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CAT - Q1 2015 Caterpillar Inc Earnings Call

EVENT DATE/TIME: APRIL 23, 2015 / 3:00PM GMT

OVERVIEW:

Co. reported 1Q15 sales and revenues of \$12.7b and profit per share, all in of \$1.81. Expects 2015 sales and revenue to be about \$50b and profit per share, all-in to be \$4.70.



CORPORATE PARTICIPANTS

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Doug Oberhelman *Caterpillar Inc. - Chairman & CEO*

Brad Halverson *Caterpillar Inc. - Group President & CFO*

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Jerry Revich *Goldman Sachs & Co. - Analyst*

Seth Weber *RBC Capital Markets - Analyst*

Eli Lustgarten *Longbow Research - Analyst*

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PRESENTATION

Operator

Good morning ladies and gentlemen and welcome to the first-quarter 2015 results conference call.

(Operator Instructions)

It is now my pleasure to turn the floor over to your host Mike DeWalt. Sir, the floor is yours.

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

Think very much, Dana, and good morning and welcome everyone to our first-quarter earnings call. I'm Mike DeWalt, Caterpillar's Vice President of Finance Services. And on the call today I'm pleased to have our Chairman and CEO Doug Oberhelman and our Group President and CFO Brad Halverson.

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This morning we will be discussing forward-looking information that involves risks and uncertainties and assumptions that could cause our actual results to differ materially from the forward-looking information. A discussion of some of the factors that either individually or in the aggregate could make actual results differ materially from our projections, that can be found in our cautionary statements under item 1A, Risk Factors of our Form 10-K filed with the SEC in February of 2015 and it's also in our forward-looking statements language in today's financial release.

In addition there's a reconciliation of non-GAAP measures that can also be found in this morning's release. And, again, it's posted at caterpillar.com.

Okay, with that let's get started. This morning we will be reviewing financial results for the first quarter and our revised outlook for 2015. Now there are about three points that I would like to start with actually before we get into the details.

And the first is that from a macro standpoint in our view not much has changed since our last earnings conference call in January. So we're staying pretty focused on the things that we do have some control of and that's execution and operational improvement, things like safety, quality, marketshare efficiency, cost control, inventory turns and cash flow. And we continue to make progress.

That brings me to my second point. Given the environment we're in we were pleased with our first-quarter results. Sales in the quarter were pretty close to what we expected and we were pleased with the bottom line.

That brings me to my third point. That's a reminder of what we said in our year-end conference call back in January. We said that we expected the year to start out stronger than it would end and that's still what we expect. That's probably evident to you if you consider our first-quarter actual results and what we're expecting for the first year.

Okay, with those three points let's get into the quarter. Sales and revenues were \$12.7 billion and that was about 4% less than the \$13.2 billion that we had in the first quarter last year. \$342 million of that decline in sales was a result of the stronger dollar and sales volume was unfavorable \$295 million.

Those two items were partially offset by a small improvement in price realization, that was \$105 million. Definitely in the right direction but less than 1%.

Now the only region in the world that was up was North America and that was up 9%. The North American improvement was pretty much across the board with each of our segments being in positive territory.

Outside of North America that wasn't the case. Sales in each of our segments were down in Latin America, Europe, Africa, Middle East and in the Asia-Pacific region. In total sales and revenues were off 18% in Latin America and sales of all of our equipment segments, that's Resource Industries, Construction Industries and Energy & Transportation were down double digits.

Construction was off 23% and a sizable portion of that was the absence of a large order from the Brazilian government that we had in the first quarter last year. And weaker construction activity in general in the region, particularly Brazil.

Resource Industries was also down 23% in Latin America reflecting continuing weakness in mining. And that's pretty much the case in every region. And Energy & Transportation was down 11%.

Sales and revenues in the Europe, Africa, Middle East region were down 12%. Construction Industries was off 14% and most of that was from less favorable dealer inventory changes and the impact of currency on our sales. Resource Industries was also off 14%; again, weak mining and Energy & Transportation was down 8%.

Sales and revenues in Asia-Pacific were down 13% with the most significant decline in Construction Industries at 21%. Construction Industries were down substantially in China and lower in Japan as a result of the stronger dollar versus the yen. Our sales in Japan which are in yen essentially translated into fewer dollars.

Okay, that's a recap of sales. Profit per share, though, was higher in the first quarter than it was in the first quarter a year ago. This year it was \$1.81 per share, a year ago in the first quarter it was \$1.44 a share.

Now we had restructuring cost in both quarters. In the first quarter of last year we had \$0.17 per share of restructuring cost and that was mostly from the actions that we took in our European operations.



This year we had \$0.05 per share of restructuring costs in the first quarter. So excluding restructuring profit per share improved from \$1.61 a year ago to \$1.86 in the first quarter.

Now, the primary reasons profit per share was up, number one was the \$120 million gain that we had from the sale of our remaining ownership in what was our third-party logistics business. We also had as I mentioned a minute ago \$105 million of positive price realization and we had \$77 million of favorable currency impacts that helped operating profit.

I'm just going to stop there for a minute and chat about currency. It's a subject that for us seems to be frequently misunderstood and I'd just like to clarify things again.

We do have substantial sales that are in currencies other than the US dollar. Where the dollar strengthens that causes those sales to translate into fewer dollars and that's a negative for our top line.

That said, we also have substantial manufacturing operations and we source substantial purchase material outside the US. So a lot of factories outside the US, a lot of sourcing outside the US.

That results in lower cost when translated to US dollars. That's exactly what happened this quarter. Sales translated into fewer dollars.

As I mentioned a little bit ago \$342 million fewer; however, the impact on costs was favorable \$419 million, and the net to operating profit was positive \$77 million. While we're not 100% exactly balanced in our currency exposures we do have reasonably offsetting sales and cost positions that usually keep the profit impact of exchange rate swings to a reasonably manageable level.

Okay, that's the story on currency. I'll get back to profit now. I'd already talked about the positive items and offsetting those positives for the quarter we did have lower sales volume and that was negative to our operating profit about \$83 million and we had higher costs.

The most significant cost factor was a change in the timing of expense related to the vesting of stock-based compensation. The timing change won't have an impact on the full-year versus 2014 but it did add to cost in the first quarter. Okay, that's a quick run through of profit versus the first quarter of last year.

Let's turn to the balance sheet and cash flow. Machinery and Energy & Transportation operating cash flow was a little over \$1 billion in the quarter but that was about \$800 million lower than the first quarter last year. And most of that decline came from higher incentive compensation payments in the first quarter of this year and they are based on performance in 2014.

We used about \$400 million of cash in the quarter to repurchase shares and with relatively modest needs for CapEx this year we currently expect to continue to repurchase shares in 2015. As you might expect the timing and the amount that we ultimately repurchase, well that will be subject to business and market conditions as we progress through the year and on our cash deployment priorities.

Our balance sheet remains strong with a debt to total capital ratio of 37.1% and that's about right in the middle of our targeted 30% to 45% range and it was slightly favorable versus year-end 2014. If you net cash with the debt our net debt to capital ratio at the end of the quarter was 18.3%.

Now before we get into the revised outlook I'll just recap changes in the order backlog over the last quarter because I suspect many of you are interested in that. We ended the first quarter with an order backlog of \$16.5 billion and that's about \$800 million lower than year-end 2014. The decline was split between Construction Industries and Resource Industries.

You might have expected that Energy & Transportation would have also declined from year-end as a result of weakness in the oil industry. It was in total, however, about flat. We did have a decline in the backlog because of weakness in oil but that was about offset by an increase in the backlog for locomotives.



Okay, with that let me go through the 2015 outlook. As I started out in terms of overall world economic growth we don't expect much change from the outlook that we provided with our year-end results in January.

The same goes for our sales and revenues. We're holding it at about \$50 billion for 2015.

Now while we're not changing the sales outlook just as a reminder we do expect 2015 to be over \$5 billion lower than 2014 and as we said last January and I'll reiterate today the impact of substantially lower oil prices is the most significant reason for the decline. And we still think the most significant impact from oil will be from engines and other equipment that we sell for drilling and well servicing. That's the spot where we expect a large drop in demand this year.

We've already started to see the impact of that in our order backlog as new orders have not kept pace with sales and the backlog has declined and we'll start seeing that hit sales over the course of 2015. We also expect that indirect effects from substantially lower oil prices will be negative in 2015 versus 2014. In countries and in some regions of the US where oil production is significant for either government receipts or for the local economies it will likely be negative for sales of construction equipment and for our electric power generation business.

In some cases it can be fairly direct like building a road to service a new well or it can be very indirect like construction spending in a country where the government relies on oil revenue to fund spending. Because many of those construction-related impacts are indirect it does make it tough to measure but anecdotally we believe we're already starting to see the impacts of that in our construction business.

Now in addition to oil there are several other factors that are contributing to the year-over-year decline in sales. The stronger dollar is a headwind to sales but again not profit. Commodity prices in mining are generally weak, particularly iron ore and coal, and that's negative for mining in our Resource Industries segment. With weaknesses in agriculture we're expecting lower sales of industrial engines and we expect our rail business to be down in 2015 after a great year in 2014.

We expect weakness in the construction industries of key developing countries like China and Brazil. That was certainly evident in our first quarter. So that's a recap of our year-over-year changes, down from 2014 but no change in the top-line outlook for 2015.

We did raise the profit outlook again this morning. Our previous outlook was \$4.60 per share all-in and \$4.75 excluding restructuring costs. This morning we raised the profit outlook to \$4.70 all-in and \$5 per share excluding restructuring costs.

Now the changes from the previous outlook include more restructuring activity. We've increased our restructuring cost estimate from about \$150 million expected for this year, up \$100 million to about \$250 million with almost all of the increase related to facilities that produce mining products.

We added the \$120 million gain in the first quarter on the sale of our remaining ownership in the third-party logistics business that wasn't in our previous outlook. And based on our first-quarter actual results we made some additional improvements to the profit outlook. While we held the top line and made a modest improvement to the bottom line of our outlook 2015 is still shaping up to be an uncertain and challenging year.

There continues to be softness in Latin America, particularly Brazil. China growth is concerning. Stability and scale of economic recovery in the United States remains concerning. Europe is still a question mark. Mining hasn't shown improvement yet. And while we're still planning a sharp decline in our oil-related sales in 2015 there's still a concern around that.

So to wrap up and move on to the Q&A portion of the call sales and revenues in the first quarter were about as we expected and we had a solid profit quarter. We repurchased \$400 million of shares in the quarter, the balance sheet remains strong and we're very focused on operational performance and cost control. But it still looks like a tough year and we've not seen meaningful signs of recovery in many of our cyclical businesses.

So with that, we're ready to move on to the Q&A portion of the call.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Ted Grace. Sir, your line is live.

Ted Grace - Susquehanna Financial Group - Analyst

Hey guys, congratulations on the quarter. Two questions on guidance. The first on revenue.

Mike I know you said you're reaffirming at \$50 billion. Last quarter you walked through expectations for Construction Industries and Resource Industries and E&T. I was wondering if you're reaffirming each of those or have there been any tweaks across the business segment at the revenue level?

Mike DeWalt - Caterpillar Inc. - VP, Finance Services Division

I'd say by and large it looks pretty close to what we said at the end of the year.

Ted Grace - Susquehanna Financial Group - Analyst

Okay, that's helpful. And the related question would be on the EPS side you raised guidance \$0.25. I know you mentioned \$0.14 is from Cat Logistics.

I'm just wondering if you could walk through the other puts and takes? It looks like incentive comp would have been about a \$0.05 tailwind if I read that correctly.

Mike DeWalt - Caterpillar Inc. - VP, Finance Services Division

I'd say that's our fault. We rounded to the nearest \$100 million last time and we rounded to the nearest \$10 million this time. There was by and large little change in our forecast for incentive comp.

We did raise guidance \$0.25 and you would normally think that would add to incentive comp but most of the add was for the gain that we had on the sale of the logistics business. And our comp is based on OPACC, operating profit after a capital charge. And that gain was below operating profit so it's really not having any impact on the incentive comp.

Ted Grace - Susquehanna Financial Group - Analyst

Okay, was there any incremental benefit from restructuring that you'd realize in 2015 that was not previously anticipated?

Mike DeWalt - Caterpillar Inc. - VP, Finance Services Division

I would say that was not previously anticipated. We did expect benefits from restructuring to be better this year so no, I would not say we added anything to that. Now we did add to restructuring costs and down the road after those are complete those should definitely lead to more benefits.

Actually in the short-term there are related costs for things like rearrangement that aren't included in the number that tend to be a little bit negative around the time you are actually doing it. So I'd say on balance that is relative to our original outlook, not a big reason for change.



We took the profit outlook up mostly because of very good cost control in the first quarter. I know we don't give quarterly guidance but we were a little better than we thought we were going to be in the quarter and some of that of course was timing but some of it is spending that we don't think we'll have to make as the year goes on.

Ted Grace - *Susquehanna Financial Group - Analyst*

Okay and FX was that any dynamic in the revision?

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

No, not much. In fact we didn't really change our outlook for currency. We did do a spot check on the impact on profit of recent changes and it was pretty neutral. So we'll take another look at that at midyear and see if there's any changes needed for that.

Ted Grace - *Susquehanna Financial Group - Analyst*

Thanks a lot and best of luck this quarter.

Operator

Jerry Revich.

Jerry Revich - *Goldman Sachs & Co. - Analyst*

Good morning, it's Goldman Sachs. I'm wondering if you could talk about what was just the magnitude of material cost benefit that you realized this quarter. And I know you're working hard with the supply chain, just help us understand how we should think about the puts and takes over the balance of the year for material costs, with volumes coming down but commodity costs that should be I think lower sequentially can you may be give us more color there?

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

Actually, material cost control has been a real positive; actually, not just in the first quarter but over the past few years the team has done a great job. That's a combination of the purchasing group and the design group in terms of designing for cost reduction.

So it's been pretty good. It was a decent positive again in the first quarter. If memory serves me it was in the neighborhood of 1.5%.

Now to the extent that we buy things in non-US currencies we wouldn't be including it in that kind of number. We isolate the impact of currency on our expenses separately, at least for those that are denominated in foreign currencies.

Jerry Revich - *Goldman Sachs & Co. - Analyst*

And my follow-up on the dealer inventory side, how should we think about inventory levels over the balance of the year? And out of the inventory build that we saw in the quarter is it in the right regions, is it in areas that you folks want?



Mike DeWalt - Caterpillar Inc. - VP, Finance Services Division

Yes, we did have an inventory build in the first quarter and we didn't talk a lot about that in the release partly because I think sometimes it gets taken out of context. We expect an inventory build in the first quarter.

The selling season from dealers to end customers tends to be heavier in the summer time and so dealers add the inventories ahead of summertime. That occurred this year in Construction Industries. We have an order of magnitude 180 million dealers -- or 180 dealers roughly around the world and at any given point in time you've got some of them that probably have a little too much and some that have probably a little too little.

If we look at our months of supply on hand, we try to judge that in a reasonable range. We do look at that by region. And by and large I think our dealer inventory we would say is in a reasonable range.

Now from here we definitely believe it will come down over the course of the year. That happened last year, that's kind of normal to have a build in the first quarter and then have dealers sell that down as we go through the year.

Jerry Revich - Goldman Sachs & Co. - Analyst

Thank you.

Operator

Seth Weber.

Seth Weber - RBC Capital Markets - Analyst

Hey, good morning it's RBC. I wanted to ask about the Resource Industries segment.

The margin there in the first quarter actually went up sequentially even though revenue was down. Do you feel like the margin has bottomed in that business at this point?

Mike DeWalt - Caterpillar Inc. - VP, Finance Services Division

No, I wouldn't say that. If you look at it sequentially you always have to consider that we have some reasonable seasonality between the first quarter and the fourth quarter or fourth quarter and the first quarter in discretionary cost.

So fourth quarter was a pretty heavy quarter, first quarter was a pretty light quarter in terms of spending. So I think that has a lot to do with the sequential improvement.

Now I think Resource Industries' margins will likely come down as the year progresses. We'd kind of said before we thought something around breakeven was probably reasonable. I think that we're going to add to spending over the course of the year.

We've got some R&D programs that we need to do there. We talked about that in January. So my guess is coming off of a pretty light quarter for cost and some increase in engineering as the year goes by and probably not a lot of change in the top line, margin will probably moderate from where it's at.



Seth Weber - RBC Capital Markets - Analyst

So just to be clear to get to a breakeven number would you go negative in a given quarter for the year?

Mike DeWalt - Caterpillar Inc. - VP, Finance Services Division

You know once you get around breakeven the numbers are so small that \$10 million or \$15 million one way or the other could cause that. If we were positive in the first quarter we're thinking breakeven for the year, if it slipped a little below that at a quarter during the year that wouldn't be surprising.

Seth Weber - RBC Capital Markets - Analyst

Okay, thank you. And if I could just ask a follow-up on the aftermarket business for Resource it was down, revenue was down.

Is there any kind of light at the end of the tunnel there? What do you think needs to happen there for the aftermarket business to get better on mining?

Mike DeWalt - Caterpillar Inc. - VP, Finance Services Division

That's a very good question. We've been asking ourselves that. We've got customers with some parked equipment.

We think again there's been some cannibalizing of equipment in the field. We're looking -- I think customers are pushing out rebuild times. In our view that can't keep happening but it has been happening.

So when that turns around it's like the industry overall, it's a little bit hard to predict the timing but we understand where both parts sales and equipment sales are to what's at least for equipment a reasonable replacement level. It's far below that. But when that's going to turn around it's hard to say.

Seth Weber - RBC Capital Markets - Analyst

Fair enough. Okay, thank you very much guys.

Operator

Eli Lustgarten.

Eli Lustgarten - Longbow Research - Analyst

Good morning everyone. It's a nice quarter, we are all impressed.

We talked about the breakeven in our Resource now, can you talk to us about what we should expect profitability wise which were very impressive in both construction and in E&T? Particularly we know volume is going to drop in E&T but you did north of \$0.15, almost 16% in construction and over 20% in E&T and while we expect to come down in order to hold the guidance where you are these numbers have to come down quite a bit. Can you give me some idea of what we should expect and do we think does construction go below double-digit operating margin for the year but what happens as the year unfolds and the business weakens?

Mike DeWalt - Caterpillar Inc. - VP, Finance Services Division

Yes, so I think this really goes across the Company. I'll touch on several of the segments but we expect that the first quarter was kind of seasonally low on cost, so just as a matter of course discretionary costs will go up a bit from the first-quarter level.

We do plan to spend some more on R&D and we talked about that last January. We're looking at negative mix, we will have negative product mix in E&T because of the decline in the oil business that's coming.

We also expect some negative mix in Construction Industries. If you look at what they sold in the first quarter it was relatively balanced between we have three pieces of construction, earth moving, excavation and building construction products or BCP, our smaller equipment. So what we actually sold in the quarter at least in terms of new equipment was fairly balance between those three subsectors.

But if you look at what was ordered and what we think is going to happen for sales as the year unfolds probably not a lot of change in total for construction but a bit more of a shift to BCP, smaller machines. I think part of that is in countries like China where the selling season is very early in the year that helps excavation sales and then that tails down later in the year.

So we're looking at some negative mix in construction as the year goes on. I don't think for the year we're not at least in our contemplated in our outlook we're not going to fall below double digits for construction. E&T operating profit percent will I think for sure come down.

I guess I can't say for sure. We would expect it would come down. And mostly because of declines in the oil business which is tends to be bigger, a little bit higher-margin product.

Eli Lustgarten - Longbow Research - Analyst

And can you to follow-up, can we talk a little bit about what's going on in pricing across the businesses? You did single out that one of the problems in the resource business was basically pricing more than anything else.

So what's going on in the other two sectors pricing wise? Are things relatively holding or is there some more price competition showing up?

Mike DeWalt - Caterpillar Inc. - VP, Finance Services Division

You know, that's a good question and it's interesting when the numbers get this small sometimes we end up talking too much about numbers that are relatively small. We had for the Company overall \$105 million of price realization. That's less than 1%.

I think the segment that is doing, the segments that are doing better right now, Construction and Energy & Transportation, Construction in particular did a little bit better. But part of that is really from three things.

One is we had last year this big Brazilian order from the government and while that was good volume it was pretty low price. So without that our average price level is up a bit.

We had some favorable geographic mix and we did take list price increases small but up at the beginning of the year. So that all contributed a bit.

I think with Resource Industries it's been down year over year for the last certainly the last couple of quarters, I can't remember the third but probably in the third last year as well. It's just a tough business right now. It's dog eat dog.

And although a lot of that product that we sell is dollar-based, the sales are conducted in dollars a lot in mining, some of our key competition like Komatsu probably has more of a yen cost base than we do and they are being aggressive. So it's a tough industry.

Doug Oberhelman - *Caterpillar Inc. - Chairman & CEO*

Eli, it's Doug Oberhelman here. Mike said dog eat dog, I'd rather say Cat eats dog. But be that as it may we are seeing a very competitive marketplace right now.

We did post up a little price realization in the first quarter which I was very happy to see. But I will tell you with a yen that's off over 50% in three years, euro, Brazilian currency, pound currency off 20% to 30% in the last year you know all of our competitors aren't in the US. So it really is a competitive environment out there but we are not giving up our PINS goals, our marketshare goals.

We're doing as well as we can be expected in a tough market that we are, certainly our cost management the last couple of years has helped that, our lean manufacturing where we generated cost advantage has helped. We're still very much focused on marketshare but I would say the competition for every deal has gotten greater as we've seen this dollar strengthen.

Eli Lustgarten - *Longbow Research - Analyst*

Thank you very much.

Operator

Ann Duignan.

Ann Duignan - *JPMorgan - Analyst*

Hi, JPMorgan. My first question it's really I suppose it's to you Doug. We talk about Europe and the euro being weak and what that's doing to help the European manufacturers export but are you seeing any signs of European economies getting any better at all or is that something that you think might be on the up-and-come into 2016?

Doug Oberhelman - *Caterpillar Inc. - Chairman & CEO*

I think it's in our future. I said on the show this morning that it seems to me that with the QE coming in by the ECB with a euro that's off like I said 25% or so in a year's time, with energy prices where they are the stimulus of all three of those and not to mention continuing lowered rates which has finally happened across Europe, I liken the eurozone an awful lot to the period of say 2010, 2011 and 2012 in the US where there was a lot of stimulus. We didn't see much growth but we see better growth now.

So I am convinced it's coming. I don't know when it will be and I'm not going to predict that.

But we still see, and I was just with several of our European dealers, we still have the north-south divide. I think the Germans would say they see some green shoots in that economy. We're not seeing it in our numbers but they were a bit more optimistic in Germany, of course a euro at \$1.07, \$1.08 really benefits those exporters.

So I think we're in the early stages of what will be a recovery. I don't think it's going to be a boom and I think it's going to be anemic growth probably looking a lot like what we've seen here. But it will feel better when it happens for sure, Ann.

Ann Duignan - *JPMorgan - Analyst*

I'm sure it will. And then just switching gears as my follow-up, we track the US construction industry shipments from census data and those have down but orders are down about 27% in Q1. That's just through February.

Can you talk about what you're seeing out there on construction industry orders? Does that include exports that might have weakened because of the strength of the dollar or what's going on out there in terms of industry orders on the construction equipment side? Thanks.

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

Yes I haven't looked at it by region so much but I know that for our Construction Industries segment if I look at orders in the first quarter all I'd tell you is they are not down, they were down I mean no doubt about that but our backlog was a little bit lower in the first quarter. But our orders were certainly not down anywhere near that order of magnitude.

Ann Duignan - *JPMorgan - Analyst*

Okay. And does that have anything to do with the fact that your dealers cannot cancel orders so we might be seeing some delivery, we may have to have inventories corrected later in the year or have you changed that policy? And then I will leave it there.

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

We actually worked very closely with dealers to help them set in combination what an appropriate level of inventory for them is. The last thing we want is a dealer ending up with too much. It never helps anybody if that's the case.

So I don't think -- as far as I know I can't see any inventory problem sitting out there. If you were going back and looking two years ago that was the case but that's just not the case now. I'm probably not looking at the same data that you're looking at on the 27%.

All I can tell you is our orders aren't down. Are you talking versus a year ago?

Ann Duignan - *JPMorgan - Analyst*

Yes. It's the US consensus data or census data, excuse me, and it is year over year through February.

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

Any comment on how we are relative to that number would be pure speculation on my part. But we're not seeing that kind of a decline, no.

Ann Duignan - *JPMorgan - Analyst*

Okay, that's helpful color. I'll get back in line. Thanks guys.

Operator

Steven Fisher.

Steven Fisher - *UBS - Analyst*

Great, thanks, it's UBS. Just a follow-up on that last question there, how did the 9% increase in North American construction sales compare to your expectations?

I know you are earlier in the year looking for North America to be up for the year. Is that still the case and should we maybe now be prepared for some year-over-year declines in North American construction as the year plays on?

Mike DeWalt - Caterpillar Inc. - VP, Finance Services Division

I think on balance in our outlook in January and I kind of updated that a little bit today we expected construction sales to be down 5% to 10% but then and now the only region that's likely to be in neutral to positive territory is North America. The first quarter was by and large about what we expected.

Steven Fisher - UBS - Analyst

Okay, so North American construction still expected to be up for the year in the context of that down 5% to 10%?

Mike DeWalt - Caterpillar Inc. - VP, Finance Services Division

Yes, I would say the total is down 5% to 10%. The only region that's not really down is North America but the numbers are very small. I would say it's within the margin of error to be neutral to positive.

Steven Fisher - UBS - Analyst

Okay. Then can you just give us a sense of the pace of the bookings on the Solar Turbines in the quarter and maybe how far out that backlog extends now for the business?

Are you putting anything in there for 2016 yet? Thanks.

Doug Oberhelman - Caterpillar Inc. - Chairman & CEO

I'll take that, Mike. I just came back from Solar in San Diego two days ago and got a pretty good briefing. I would say their forecast which has rolled up into ours for 2015 is there's a pretty good line of sight to that.

They would not speculate and really don't know much beyond that into 2016 as yet. I would say around gas compression of course which is the big piece of Solar business that has held up and there's a lot of pipeline work going on, there's a lot of pressure behind that that's required and that's our turbine and compressor in most cases.

So I'd say it's again a challenging environment but for gas compression the rest of the year they're pretty much going to end up where we thought they would be and that's good and we're not going to do anything about 2016 and even speculate today. We will later in the year because things are evolving so quickly here that I don't know what it will be and we're concentrating on 2015. But Solar I think has got a year and we're pretty confident about that, it's baked into here as well.

Steven Fisher - UBS - Analyst

Okay, thank you.

Operator

Andrew Casey.



Andrew Casey - Wells Fargo Securities, LLC - Analyst

Wells Fargo Securities. Thanks a lot. A bigger question, a bigger picture question within North America have you seen any sort of equipment flowback from the energy production areas to date or do you think that's a potential more in the second half?

Mike DeWalt - Caterpillar Inc. - VP, Finance Services Division

I think we've seen weaker -- I'm going to use the US regions as the example here. We've seen certainly a decline in orders in business there.

We've actually even seen some decline in part sales in those regions. So yes anecdotally I would tell you I think we are seeing the impact of lower oil prices in our construction business today.

Andrew Casey - Wells Fargo Securities, LLC - Analyst

Okay, thanks Mike. Then if I could follow-up on the pricing question specific to construction, you gave a litany of things. Is it your sense that full-year pricing may be more like flat coming off the strong Q1 performance because you have more difficult comps related to Brazil construction the shift to BCP and then what you describe the competitive marketplace?

Mike DeWalt - Caterpillar Inc. - VP, Finance Services Division

You know, when we did our year-end release we said that we expected price realization to be favorable but less than about half a percent and by and large I think that is still the case. The first quarter was in positive territory.

We expect to end the year in positive territory but pretty small numbers. By and large if you think around half a percent plus or minus you're probably in the ballpark.

Andrew Casey - Wells Fargo Securities, LLC - Analyst

Okay, thank you very much.

Operator

Andrew Kaplowitz.

Andrew Kaplowitz - Barclays Capital - Analyst

It's Barclays. Good morning guys. Nice quarter.

Mike, can you talk a little bit more about your backlog movements within the quarter? You noted an improvement in locomotive backlog and in your segment commentary you talked about a large locomotive project in Asia.

So can you talk about what drove your locomotive backlog? Is that the ending of the North American locomotives or is that more international-related growth?

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

Okay, so the Asia comment around the quarter was, you know locomotive shipments can be kind of lumpy. We had a decent size order for multiple locomotives go out to a customer in Australia in the quarter. So that was the genesis of the Asia comment in the quarter.

In terms of the backlog we during the quarter took an order from one of the North American railroads for new locomotives. And what the railroads do is they will place an order and it's usually for multiple years and you will produce portions of it over the course of the contract. We had an order placed in the first quarter from a North American railroad.

Andrew Kaplowitz - *Barclays Capital - Analyst*

Got it. But it's a long-term contract when it comes down to it?

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

Sure. Yes, absolutely.

Andrew Kaplowitz - *Barclays Capital - Analyst*

Okay. So just shifting gears, you increased restructuring cost at \$250 million up from \$150 million with the increase primarily related to facilities that produce mining products. Can you talk about your decision process when it comes to restructuring Resource Industries?

You disclosed in your 10-K that you've got 36 mining-related facilities at the end of 2014. So how do you gauge when to take action regarding these facilities? And can you talk about the payback period and benefits you expect in your recent actions?

Doug Oberhelman - *Caterpillar Inc. - Chairman & CEO*

It's Doug here. Brad, just before you do that I'd like to come back to that locomotive order that Mike mentioned to one of the big six in North America.

That was a Tier 4 order for our new emissions locomotive which will be available in 2016 and there's been a lot of discussion around our Tier 4 readiness. And that was a big order for us and we'll start shipping that in 2016 while our long-term contract it starts pretty quickly as soon as we have that technology ready which as I say will be next year. Sorry, Brad.

Brad Halverson - *Caterpillar Inc. - Group President & CFO*

No no, it's good. Hi, Andy, it's Brad. Let me talk a little bit about this.

There's been a lot of discussion about it and we've been fairly active in terms of the studies that we do here. We'll go through a process where we are cyclical, we've seen this before.

On the one side we want to be ready for the upturn. Our business model is to produce quality products, lowest owner operating cost, produces parts and service for us and the dealers and repeat business. So on that side given the fact that our sales can move fairly dramatically through the cycles we want to be ready to be able to meet that demand.

But on the other side it's absolutely clear and a good question that this current economic environment presents a lot of opportunities. So we've been at this since 2013.



In fact, if you add up what we've done in the last three years including what we plan to do in 2015 we'll incur roughly \$900 million of restructuring cost. We've closed or downsized roughly 20 facilities, about 5 million of square feet during that period again through 2015 and about 15,000 employees which is unfortunate.

All in then if you look at the benefits we mentioned to you before that we believe after 2015 the benefits per year would be \$400 million to \$500 million per year. With what we've done which we've had higher benefits on than we anticipated and what we have in place we'll be at the high-end or exceed that in terms of our benefits per year.

So it's a robust process, it's done by our product source planning group with involvement across all the facilities, all the regions. There's been some discussion about big facilities. It's very hard to close a single source Decatur facility, in terms of the mining trucks it would be the same for East Peoria.

So those things don't just dollar out in terms of return to shareholders and we do a net present value calculation through that. So I would say that we're continuing to look. We've added a few more in the mining space.

If you go back to 2012 we were at \$66 billion in sales, we're \$50 billion now. We've lost roughly \$16 billion. 75% of that is mining and we've held at a 25% decremental pullthrough right in that range.

So there's a lot of things going on that support that including lean and material cost but I would say that we're pretty happy with that pullthrough over that three-year period. We've done that with little price and higher quality and growing marketshare. So I'm not saying we won't have more to do but that process is ongoing and we've been pretty active in it.

Andrew Kaplowitz - *Barclays Capital - Analyst*

Okay, thanks Brad.

Operator

David Raso.

David Raso - *Evercore ISI - Analyst*

Evercore ISI. Good morning. I'll keep it pretty simple.

I'm just trying to figure out the cadence of earnings for the year. The first quarter was \$1.86 ex the restructuring and almost never is the second quarter not as high or higher than the first quarter, maybe once in the last 20 years and that was a quarter when you were just starting to buy Bucyrus.

So even if I pull out the gain on the first quarter, call it \$1.72, if the second quarter has also been \$1.72 or higher to do your full-year the back half of your has to be doing \$0.70, \$0.75 per quarter. (multiple speakers) Is there conservatism in the guidance or does it drop-off that sharply?

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

No. What I would tell you is if you look at our internal forecasts of the three quarters they are very close to each other. So we see it beginning in the second quarter.



The second quarter we would expect to be lower than the first quarter in sales. And to your point that almost -- that doesn't happen very often but our forecast for this year is second quarter actually lower than the first quarter on both sales and profit and not much different through the rest of the year. There are small pluses and minuses but by and large you can look at our full-year, take out our first quarter and think about the remainder as close to what we're thinking.

David Raso - *Evercore ISI - Analyst*

All right. I'm just trying to figure if sourcing in the second quarter is dropping call it \$1.20 or something like that and the last two quarters are \$1.

The drop-off from energy and some locomotives, what's the offset in the second half of the year to make up for some of that? You still have the earnings dropping off, I'm just trying to understand they drop-off pretty sharply, so what are some of the things we're expecting to be better?

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

Yes, so a couple of things. So you're correct in the idea that particularly for reciprocating engines we will have fairly sizable declines in the second half of the year, actually beginning probably beginning sometime in the second quarter and continuing on through the year.

But there are other parts of the business like Solar where the timing of the year is usually in the second half is higher than the first half and we certainly see that happening this year. We have I think marine sales a bit higher in the back half of the year than the front half of the year.

And much of the rest of the business is actually reasonably, in fact I just looked at this this morning almost anticipating this question, the rest of the year for most of the rest of the businesses are by and large relatively stable as we go through the year. So the drop-off will be more oil but it will be mitigated a little bit by timing in some of the segments and a little bit of an increase in marine.

David Raso - *Evercore ISI - Analyst*

And then it's not related to that, the inventory you mentioned a bit of a tickdown through the rest of the year. Can you help quantify it at the Company level as well as dealer level?

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

Yes, if I look at Company level I'm going to be a little bit more vague because we have continuing benefits from our lean manufacturing journey above and beyond where we were last year baked in. We've got I'll say aggressive goals in our forecast.

So I would say without giving a number we're looking for kind of a cadence of improvement as a result of that or a decline in inventory as we go through the year. Not massive, certainly not like we had in the fourth quarter of last year. But our forecast would reflect modest declines in each of the next few quarters.

David Raso - *Evercore ISI - Analyst*

So the dealer inventory for the year I think (multiple speakers)

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

The dealer inventory for the year.



David Raso - *Evercore ISI - Analyst*

About \$1 billion?

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

I don't think we've given a number but we added to inventory in the first quarter our forecast would reflect all of that coming out plus a little bit more.

David Raso - *Evercore ISI - Analyst*

Okay, that's helpful.

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

It's a case where our sales for the year are coming down from 55 to 50 and not all of that is oil. Some of that may be oil related but it is still in construction.

So I think that we'll probably end the year a bit less than we were last year. Mining inventory is going to continue to come down a little bit this year, not as much as last year but continue edging its way down like it did in the first quarter.

David Raso - *Evercore ISI - Analyst*

All right. I appreciate the detail. Thank you.

Operator

Robert Wertheimer.

Robert Wertheimer - *Vertical Research Partners - Analyst*

It's Vertical Research. Good morning everybody. So I guess the question is on capital allocation, the commentary on share repurchase in the press release was balanced I guess with that and other opportunities.

I'm just curious if just given the maybe bounding opportunities in oil and gas, I'm not sure, whether it we should expect you to cut back on share buybacks for a couple of quarters just in case something develops? Or how you think about staging that, if you'd buy something and then reissue shares, how are you thinking about that?

Doug Oberhelman - *Caterpillar Inc. - Chairman & CEO*

I'll take that one. Doug Oberhelman here. We really haven't changed our priorities of cash at all.

If anything the top priority to maintain the balance sheet is I think becoming more important to us as the uncertainty around us continues on if not increases. You know, we reported that we're about I guess 37% or so debt to debt and equity. That's been trending down and we'll trend that down throughout the year.

We bought \$400 million of shares in the first quarter which I think is a reasonable planning rate for the rest of the year assuming our plan holds up. We will end, I have no doubt we'll end the year with cash, a lot of cash as we did in the first quarter over \$7 billion.

I think in this area of uncertainty where day to day one never knows what's going to happen and having recently been burned on that in 2008 with a big downturn and a weak balance sheet that's where we are going to be. The other thing and I've said this before is that we're continually looking for growth opportunities and that strong balance sheet allows us lots of flexibility for growth, for protection, maintain our dividend and modestly increase it as we've said before and buy shares back.

But I would say that we're in the driver seat with cash generation, with our inventory turnover rising, our lean manufacturing freeing up cash. And as these other priorities work through share buyback will likely over time continue to be an important thing for us. But in 2015 we're just planning right now on that \$400 million until we kind of per quarter or so given the uncertainties and the challenges we face that we see every day in the marketplace.

Robert Wertheimer - *Vertical Research Partners - Analyst*

That's wonderful. Thank you Doug.

If I can ask my follow-up, Mike I think mentioned that oil and gas in the drilling and completions and Doug I believe you mentioned that Solar looks okay. Is there any risk or is it long enough into this downturn to see if there's a risk to parts a la mining not just in sort of fracking, completion drilling but just production pipeline and anything else?

Do you anticipate right now that this is isolated to drilling and completion or could it spill over either on pricing or volume on the rest of it? Thank you.

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

You know you never say never about anything but generally speaking if you're going to produce and you're going to move things through oil through a pipeline or you need the equipment to work to do that. If there's hesitation, if there's customers maybe like mining they have a possibility they could push out things like overhauls and rebuilds, that potentially could be a negative.

I would say we're not really seeing a lot of that right now outside of the drilling and fracking where activity is off. Remember, though, and I think this needs to be said a lot of our business in oil and gas, probably most of our business in oil and gas is gas and so far that's held up pretty well.

Demand for gas is good and the compression business is doing pretty well. So oil is just one piece of our oil and gas business.

Robert Wertheimer - *Vertical Research Partners - Analyst*

Thank you Mike.

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

Well, with that I think we are going to wrap it up. We're at the top of the hour. Thank you for joining us and we'll talk to you again next quarter.

Operator

Thank you. Ladies and gentlemen, this does conclude today's conference call.

You may disconnect your phone lines at this time and have a wonderful day. Thank you for your participation.

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