out there. And a lot of that was taken out in the fourth quarter. So, we are pleased by that.

If you look at total machine dealer inventory, in the fourth quarter it decreased by \$1.4 billion. And Energy & Transportation increased due to some strong fourth quarter shipments. And when you think about both Resource Industries and [Energy & Transportation] dealer inventory, 70% of that dealer inventory is tied to a firm customer order (company corrected after the discussion). So, there is commissioning that the big mining truck has to be assembled or the Power Generation package has to be assembled. So, there is lead times in terms of execution which impact that. So, really, the focus is generally around Construction Industries. And we are in the middle of a [typical dealer inventory range of 3 to 4 months of sales] for Construction Industries

based on the amount of business that is out there, so we are quite comfortable with that (company clarified after the discussion).

We've also said we don't expect a significant change in machine dealer inventory in 2024. We did see a bit over one billion. It's a \$1.1 billion increase in machine dealer inventory in the first quarter of 2023. So, again, we do expect a bit of an increase in the first quarter of this year; but it's typical seasonality ahead of that spring selling season.

Moving to our inventory, Caterpillar inventory decreased by a billion in the fourth quarter. And we had a really strong year in terms of ME&T free cash flow, \$10 billion, significantly over any other level we've ever achieved. And so, in terms of CAT inventory, we have gotten a bit better in terms of as the supply chain improves. But I'd argue we are not as lean as we were a few years ago, and so something we really have to keep focused on to get back to being as lean as we were previously. And really so much of that ties to our supply chain being more resilient. And one thing that will help is when we get the large engine capacity and that will help as well. But, again, we feel comfortable, certainly, with dealer inventory and CAT inventory. We have a ways to go. We are working on it.

>> STEVE VOLKMANN: Okay. And was that 4Q dealer inventory draw down, was that larger than you had initially expected?

>> JIM UMPLEBY: Yeah, in some areas it was a bit larger than we expected.

>> STEVE VOLKMANN: Okay

>> JIM UMPLEBY: Slightly more. Slightly more. Slightly more.

>> STEVE VOLKMANN: And as we think about what normal looks like, I guess, in '24 maybe and beyond, I guess we would expect a little bit of build in the first half and then some draw down in the second half seasonally?

>> JIM UMPLEBY: We expect a bit of increase in the first quarter, around machine dealer inventory. Again, that typically happens because of the spring selling season. If we look at total dealer inventory for the year, we don't expect a significant change in 2024 in total, up or down.

>> STEVE VOLKMANN: And the final thing on this thread is just thinking about backlog, you know, that's come down a little bit. I think part of that is probably just normalization of supply chains and availability. Do you think backlog kind of continues to come down to some lower, more normal level as we go forward?

>> JIM UMPLEBY: Backlog is still above what it typically is for the amount of business that we have. And so, again, as we work to normalize our supply chain, as we work to become more lean inside, get our lead times back to where I would like them to be. That allows dealers and customers to wait longer to place orders for equipment, and that's a positive thing.

So, again, I would like to improve our availability and, correspondingly, I would think our backlog. And it all depends on what is happening in various parts of the business;

but it should come down a bit, right? But it's still a bit elevated compared to historical levels, our backlog.

>> STEVE VOLKMANN: Right. Right. Okay. Great. So, let's switch to margins, which have obviously improved across the cycle in recent years and you were able to boost the top end of your margin guide when you reported last week. So, what are the key drivers of these higher margins in recent years and what initiatives do you see that could drive more upside?

>> JIM UMPLEBY: Well, it really ties back to the strategy I talked about, that we introduced in 2017. One is using the O&E model and really understanding at a much more granular level than we have in the past by product, by market, by application how we are performing. And by shining a light on it in a much more detailed level, that's allowed us to challenge our leaders that had underperforming products to improve the profitability or the OPACC generation around those products. And the vast majority of cases they have done so and have been able to do that. And in some cases where we concluded, you know what, based on our competitive position, based on what we would have to invest, to make this an acceptably profitable product, we've divested a few things, we've exited a few things, not a lot but we have. It's really a never-ending journey of continuing to do that.

We also are working hard, continuously to reduce our structural costs. And, of course, by reducing our structural costs, that allow us over time to, again, to have stronger financials. As you know, we have a progressive [adjusted operating profit] margin target, so higher volume, you should get higher operating leverage and have higher margins (company clarified after the discussion). However, it's not a situation where they can keep going forever. So, our measure of profitable growth is absolute OPACC dollars as we believe over time that it most closely aligns with total shareholder returns. And so, we are not just focused on growing the top line, empty calories, if you will, without profitability. We are also not just interested in always trying to have higher margins every day, although, yes, we produce higher margins, we have margin targets, we intend to meet those targets. But the key, the real message is let's increase absolute OPACC dollars, profitably grow our business, and that's what we will award our shareholders in terms of better TSR over time. And we've seen it. I would argue we have seen it happen over the last seven years, better OPACC dollars and higher TSR.

>> STEVE VOLKMANN: Yeah, clearly. Let's just pull in that thread a little bit though, the Operating and Execution model. Are there still parts of the business that are maybe sort of not performing where you would like them to be from an OPACC dollar perspective? Are there still some opportunities to, I don't know, prune the portfolio a little bit as we go forward?

>> JIM UMPLEBY: It's something we will continually do. And maybe an important thing to keep in mind with the O&E model, it's not just about improving underperforming products, which is part of it. But a big part of it is biasing our resources, our investments

in terms of capital expense, management attention to those areas that represent the best opportunities for future profitable growth. And that's even more important.

And so, again, you stop and think about the investments we are making around large engines, that is a great example of the O&E model at work. We believe it's an outstanding opportunity. We believe there is a secular growth trend. We are pleased at the margins that we achieved there, and we are investing to grow that part of the business. Services is another one. I will talk a lot about this. We believe that we have a lot of service opportunities still ahead of us. And so, we are investing in our digital capabilities, which Bob will explain. We are investing in working with our dealers in new ways. And so, again, that is a big part of the O&E model. It's a natural outgrowth of the O&E model, investing in services, investing in products that allow us to profitably grow our business.

>> STEVE VOLKMANN: And kind of on that note, I think you have done a fair amount on the new product side and trying to make sure you are focused, having the right product for the right market sort of segment. Where are we in that process? Is there still more kind of new product niches or holes that you might want to be filling?

>> JIM UMPLEBY: Again, Steve, in my view it's never ending. It's kind of like lean or the O&E model or any of the things we talked about, are becoming more efficient on structural costs. It's a way of life. So, a way of life is improving our structural costs. The way of life is working on our product line, continuing to upgrade things. You know, we continue to introduce machines that are more fuel efficient, continuing to improve the power density of our engines. And, you know, we recently introduced a new, larger gas turbine, one we've never had in the past at Solar. It's another example of continuing to move up in that product line. Because it's a profitable business and one that we think has a great opportunity.

So, it's continuous. You know, we have no shortage of ideas, of things that we want to do and things that we would like to invest in. And we use the O&E model to prioritize them. And, of course, it's not just about looking at a spreadsheet and looking at where we are today as business judgment. To use a hockey analogy, we want to just skate where the puck is going to be. We think about future trends in our view and invest around those.

>> STEVE VOLKMANN: And I know China has become kind of a smaller part of the pie these days, but I still get a lot of questions about it. So, I'm just curious how you feel about China. Is this still an important market in the long-term? Are there other emerging markets where you might be sort of more focused going forward?

>> JIM UMPLEBY: We do still see China as an important market for Caterpillar as you mentioned. And we discussed earlier the market now is relatively low. But, again, it wasn't that long ago that the market was much larger. So, again, great news is even with China relatively weak, we just turned in financial records last year. So, again, it continues to be an important market for us. And we have a number of facilities there.

We very much value our customers there, our dealers there, our employees there, and we will continue to be there.

>> STEVE VOLKMANN: Great. And I should have asked this earlier, but I'm going to come back to it. You mentioned that supply chain is sort of largely normalized. But I know that the volatility around that created a fair amount of efficiency headwinds for you through sort of the COVID period. And, I'm curious, do you sort of feel like you got those efficiency headwinds addressed or is there still some opportunity on productivity as we normalize supply chains?

>> JIM UMPLEBY: There is still opportunity. And I think it has gotten better. But we still have opportunity. You know, when you go through the kind of shock that we all went through post COVID with the supply chain challenges, our inventories are not as lean as they need to be. People are still holding a bit of extra. And, again, we still have some issues with some products. And, of course, the main one is the large engines. But, yeah, there is still work to do and improvement to be had in terms of improving how lean we are in our facilities.

>> STEVE VOLKMANN: Okay, great. Let's talk a little bit about cash flow. You were actually able to raise your cash flow guidance during the earnings report last week. What gave you the -- what was the impetus for that? What gives you the conviction and why did you feel like this was the right time to do that?

>> JIM UMPLEBY: It's really our demonstrated performance over the last few years. You know, ME&T free cash flow of \$10 billion in 2023 was well above our target range. Over the last five years we generated over \$30 billion in ME&T free cash flow. And one of the things that I believe that it's starting to be appreciated, but I still think it's a bit underappreciated is to how much cash we produced and how consistent we have been. When we put our new strategy in place, we said that we would have higher margins and higher ME&T free cash flow relative to similar sales levels that we achieved in the recent past. So, we took a reference period between 2010 and 2016. And we said, all right. We know that our volumes move around a bit. Let's say you are \$55 billion, you are at \$60 billion, you are at \$52 billion. Where were we during that 2006 to 2010 period, in terms of adjusted operating profit margin and ME&T free cash flow? We are going to do better than that. That's what we said we would do. And we just have been really pleased with the performance of the business. We've generated over \$30 billion of ME&T free cash flow over the last five years.

And one of the things I'm particularly proud of is that in 2020, when COVID hit and we lost more than 20% of the top line, we still produced \$3 billion in ME&T free cash flow. Where I know, Steve, you have been following CAT for a long time. And so, if I would have told you seven years ago that we would have a decline of more than 20%, we still produced \$3 billion in ME&T free cash flow; and, oh, by the way, we are going to have \$10 billion ME&T free cash flow in 2023, you probably wouldn't have believed me. So,

again, what gave us the confidence to raise our target, it's really how we performed over the last few years, so we raised that target.

>> STEVE VOLKMANN: Yeah, obviously a big shift from the early 2000s when things were much different. So, obviously, also, the other side of this equation is you returned almost all of this to shareholders over time and that's interesting. Obviously, your balance sheet is in really good shape. I'm just curious, you know, if there is any circumstances where you might ramp up something more on the M&A side?

>> JIM UMPLEBY: Firstly, we believe we have some outstanding opportunities to organically, profitably grow our business. And, in my view, that's the best way to profitably grow a business, if you have organic opportunities to go for those. And we have a number of them. I've talked about large engines. I've talked about the fact that we believe our total addressable market is increasing because of the energy transition. Think about mining demand over time. You know, services. We were investing in services, that is an opportunity to profitably grow the company.

So, having said that, we are always evaluating opportunities. As you know, we purchased SPM from Weir Oil & Gas, that was, you know, it allowed us to expand our Oil and Gas portfolio around well servicing. It's a great services play. The timing was excellent. I believe, as we were negotiating that deal, oil prices went negative when everybody had given up on Oil and Gas and said it was going away soon. So that was a great time to buy it.

We've done things like buy CarbonPoint, which gives us technology, which we need around carbon capture to help our customers achieve their sustainability objectives.

Tangent is one we are excited about. It's one that really ties into distributed generation, which we haven't talked about yet. Let's talk about that for a moment. We believe that as more renewables are added to the grid, that creates instability issues due to the intermittent nature of those power sources, like solar and wind. So, we believe that over time there is an opportunity for us to sell more of our reciprocating engine and gas turbine engine driven generator sets in what we call distributed power generation applications across the grid. And that allows grid stability. And those engines and turbines could burn, as I mentioned earlier, natural gas, biofuels, hydrogen blends, and all the rest.

And Tangent allows our customers to monetize investments they make in those generator sets. They help monitor grid patterns, figure out when you turn the gen set on, when you turn it off, if you have an agreement that allows you to sell electricity back to the grid, it allows you to do that. So that is an example of acquisitions we are making to help us on the technology front and to help us with some product gaps. But, we like to have a strong balance sheet, it's there if a larger M&A opportunity comes along. But, honestly, we are not out elephant hunting because we have so many good opportunities to organically, profitably grow our business. And I think that approach over the last seven years has really proven itself.

>> STEVE VOLKMANN: Okay, good. One area that I get, sort of follow-up questions on this quite a bit, is in Resource Industries. Obviously, you guys are very strong in surface mining, a little more nichey, I guess, in underground. I've heard some people sort of pontificate that the future of mining is more underground. Do you agree with that? Is this sort of an area that might need to be addressed at some point?

>> JIM UMPLEBY: We would characterize us as having areas of strength in both surface and underground. And, certainly, we continue to invest in those products. We have a battery-powered underground loader that is out there, operating. We believe there is opportunities in both. And we are investing in those areas that we believe represent good, long-term growth opportunities. And that's one of them. So, we feel good about that as well.

And one of the things, back to cash for a minute, Steve, just quickly, we are back to cash. You know, people sometimes ask about that, hey, you've got a lot of cash and a strong balance sheet. And that served us really well in 2020 when COVID hit and a lot of companies were scrambling to raise cash to ensure they can meet payroll, I slept like a baby. So, obviously there is some advantages of a strong balance sheet. Gives you opportunities, but also kind of guards against shocks.

>> STEVE VOLKMANN: Absolutely. Absolutely. So good, and then maybe the final one, and we will sort of wrap up, I'm just curious what your view is, you have talked about energy transition, but, obviously, you have a lot of, sort of more, you know, core energy business in the oil and gas segment. Do you think we get another oil and gas cycle over the next few years? Or is this something that sort of continues along maybe the path that we are on today?

>> JIM UMPLEBY: Well, you know, I learned over the last 43 years to never predict oil prices and to never try to predict oil and gas cycles. I will say that it's a business that we are glad we are in. It's certainly healthy right now. And we expect it to be healthy in 2024, both on the reciprocating side and the Solar side.

I know there is some controversy about LNG; but, you know, stop and think about Caterpillar and our products, we play across a wide portion of that natural gas value chain. Our engines are used for drilling. Our reciprocating engines drive reciprocating compressors, close to the well head for gas gathering, well servicing. We talked about pumps, transmissions, e-frac, DGB engines, flow iron. And then our Solar and gas turbines are used to compress gas pumping pipelines. So, we believe that is an area for growth globally, moving forward. And, again, oil is impacted by, of course, supply and demand. And something can happen in the Middle East, and it can have an impact on our business. But, again, it's an area that we feel good about.

And one of the things also is that our customers: Power Generation customers for the data center, a mining customer, an Oil and Gas customer really values the quality of our product, the service support that we provide, the fact that we have a technology edge, I'd argue, in all of those areas. And we continue to invest money to maintain that quality

edge. And customers are willing to pay for the value that we provide. And so, again, it's a perfect kind of business for CAT to be in.

>> STEVE VOLKMANN: Super. All right. Well, I think we have about a minute left. So maybe I'll just start by saying thank you, really appreciate all the insights and just see if there is anything you want to sort of say to wrap up.

>> JIM UMPLEBY: Steve, again, it's been really good to spend time with you and appreciate everyone taking time to join the call. We just had a record year. And I think we surprised a lot of people in terms of the way the team performed and I am very proud of them. But, honestly, as good of a year as we had, as I look forward, based on the secular trends that I talked about growth in Power Generation, the energy transition, and what that should do for mining; natural gas and gas compression; all the infrastructure investments have to be made around the energy transition globally, I'm absolutely convinced our best days still lie ahead.

>> STEVE VOLKMANN: Super. Again, thanks so much. Really appreciate the time. I think we are going to do like a five-minute transition here, and then we will be back with Bob De Lange in five minutes.

>> JIM UMPLEBY: Thanks, Steve. Stay safe.

[Recess for five minutes]

>> STEVE VOLKMANN: All right. We are back. Thanks, everybody. So, this is Steve Volkmann with Jefferies again. Thank you for sticking with us for the Caterpillar virtual headquarters visit. And the second session here we are going to be joined by Bob De Lange who is the Group President of Services, Distribution and Digital.

And this is great, Bob, because, obviously, services is a big focus here for CAT. So, it feels like you are maybe in the hot seat, but we will talk through some of that with you. I don't think we get to see you quite as much as some of the other folks, so maybe you could start by just giving us an overview of your career path and sort of current responsibilities.

>> BOB DE LANGE: Good morning, Steve. And thank you for the opportunity. So, I joined Caterpillar actually in the mid-90s in Europe. And since then I've been pretty fortunate to be able to see many different areas of the company. I think in that period that I've moved about 13 times internationally around the world, so many places around Europe and Asia. And right now it's actually the third time, I live in the U.S. as well. I've been in different areas, small equipment to larger equipment in manufacturing and engineering, on the sales side as well, distribution with the dealers in some parts of the world. But I'd say that especially the last few years and with our new strategy with Jim, since 2017 have been especially exciting. I joined the executive office in 2017 with responsibility for Construction Industries. And then now in the last couple years, as you said, for Services, Distribution and Digital.

>> STEVE VOLKMANN: And, if I'm not mistaken, I saw in your CV, amongst all of that, you find time to do Ironman Triathlons. Is that still true?

>> BOB DE LANGE: Absolutely. That is my biggest passion outside of work.

>> STEVE VOLKMANN: Great. Well, you are responsible for one of CAT's higher profile initiatives, to grow the services side of the business, so maybe start there and talk about how the CAT services offerings have changed in recent years.

>> BOB DE LANGE: Thanks, Steve. And I would start by saying the one thing that has not changed is our focus on success. I believe that is what Caterpillar's brand and reputation has been built on for the last 90 plus years. But, as Jim said earlier, in our new strategies, since '17, we've doubled down on services as a key growth driver; again, rooted in customer success. But if you ask what are the key changes we have implemented since then, I would say first and foremost is setting a bold goal, as you're all aware of, and make sure we motivate our teams to help us get there. But there is really a number of pretty significant shifts in our operations and our investments that we have implemented since then. The first one being connecting our fleet. Back then we had less than 400,000 connected assets. And now, in the last year, we exceeded one and a half million, one of the biggest connected fleets in our industries. We also built what we call Helios, which is an integrated data platform that collects all information in the enterprise from our connected assets in one place, which is really, I'd say the foundational element, to be able to build all digital applications for the future. Then we've also started to approach the services opportunity in a different way. Rather than a broad-based approach, we now utilize what we call PSEs, Prioritized Service Events, which really help us pinpoint and identify services opportunities by using those connected assets information, all of our data analytics and AI, to really go after with very high levels of precision to customers that identify those opportunities so we can help customers a lot more, making sure they can take predictive action rather than waiting for a failure on their equipment.

Another key element, because we often talk about services being a more stable, recurring, predictable revenue for the enterprise, is we significantly grown our mound of what we call CVAs, Customer Value Agreements, which are service contracts we sign with customers so that we take away the worries about maintaining their equipment. They know they can count on expert care. And we make sure they can minimize their downtime, that is the benefit for the customer. We have now, in the last year, sold over two thirds of all of our new equipment with the CVA. But you can see how that is leading to that, very profitable for us as well, but recurring services revenues over time.

We've also made significant investments in what I call "become even easier to do business with". And a good example of that is eCommerce, which has grown dramatically over the last five years. I mean, we have already exceeded the target we had set, that you heard Steve at our Investor Day, in May '22, a year and a half early. Last year we added another 100,000 customers to our eCommerce platform. So big digital is to become easier to do business with. And I keep going. I mean, also big investment in technician efficiency. How we execute that service and using, again, that

connectivity so we can do remote troubleshoot by experts away from the equipment, remote flash to update software in the equipment. We have an application we call SIS2GO, which really puts troubleshoot information and guides, repair instructions, ability to order parts right in the palm of a technician when they are working in the field. And so, you can go on and on. But it's really fundamental and big investments each time that change our approach and that gives us confidence that we will continue to make progress towards that services growth goal, all, again, rooted in customer success; make sure we reduce their downtime; allow them to make more money; become easier to do business with.

>> STEVE VOLKMANN: All right. Super. Great overview. I think I have questions on just about every part of that as you might imagine. But let's just start off, you know, last week I think you guys updated services grew something like 5% in '23 to \$23 billion, that growth rate is going to need to accelerate a little bit to hit the \$28 billion in '26. So what gives you sort of confidence that that sort of acceleration can happen?

>> BOB DE LANGE: First, we've got to look at it over a number of years, a period, and that's coming from \$14 billion a few years ago. But if you look specifically at the services revenue growth last year, it was positive and impacted by price realization and by pretty strong sales to end user growth and that also all of our services growth initiatives. But if you look particularly at last year as compared to the year before, in 2022, at the tail end of the pandemic, we all had supply chain issues. And dealers had worried they needed to wait for parts longer and had logistics issues around the world. So, dealers probably started holding a little more buffer just to make sure they can provide the leading parts availability to customers. What we have seen last year is those dealer buying patterns normalizing more for parts, which had that impact on our services sales to dealers. But if you look at the underlying sales to end users, that was very similar last year as in the years before. So that also gives us confidence, together with our continued investment in service growth, that we will see that continued growth this year and going forward. And so, we continue to strive towards that 2026 goal.

>> STEVE VOLKMANN: Okay. That's interesting. Do you think the dealer parts stock is kind of normal now and that headwind is done?

>> BOB DE LANGE: Yes. Those dealer buying patterns have normalized between 2022 and 2023. So, I think we are in a more stable situation going forward.

>> STEVE VOLKMANN: Okay. Interesting. Thank you. Can we talk about CVAs, were one of several things you mentioned at the outset there? Let's talk about CVAs specifically. I think you said 70%, or something, of new equipment. Is there an opportunity on existing equipment as well? And how do you see benefits to CAT in terms of, you know, parts captured or something with these CVAs?

>> BOB DE LANGE: I think first and foremost we focus on the benefit of CVAs, these customer service contracts for the customer. I mean, we want to take away the operational worries, maintenance worries away from the customer, make sure they can

rely on the best care, expert technicians to help maintain their equipment, making sure we are watching over the condition of the equipment so we can help them guide towards the right overhauls if something might go wrong. So, adding value to the customers through those CVAs. We do that now. And last year about two-thirds of all new equipment was sold with a CVA. But we also have a strong focus on existing fleets in the field. There are also renewal rates, all of that to make sure that we create value for the customer, but also very profitable and recurring revenue, predictable revenue, for us over time.

And, to the other part of your question, Steve, we do see, if you think of in terms of capture rate, that if we have a [machine] that is connected and has a CVA, we get about 30% more parts sales from that [machine] than a unit that would not have a CVA (company clarified after the discussion). So, it's helping us maintain a relationship with the customer over time and creates that predictable, recurring revenue; but it also improves our capture rate.

>> STEVE VOLKMANN: Okay. Great. And just in terms of how these things work, am I paying you a monthly fee, for example, and then you're covering all the maintenance on my equipment? Is that the right way to think about it?

>> BOB DE LANGE: Basically, yes. And we have different levels of CVAs. I mean, you have to remember we cover everything from maybe a landscaper that has one or two compact track loaders to very complex oil and gas installations. And so, some of them are only including preventive maintenance. But there might also be, if you go to larger equipment, it might also include up-time guarantees or it might include, for example, so the wear and tear on an undercarriage. So, it can include at varying levels of coverage. I would say starting from just preventative maintenance to, on the higher end, many more components than that.

>> STEVE VOLKMANN: Okay, great. Let's shift. You mentioned PSEs, Prioritized Service Events, as well. Can you just say a little more about, you know, what those are, how they kind of come about, and how those help your service targets?

>> BOB DE LANGE: Thank you for asking, Steve. I think PSEs, the Prioritized Service Events, really for us have been a breakthrough in how we go to market, how we become a more digital enterprise, and one of the growth engines of services growth. You have to imagine that, if I go back ten years, how would we go after services? We would have an aftermarket sales rep that has maybe 200 accounts to cover. And so, they would go and visit everyday a few customers, say how is it going? How is your fleet going? Do you have any issues? And then, depending on what the customer says, see whether we can make an offer to do something - oversimplified. Today what we are trying to do is work with pinpoint accuracy, look at all the connected data we get in. Combine it with all of our engineering expertise, application expertise, and then apply data analytics and AI to help predict when a piece of equipment might need a certain event. So that we can go to a customer, predictively and before a failure, let's

say we think this might be wrong, and this action should be taken, the value for the customer is they avoid downtime. If you wait until a failure, you always have a lot of collateral damage. For us it's also good because, by us being proactive, we have a higher chance of getting that repair versus a third-party. So, we believe it's a win-win.

But, maybe to bring it to life, Steve, I brought two examples of what that means in practice. For example, here in January our systems created an alert for a 938, a medium-sized wheel loader, working in a waste application in Southern Europe. The machine had 13,200 hours on the clock. And our analytics engines saw a few irregular temperature readings on the engine coolant system. Normally, I mean, it would not cause an immediate stop and no immediate emergency. But if you compare it to our worldwide population where something similar had happened and you correlate to subsequent repairs that were done on those other pieces of equipment, we said here might be an indication of an impending failure. So, we sent a PSE link to the local dealer who then had a discussion with the customer and said, well, why don't we be sure and allow us to come and do an inspection. In the inspection they found that the waste application can be very harsh on the coolant system, and they saw some preliminary damage in the cooling system. And so, we made a proposal for repair prior to failure of that damage and gave the dealer the revenue of \$42,000, something we might not have had. But so that is analytics generated, and we can do thousands of those every day through all the systems.

Another example from the southwest in the U.S. You might have heard us talking in ConExpo last year about starting to implement more and more sensors on our equipment, including on the end of carriage, a wear sensor. This in the case is in the Southeastern U.S., a D6, one of our track-type tractors equipped with those wear sensors in the undercarriage, very abrasive application, machine only had about 4,200 hours. And normally we would count on the customer sometimes in cold or muddy conditions on a regular basis to start measuring with an ultrasonic tool the wear on the undercarriage, which is not a very enjoyable job. In this case, the wear sensor tells us remotely through product link, oh, there is only 10% life left on this undercarriage which then allows the dealer to make sure that there is a technician available and make sure that they stock the right parts and preventatively make an offer to the customer. Here is the repair or the overhaul we suggest on your equipment before even the links start wearing out, and that would be a much higher cost repair, with more downtime. In this case \$10,600 of repair in this case.

So those are the two examples of how PSEs are where we are using connectivity and the power of big data and AI to start covering, identifying those aftermarket service opportunities with pinpoint accuracy and really change the way in how we identify and go after those opportunities. I mean, we had set some pretty bold goals, but for PSE growth, but our dealers are really embracing, adopting on how it is working. And we are actually well ahead of all the forecasts we had for this driver of our services growth.

>> STEVE VOLKMANN: Okay. Great. And I think at your Investor Day you had a target to double your part sales through PSEs. I think the number was two billion by 2023, if I remember correctly. Did you hit that and where can we go by 2026, do you think?

>> BOB DE LANGE: We are well ahead of the target already, well ahead.

>> STEVE VOLKMANN: Alright.

>> BOB DE LANGE: But I would also say we still see a lot of opportunity to continue growing that. Without getting too technical, but give you an indication, we increasingly see opportunities to help customers becoming more accurate. To give you an example, in the past, we would say when do we replace a hydraulic pump or suggest the customer replace a hydraulic pump? We would go first with engineering assumption and say, well, in the worst conditions that pump might live 10,000 hours. So, after 10,000 hours we would send the customer a link. In the next generation we would say, well, let's look at our million and a half connected assets, when do customers actually replace? And it might be different in harsh conditions in the Middle East versus a lower duty application in moderate climate conditions. So, we look at actual numbers and say, well, it might actually be 12,000 hours. We make it 12,000 hours. That the third step we are going to now is having condition monitoring based leads that we don't only go on assumptions or measurements, but also look at all the sensors information we get off the equipment to make our predictions increasingly accurate. The more accurate we can be, the more value we can create for the customer. And, with that, also the higher win rate we see, we get because customers recognize that the value that we get, which helps us grow our services revenues, too. So, there's a lot of opportunity, Steve, to continue using this as a growth driver for services.

>> STEVE VOLKMANN: Okay. Great. And it strikes me that there is a little bit of a double-edged sword here because, if you are successful in avoiding big repairs, catastrophic repairs, and then you can actually, perhaps extend the life between repairs because you have better data, that's probably not helpful for part sales. But, to your point, you get better capture, just how do you balance that?

>> BOB DE LANGE: I think it depends on the time horizon you use. If you want to build, the best way to build long-term customer loyalty is by helping the customer be more successful. So, yes, we might sell five dollars less in the short term, but by helping and creating value for the customer, that we will generate their loyalty so the next piece of equipment is Caterpillar, too. And we will increase our capture rate on services. And so, we are seeing this actually as a very positive, but exactly for the reason you mention. We always start by making sure we add value to customers and make them more successful.

>> STEVE VOLKMANN: All right. Okay. And kind of an adjacency here, I think is sort of the focus on remanufacturing that you guys have been doing. And maybe you can talk a little bit about how that's grown and how that benefits CAT and the dealers.

And then, again, I'll just throw in the cannibalization question at the end there because I assume that there is some potential there.

>> BOB DE LANGE: One of the reasons our customers, we believe, like buying Caterpillar equipment is because we tell them our equipment is built to be rebuilt. Just so you can get more than one life out of a piece of equipment and you can rebuild it with a remanufactured engine, remanufactured drive train, so that, compared to some of our competitors, it's not like you need to buy a new one. You can get a second life, which is a very interesting proposition for a customer. And by the way, it's also a very good sustainability play because rather than throwing all the iron away, I mean, you can give it a second life. So, it's very good for the customer.

From our perspective, I mean, what we are after is making sure that, whether it's a new or remanufactured piece of equipment, that the work out there is being done with a piece of Caterpillar equipment or Caterpillar engine rather than a competitor piece of equipment. And we actually see that both for us, and for our dealers, rebuilding equipment, using Reman is also very attractive and profitable revenue, more predictable and recurring revenue as part of services. So, we are equally happy from a profitable growth perspective in rebuilding machines with Reman components versus a new piece of equipment, so I wouldn't necessarily see this as cannibalization. It is making sure we provide customer options so that they continue to work with Caterpillar equipment rather than anybody else.

>> STEVE VOLKMANN: I suppose it's probably a little less revenue but higher margins. Yeah. How about maybe let's sort of tie all this together? And one thing investors are really focused on is to see companies growing subscription or software-type revenues and, you know, where are you with that and what are the opportunities?

>> BOB DE LANGE: So, for us I would say, Steve, our investments in digital, and sometimes we get the question: Do we get subscription revenues from connectivity? In our mind digital is an enabler for services. And that is really the prize that we are going after. And because that is also what adds value to the customer. And the order of magnitude of opportunity there to create recurring revenues, very profitable revenues with services, is many orders of magnitude larger than subscription revenue we can get from connectivity. So, we are not necessarily trying to sell connectivity. It's an enabler for services. Yes, and in many services contracts somewhere in there is built in cost of connectivity and that we, our dealers, own, sell as a standalone service rather than include it in the overall offering of their CVA, of their service contract they are offering. So that really is the main driver.

If you think of, because I'm thinking, when you say subscription, you are thinking about recurring revenues, in our mind those recurring stable, very profitable revenues, that is our services revenues. Yes, we still have some, like you talked earlier on today with Jim about autonomy, yes, there is some recurring subscription, too. If you go in our

fleet management software, VisionLink, if you want the most advanced features to do productivity tracking, yes, there are some subscription revenues, too. So, I'm not saying we don't have any. But for the most part, that connectivity really is an enabler for what we are really after, which is that recurring services revenues.

>> STEVE VOLKMANN: Okay. And have you guys sort of broken down the \$28 billion target in services revenues amongst sort of big buckets like some portion of that is parts and some portion of it is more SaaS-type revenue, just any color on what that looks like?

>> BOB DE LANGE: You also have to keep in mind, Steve, if you think of services, for dealer services will include parts, labor, and many other condition monitoring services, many other services, that is for the dealer. If you look specifically for Caterpillar, the majority or the big majority of that services revenues for us is aftermarket parts.

>> STEVE VOLKMANN: Right. Good. Let's pivot a little bit. You mentioned eCommerce on your sort of opening comments. I think you said you have exceeded your eCommerce goal that you shared in 2022. And, if I'm not mistaken, I think that should mean you're doing \$3 billion or so in annual parts through eCommerce. But, correct me if I'm wrong, and where do you think this platform should go?

>> BOB DE LANGE: Thank you, Steve. And you are right, eCommerce is another big area of investment and a big area for growth for us. I mean, with CAT you are becoming easier to do business with for our customers. And, as you recall in our May '22 Investor Day, we said our volume was about \$10 million per workday. And our goal was to increase them by 50% in the coming three years. Like I say, today we are only 18 months into those three years. But we have already, well exceeded the target we set for the full three years. So, it's growing a lot faster than what we thought. And so, the number is actually well above your estimate already, Steve, which we are very happy with.

I also mentioned just in the last year we added another 100,000 active customers in our different eCommerce platforms. It is a major source of investment, and you have to keep in mind we serve a very diverse set of customer segments. So, we have, as you mentioned, very large miners, oil and gas companies where we have what we call integrated procurement, a system where we integrate with the customer's ERP system so that they can use their own planning software and within their own ERP system automatically order parts from us. Then we have other systems for very large accounts where there is maybe multiple approvers within a company. So, we adapt to the customer's internal approval process, repeat buys, and all those convenience features.

And then we also have, you might have seen it at ConExpo last year, we launched a new hand-held application called CAT Central, which is really targeted more at the smaller retail customer, which makes it very easy, very convenient for them. Think of your Amazon-like experience to order parts and very easily. We also did things like

putting QR codes on all of our equipment, and even a number of components, to make sure that when you need an air filter, for example, for Caterpillar, you don't need to guess which one of the 28 air filters we have in the offering you need. But by using that QR code we can offer a much more easy and personalized experience for customers. So, it's an ongoing progress. And there as well we see a lot more further opportunity to build this as a competitive strength, become easier to do business with, and actually much more growth opportunity ahead of us, even though we might have exceeded our original goals already.

>> STEVE VOLKMANN: Are there any sort of KPIs that you track like these, you know, online customers order bigger tickets, or something, anything we can point to there?

>> BOB DE LANGE: Well, as mentioned, we looked at the overall revenue in eCommerce and we look at the, like I mentioned, the number of customers that use our platforms. We added 100,000 customers last year. And then we also measure how easy it is for dealers to onboard new customers. Digital marketing is a whole new field where we are bringing in expertise on how all that is done, but make sure customers don't just come once and what recurring revenue we get from customers. So, it's a whole new discipline that has developed over the last few years.

>> STEVE VOLKMANN: Okay. Great. A couple more things I'm hoping to get through here. One is just around, I think, you mentioned 1.5 million connected assets. And that must be terabytes of data that you are getting off all these machines. And I understand the benefits of sort of machine health monitoring. But are there other insights that you guys can glean from all this data?

>> BOB DE LANGE: I think it's really becoming a fundamental shift in helping us drive Caterpillar to become a more digital and modern company. I mean, engineers can use it. I mean, one of the difficult parts for engineers when they design equipment is to actually understand the working conditions for which they need to design. That data from connected assets gives us a great view of, in different applications around the world, what exactly they need to design for. If they need to fix warranty issues quickly, speed up product issues, that data helps us do that, too. As you mentioned, we talked about condition monitoring, doing predictive repairs to lay the foundation for PSEs. There is also value we give directly of the data to customers, fleet management software, we call that VisionLink, where customers can follow their equipment, the hour accumulation, see the status for all codes on their equipment. They can put in geo fences to help with security. I mean, attract productivity. A lot of application for customers.

It also helps our operations internally. As you think through the demand of different products and different parts of the year, I mean, we can track hour accumulation and trends of different pieces of equipment to help with our sales and operations planning. Depending on what we see, we can also help strategically position our parts inventories

to maximize parts inventories. So, it really is a true discovery process for all parts of the enterprise and really using that connectivity, I would say, as a driver for digital transformation across the company.

>> STEVE VOLKMANN: Great. And I'm going to switch a little bit because I think the dealer sort of relationship reports to you as well, dealer relations maybe?

>> BOB DE LANGE: Yep.

>> STEVE VOLKMANN: I'm curious, obviously the CAT dealers are sort of one of the core key competitive advantages for Caterpillar, so what's kind of on your plate now in terms of dealer relationships and what are you spending time on to sort of move that forward?

>> BOB DE LANGE: You're right, Steve. We believe our dealer network has been and continues to be one of our key competitive advantages. I think a lot of that is rooted into the type of relationships we have with our dealers where we have [approximately] 160 dealers around the world, average age is [about] 52 years of our tenure of our dealers (company clarified after the discussion). So, these are multi-generational relationships, built on longstanding trust through good times and bad times.

And so, yes, we have an organization internally that helps work with the dealers on making sure they are financially strong and help them realizing, as Jim also mentioned, and that they're independent companies make their own decisions. But we help them a lot. And we have a lot of discussions on how they can continue to evolve and raise the bar in terms of the services they offer versus their competitors. But a lot of work we spend our time on right now, Steve, is also that digital transformation. We do a lot, but there is also, I mean, customer expectations, just as in our daily lives, are changing in the way you would like to interact with a dealer partner in terms of communication, planning, scheduling, all your service needs. And so, we spend a lot of time also to, like we do internally, support dealers in their digital transformation right now.

>> STEVE VOLKMANN: Okay. And one of the things that dealers do is rental as well as sales and service.

>> BOB DE LANGE: Yep.

>> STEVE VOLKMANN: And I'm curious, we kind of hear from the channel that the rental fleet is perhaps a little older than they would like or a little smaller than they would like if they have been more focused on new and used equipment sales, I'm curious, how do you see the state of the rental business at CAT dealers today? And do you think that is a sort of real growth area for them?

>> BOB DE LANGE: I think rental overall, Steve, is a growth industry and a great and a profitable growth opportunity. I mean, customers increasingly like a partner, not just to take care of their operational worries, but also just the ownership worries and whether it's a big customer that needs peak equipment availability and a peak during a project or a small customer wants to try before they buy or not sure whether they want to buy given the current economic outlook. I mean, there is a lot of reasons why the customers

we see increasingly shifting to renting more and more. And it's a very profitable industry as well, and also for our dealers. So, absolutely, we are working with our dealers very intently on growing their rental business. It's really a dealer business, not Caterpillar's business in rental. But we see great opportunity. It's very profitable for the dealers who do it well. And our dealers are very strong and financially very healthy organizations. So, they also have the power to invest, and they have the advantage of having both new and used and rental. So even if there is an availability challenge, I mean, they can still find solutions. And so, we definitely see that as an area for growth. And I kind of see a rental as a very complete service, again, that you can offer to customers.

>> STEVE VOLKMANN: And do you think those rental fleets are likely to grow meaningfully in the next few years?

>> BOB DE LANGE: Our primary focus is on helping dealers profitably grow their dealer rental revenue. So, our primary target is not to grow dealer rental fleets. We see that more as a consequence of us helping dealers profitably grow their dealer rental revenue. But, as an outcome, yes, more than likely there will be a growth in dealer rental fleets as well, either from growth or replacement needs. So, yes, that should be a growth area as well.

>> STEVE VOLKMANN: Got it. Okay. Thanks. And I guess the final thing that I wanted to touch on is I think logistics also reports to you, which had to be a nightmare over the past few years. I guess I'm just curious how the COVID experience sort of changed how you manage logistics, or maybe this is an opportunity where there is sort of a real cost, you know, potential take out as we move forward, just any thoughts on how that has changed things for you.

>> BOB DE LANGE: That certainly, Steve, has been an exciting ride with many surprises that tested the resilience of our team. I think we learned a lot of lessons on how to become more resilient. At the same time, I think we also took it as an opportunity to invest in the future. And to give you an example for aftermarket logistics of our parts, we have 21 distribution centers for parts around the world. And, you know, our goal is to double services revenues. We set ourselves a goal to double those services within the existing footprint of our distribution centers, which means that we've invested heavily in automated storage and retrieval systems, robotics for picking and packing, to greatly improve, to resilience, but make it more lean as well.

Then we've also invested in an application we call PIC, Parts Inventory Collaboration, tool, which really use, again, that connected data with analytics to predict which parts at one of the around 3,000 dealer branches around the world, which parts will be needed when, based on those PSEs, so that we can proactively put the inventory there, which, I mean, might come as a surprise, but even in the midst of all those logistic challenges and COVID, we've achieved, in aggregate, yes, we still have for specific parts categories, supply issues we are trying to resolve for key customers. But in aggregate,

[in 2023], we've achieved our best overall parts availability in our history (company clarified after the discussion).

>> STEVE VOLKMANN: Great. And final question, this is unfair because I think we have one minute left, but you have talked about so much technology here. Is your technology backbone to all your systems' capabilities, is that where it needs to be or is that still a work in process?

>> BOB DE LANGE: It continues to grow. But I think you heard Jim say, as we allocate our resources to profitable growth opportunities, we've invested significantly. I mean, if you compare our CAT Digital team today versus five years ago, it is a different world. We have brought in so many hard-core digital experts from the industry into Caterpillar. I mean, it's an order of magnitude larger. So, I mean, we have clearly made this a key point of focus of enterprise-wide investments and to build that, and it continues to grow because we continue to see new and new opportunities for digital. But, clearly, it's a different company because of the investments we've made in real digital capabilities, in multiple hubs around the world.

>> STEVE VOLKMANN: All right. Awesome. Thank you. That's perfect in terms of timing. And I'll just wrap up here by thanking everybody for joining us. And, Bob, big thanks to you, really enjoyed the conversation. Obviously, I'm here for follow-up if anybody needs it. Ryan Fiedler is available on the CAT side. And just want to wish everyone a great day and a great weekend and once more thanks, Bob.

>> BOB DE LANGE: You're welcome. Thank you for having us, Steve.