

**CATERPILLAR INC. (1Q 2023 EARNINGS)**  
**April 27, 2023**

Corporate Speakers

- Ryan Fiedler; Caterpillar Inc.; Vice President of Investor Relations
- James Umpleby; Caterpillar Inc.; Chairman of the Board & CEO
- Andrew Bonfield; Caterpillar Inc.; CFO

Participants

- Robert Wertheimer; Melius Research LLC; Founding Partner, Director of Research & Research Analyst
- Tami Zakaria; JPMorgan Chase & Co; Analyst
- Michael Fenige; BofA Securities; Director
- Jamie Cook; Credit Suisse AG; MD, Sector Head of United States Capital Goods Research and Analyst
- David Raso; Evercore ISI Institutional Equities; Senior MD & Head of Industrial Research Team
- Jerry Revich; Goldman Sachs Group, Inc.; VP
- Stephen Volkmann; Jefferies LLC; Equity Analyst
- Charles Dillard; Sanford C. Bernstein & Co., LLC.; Research Analyst
- John Joyner; BMO Capital Markets Equity Research; Machinery Analyst
- Matthew Elkott; TD Cowen; Director and Transportation, OEMs & Technology Analyst
- Kristen Owen; Oppenheimer & Co. Inc.; Associate
- Timothy Thein; Citigroup Inc.; Director & U.S. Machinery Analyst
- Mircea Dobre; Robert W. Baird & Co. Incorporated; Senior Research Analyst
- Steven Fisher; UBS Investment Bank; Executive Director and Senior Analyst
- Dillon Cumming; Morgan Stanley; Research Associate

**PRESENTATION**

Operator^ Welcome to the First Quarter 2023 Caterpillar Earnings Conference Call. Please be advised that today's conference is being recorded.

I would now like to hand the conference over to your speaker today, Ryan Fiedler. Thank you. Please go ahead.

Ryan Fiedler^ Thanks, Emma. Good morning, everyone. And welcome to Caterpillar's first quarter of 2023 earnings call. I'm Ryan Fiedler, Vice President of Investor Relations.

Joining me today are Jim Umpleby, Chairman and CEO; Andrew Bonfield, Chief Financial Officer; Kyle Epley, Senior Vice President of the Global Finance Services Division; and Rob Rengel, Senior IR Manager.

During our call today we'll be discussing the first quarter earnings release that we issued earlier today.

You can find our slides, the news release and a webcast recap at [investors.caterpillar.com](http://investors.caterpillar.com) under "Events and Presentations".

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Moving to Slide 2.

During our call today we'll make forward-looking statements, which are subject to risks and uncertainties.

We'll also make assumptions that could cause our actual results to be different from the information we're sharing with you on this call.

Please refer to our recent SEC filings and the forward-looking statements reminder in the news release 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 our business on an ongoing basis is contained in our SEC filings.

On today's call we'll also refer to non-GAAP numbers.

For reconciliation of any non-GAAP numbers to the appropriate U.S. GAAP numbers, please see the appendix of the earnings call slides.

Now let's turn to Slide 3 and turn the call over to our Chairman and CEO, Jim Umpleby.

James Umpleby^ Thanks, Ryan. Good morning, everyone. Thank you for joining us.

I'd like to start by thanking our global team for a strong first quarter, including double-digit top line growth, higher operating profit margins, record adjusted profit per share and strong ME&T free cash flow.

Our results reflect healthy customer demand across most end markets for our products and services. We remain focused on executing our strategy and continue to invest for long-term profitable growth.

In today's call, I'll begin with my perspectives on our performance in the quarter. I'll then provide some insights on our end markets. Lastly, I'll provide an update on our sustainability journey.

It was a very strong quarter. Sales and revenues were better than we expected, with price realization, dealer inventory and sales to users each slightly better than we anticipated. Sales to users were higher than expected in Energy & Transportation and Resource Industries. Overall, sales and revenues rose by 17% versus the first quarter of 2022.

The year-over-year increase was due to strong price realization and volume growth, which was driven by higher sales of equipment to end users. We achieved double-digit top line increases in each of our 3 primary segments.

Adjusted operating profit margins increased to 21.1% in the first quarter, as we saw margins improve, both on a sequential and year-over-year basis. The adjusted operating profit margins were significantly better than we had anticipated primarily due to better-than-expected manufacturing costs, including efficiencies and absorption, stronger price realization and volume growth. Andrew will discuss in detail later.

Backlog ended the quarter at \$30.4 billion, flat relative to the fourth quarter of 2022. Equipment availability increased during the quarter due to improving supply chain conditions. While dealer order rates are lower, they remain at healthy levels. As you know, as availability improves, order rates typically normalize, as dealers can wait longer to place orders for long lead time items.

Our healthy backlog continues to underpin our constructive views about our end markets. Despite the improvement in supply chain, pockets of challenge remain as we increase production, particularly for large engines, which impacts Energy and Transportation and some of our larger machines.

We delivered a strong first quarter, which positions us well for an even better year in 2023 than we previously anticipated. While we continue to closely monitor global macroeconomic conditions, overall demand remains healthy across our products and services.

Turning to Slide 4. In the first quarter of 2023, sales and revenues increased 17% versus last year at \$15.9 billion. This was primarily due to favorable price and volume growth. Compared with the first quarter of 2022, overall sales to users increased 13%.

For Construction Industries and Resource Industries, sales to users rose by 5%, while Energy & Transportation was up 39%. Sales to users in Construction Industries were flat, in line with our expectations.

North American sales to users increased, as demand remained healthy for both nonresidential and residential, despite some moderation of the growth rate in residential. Overall, our North American sales to users were better than we expected.

EAME also saw higher sales to users, led by strength in the Middle East. In Latin America and Asia Pacific, sales to users declined in the quarter. The decline in Asia Pacific included further weakening in China.

In Resource Industries, sales to users increased 18%, which was our third consecutive quarter of accelerating sales to users.

In Mining, sales to users benefited from a higher level of commissioning in the quarter. Within Heavy Construction and Quarry and Aggregates, sales to users also increased, supported by growth for infrastructure-related projects.

In Energy & Transportation, sales to users increased by 39%. In the first quarter, Oil and Gas sales to users benefited from continued strength in new engine sales to customers, including repowering active fleets, upgrading technology to Tier 4 dynamic gas blending and adding incremental gas compression units.

We also saw strong sales of turbines and turbine-related services. Power generation and industrial sales to users continue to remain positive due to favorable market conditions. Transportation declined from a relatively low base primarily due to timing in marine deliveries, which was partially offset by deliveries of international locomotives.

Dealer inventory increased by about \$1.4 billion in the first quarter, which was slightly above our expectations compared to a \$1.3 billion increase in the same quarter last year.

In Construction Industries, the increase in dealer inventory was primarily due to stronger North American shipments, which remains our most constrained region.

As we mentioned last quarter, over 70% of the combined dealer inventory in Resource Industries and Energy & Transportation is supported by customer orders.

Moving to Slide 5. We generated strong ME&T free cash flow of \$1.4 billion in the first quarter. We returned \$1 billion to shareholders, which included about \$600 million in dividends and \$400 million in repurchased stock. We remain proud of our Dividend Aristocrat status and continue to expect to return substantially all ME&T free cash flow to shareholders over time through dividends and share repurchases.

Now on Slide 6, I'll share some commentary on our expectations moving forward. While we continue to closely monitor global macroeconomic conditions, our first quarter results lead us to expect that 2023 will be even better than we had previously anticipated on both the top and bottom line.

For 2023, we currently expect to be in the top half of the targeted range for both adjusted operating profit margin and ME&T free cash flow. Andrew will provide additional color.

Before I discuss our outlook for key end markets, I'll provide some color on how we expect our top line to progress through this year. As I mentioned, we expect a strong top

line for 2023, supported by price and higher sales to users, with healthy underlying end markets.

We expect higher sales in the second quarter compared to the first, as is the typical seasonal pattern. Looking to the second half of 2023, it is important to highlight the second half of last year included the dealer inventory build of \$1.4 billion, as dealers began to restock their inventories.

We are not planning for this trend to repeat. Instead, we expect to see dealers decrease inventories compared to the first quarter levels and end 2023 about flat relative to the end of 2022. Although we expect sales to users to remain positive for our primary segments in each quarter, our planning assumption is that Caterpillar's second half sales will have a dealer inventory impact.

Let me explain. First, although dealer inventory and some products and regions have normalized, others remain constrained. For example, in North America, dealer inventory remains below the typical range for many products. However, there is greater Excavator inventory in a few regions, as supply dynamics improved in 2022, which, coupled with the slowing in China, has resulted in improved excavation product availability.

Given the improved availability of excavators, we expect that dealers will scale back their levels of excavator inventory in the second half of the year, even though demand remains healthy.

As a reminder, dealers are independent businesses and control their own inventory.

Second, in late 2023, we have scheduled a couple of new product changeovers in Construction Industry factories that will also impact the second half.

Now I'll discuss our outlook for key end markets this year, starting with Construction Industries. In North America, overall, we continue to see positive momentum in 2023. We expect growth in nonresidential construction in North America due to the positive impact of government-related infrastructure investments and a healthy pipeline of construction projects.

Although residential construction housing starts have softened, the growth rate of our residential construction equipment remains positive as the supply chain pressures alleviate.

In Asia Pacific, excluding China, we expect growth in Construction Industries due to public infrastructure spending and supportive commodity prices. As we mentioned during our previous earnings calls, we expect China's above 10-ton excavator industry to remain below 2022 levels due to low construction activity.

In 2023, sales in China are expected to be below the typical range of 5% to 10% of total Caterpillar sales.

In the EAME, business activity is now expected to increase versus last year based on healthy construction project activity, particularly strong construction demand in the Middle East. Although uncertain economic conditions remain, European construction is proving to be more resilient than we previously anticipated.

Construction activity in Latin America is expected to be down in 2023 versus the strong 2022 performance.

There is some concern about the potential impact of a commercial real estate slowdown. We estimate that North American commercial real estate accounts for about 1% of total Construction Industry sales. Any slowdown related to this sector should not have a significant impact on Construction Industries.

In Resource Industries, we expect healthy mining demand to continue, as commodity prices remain above investment thresholds. As I've mentioned during the last few years, customers remain capital disciplined, which supports a gradual increase in mining over time.

We anticipate production utilization levels will remain elevated. We also expect the aging of the fleet and a lower level of parked trucks to support future demand for our equipment and services.

We continue to believe the energy transition will support increased commodity demand, expanding our total addressable market and providing further opportunities for profitable growth.

In Heavy Construction and Quarry and Aggregates, we anticipate continued growth due to major infrastructure and nonresidential construction projects.

In Energy & Transportation, we expect to follow our normal seasonal pattern, with higher sales in the second half of the year versus the first half.

In Oil and Gas, reciprocating engines, although customers remain disciplined, we are encouraged by continued strength and demand for both well servicing and gas compression.

Power Generation reciprocating engine demand is expected to remain healthy, including strong data center growth.

New equipment orders and services for Solar Turbines in both Oil and Gas and Power Generation are robust. Industrial remains healthy.

In Transportation, we anticipate strength in high-speed Marine as customers continue to upgrade aging fleets.

Moving to Slide 7. We are contributing to a reduced carbon future and continue to invest in new products, technologies and services to help our customers achieve their climate-related objectives. We recently completed an upgrade of more than 50 models across our entire Next-Generation hydraulic excavator line.

The new models reduced fuel consumption by up to 25% compared to previous models and provide another option for customers to lower emissions, while improving operational efficiency. A customer can realize meaningful emissions reductions by simply moving to the newest Next-Gen model.

This example reinforces our ongoing sustainability leadership and how we help our customers build a better, more sustainable world. In addition, we look forward to issuing our 18th annual Sustainability Report in May.

With that, I'll turn the call over to Andrew.

Andrew Bonfield^ Thanks, Jim, and good morning, everyone. I'll begin by providing further color on the first quarter results, including the performance of our segments. Then I'll cover the balance sheet and ME&T free cash flow before concluding with a few comments on the full year and our assumptions for the second quarter.

Beginning on Slide 8. Sales and revenues for the first quarter increased by 17% or \$2.3 billion to \$15.9 billion. The sales increase versus the prior year was due to strong price realization and higher volume, partially offset by currency impacts.

Sales were higher than we had expected in January, with price realization, dealer inventory and end user demand each slightly better than we had anticipated.

Operating profit increased by 47% or \$876 million to \$2.7 billion, which includes the impact of the divestiture of the company's Longwall business.

Adjusted operating profit increased by 79% or \$1.5 billion to \$3.3 billion. Favorable price realization and higher sales volume was partially offset by higher manufacturing costs. The adjusted operating profit margin was 21.1%, an increase of 740 basis points versus the prior year.

As Jim mentioned, the adjusted operating margin was much better than we had anticipated. Lower-than-expected manufacturing costs, including efficiencies and absorption, were the largest variables, while price realization and volume were also stronger than we had envisioned. I'll provide additional color in a moment.

Adjusted profit per share increased by 70% to \$4.91 in the first quarter compared to \$2.88 in the first quarter of last year. Adjusted profit per share in the first quarter of 2023 excluded pretax restructuring costs of \$611 million, most of this related to the non-cash charge from the divestiture of the company's Longwall business.

This compares to pretax restructuring costs of \$13 million in the first quarter of 2022.

Other income of \$32 million in the quarter was lower than the first quarter of 2022 by \$221 million. The year-over-year decline included about \$100 million unfavorable currency impact related to ME&T balance sheet translation and an adverse impact of \$80 million for pension expense.

The dollar strengthened marginally since our last earnings call, so the currency impact within the first quarter of 2023 was about \$30 million better than we had anticipated than when we spoke to you in January.

Finally, the provision for income tax in the first quarter, excluding discrete items, reflected a global annual effective tax rate of 23%.

Moving on to Slide 9. The 17% increase in the top line versus the prior year was driven by favorable price realization and higher sales volume, while currency remained a headwind to sales. Volume improved in part due to a 13% increase in sales to users.

The impact from changes in dealer inventory was minimal, as the \$1.4 billion build in the first quarter was similar to that seen in the first quarter of 2022. Services sales volume was slightly down, mainly due to dealer ordering patterns while services to their customers remained positive.

Compared to our expectations a quarter ago, sales were higher than we anticipated, largely due to slightly stronger volume and better-than-expected price realization.

On volume, sales to users outpaced our expectations due to strong demand. In addition, the improving supply chain supported higher levels of production across our primary segments. This enabled dealers to increase their inventory levels ahead of the selling season by slightly more than we had expected.

Moving to Slide 10. First quarter operating profit increased by 47% to \$2.7 billion. Adjusted operating profit increased by 79% versus the prior year quarter as favorable price realization outpaced higher manufacturing costs. Sales volume was also a benefit.

Our first quarter adjusted operating profit margin of 21.1% was a 740-basis point increase versus the prior year.

Now let me explain why our adjusted operating profit margin was so much better than we had expected. While manufacturing costs did increase year-over-year, the increase was less than we had than anticipated and was the most important factor in the quarter. As we have mentioned, volumes were better than expected due to favorable demand and improvements in the supply chain.

This helped manufacturing cost as both factory efficiency and cost absorption were better than expected. Freight costs were also lower than we had anticipated due to lower

premium freight utilization and rate reductions. Material costs were in line with our expectations and did not impact the margin outperformance.

In addition to lower manufacturing costs, price realization was also stronger than we had anticipated a quarter ago. Stronger-than-anticipated volume had a smaller beneficial impact on margins. Spend on strategic investments was also lower than expected, as project spend ramped up slower than we had planned.

Moving to Slide 11, I'll review segment performance. Starting with Construction Industries, sales increased by 10% in the first quarter to \$6.7 billion due to favorable price realization, partially offset by lower sales volume and unfavorable currency impacts.

The decrease in sales volume was driven by the impact from changes in dealer inventories, which increased by less in the first quarter of 2023 than compared to the prior year. Compared to our expectations, sales were higher due to stronger volumes.

While sales to end users were as we'd anticipated, the dealer inventory increase was slightly above our expectations.

By region, sales in North America rose by 33% due to favorable price realization and higher sales volume. Supply chain improvements enabled stronger-than-expected shipments in North America, supporting dealer restocking in the region. This is a positive, as North America continues to be our most constrained region from a dealer inventory perspective.

Sales in Latin America decreased by 4% primarily due to lower sales volume, partially offset by favorable price realization.

In EAME, sales increased by 5% on favorable price realization, partially offset by unfavorable currency impacts.

Sales in Asia Pacific decreased by 21% primarily due to lower sales volume and unfavorable currency impact, partially offset by favorable price realization.

First quarter profit for Construction Industries increased by 69% versus the prior year to \$1.8 billion. Price realization mainly drove the increase. This was partially offset by lower sales volume, including an unfavorable product mix, and higher manufacturing costs.

The segment's operating margin of 26.5% was an increase of 920 basis points versus last year. The segment margin for the quarter exceeded our expectations on moderating manufacturing costs and better-than-expected price and volume.

Manufacturing costs were lower than we had expected on favorable freight, manufacturing efficiencies and absorption. Production volume was more favorable than

we had anticipated, which drove the usual favorable benefit to margins from the fourth quarter to the first. You will recall that in January, we said we did not expect that to happen.

Turning to Slide 12. Resource Industries sales grew by 21% in the first quarter to \$3.4 billion. The increase was primarily due to favorable price realization and higher sales volume. Although aftermarket sales volumes were lower in Resource Industries due to dealer buying patterns, dealer services to customers remain positive.

First quarter profit for Resource Industries increased by 112% versus the prior year to \$764 million mainly due to favorable price realization and higher sales volume. This was partially offset by unfavorable manufacturing costs.

The segment's operating margin of 22.3% was an increase of 950 basis points versus last year. Segment margin was better than we expected due to lower manufacturing costs, including favorable absorption, efficiencies and freight. Price realization and volume benefits also exceeded our expectations.

Now on Slide 13. Energy & Transportation sales increased by 24% in the first quarter to \$6.3 billion, with sales up double digits across all applications. Oil and Gas sales increased by 39%, Power Generation sales by 27%, Industrial sales rose by 23%. And finally, Transportation sales increased by 14%.

First-quarter profit for Energy & Transportation increased by 96% versus the prior year to \$1.1 billion. The increase was mainly due to favorable price realization and higher sales volume. Unfavorable manufacturing costs and higher SG&A and R&D expenses acted as a partial offset.

SG&A and R&D expenses increased primarily due to investments aligned with our strategic initiatives, including electrification and services growth.

The segment's operating margin of 16.9% was an increase of 620 basis points versus last year, but lower than the fourth quarter as is typical from a seasonality perspective. Compared to our expectations last quarter, margin was better than anticipated on lower manufacturing costs due in part to favorable absorption. Volume was also modestly stronger than we had expected.

Moving to Slide 14. Financial Products revenue increased by 15% to \$902 million primarily due to higher average financing rates across all regions. Segment profit decreased by 3% to \$232 million.

The slight profit decrease was mainly due to unfavorable impacts from equity securities, currency exchange losses and mark-to-market adjustments on derivative contracts. However, higher net yield on average earning assets and lower provision for credit losses acted as a partial offset.

Business activity remains strong, and our portfolio continues to perform well. Past dues in the quarter were 2.00%, a 5-basis point improvement compared to the first quarter of 2022. This is the lowest first quarter past dues percentage since 2006. And whilst retail new business volume declined compared to the first quarter of 2022, this was expected as higher interest rates drove more cash deals and increased competition from banks.

Finally, we continue to see strong demand for used equipment, as prices remain elevated while used equipment inventory is at historic lows.

Before I move on, I want to point out that Cat Financial has strong liquidity and broad access to funding. We are funded through the wholesale debt markets rather than from customer deposits, and we match assets and liabilities based on duration, currency and interest rate profile.

As we have mentioned previously, in a rising interest rate environment, banks are able to provide more competitive interest rates than Cat Financial, and we tend to lose some share of the machines financed.

In the event of a slowdown in lending from regional banks, we are well positioned to step in and fund credit-worthy customers, so they can purchase their machines.

Now on Slide 15. We continue to generate strong ME&T free cash flows. ME&T free cash flow of \$1.4 billion in the quarter was about a \$1.8 billion increase compared to an outflow in the prior year.

The increase was primarily driven by higher profit. This increase is notable in the quarter that included our annual short-term incentive payout and a rise in working capital impacted by an increase in Caterpillar inventory.

As Jim mentioned, following this strong first quarter, we expect to end the year in the top half of our ME&T free cash flow range of \$4 billion to \$8 billion.

Capex was around \$400 million in the quarter, and we still expect to spend around \$1.5 billion for the year. As Jim mentioned, capital deployment was about \$1 billion in the quarter for dividends and share repurchases.

Our balance sheet remains strong, and we have ample liquidity with an enterprise cash balance of \$6.8 billion.

Now on Slide 16, I will share some high-level assumptions for the full year, followed by the second quarter. Looking at the full year, we expect a strong top line supported by price and higher sales to users, with healthy underlying end markets.

As Jim mentioned, we expect full year reported sales for Construction Industries to be impacted by dealer inventory movements, particularly in the second half of the year.

Underlying demand remains strong as we do expect Construction Industries sales to users to show positive growth in the next 3 quarters.

We anticipate continued strength in Resource Industries end markets and stronger end user sales in 2023. In addition, as typical seasonality would suggest, we expect to see some sales ramp in the second half in Energy & Transportation given strong demand for large engines and turbines.

Moving on to margins. Based on our current planning assumptions, we anticipate full year adjusted operating profit margins to be in the top half of our target range. Given the favorable impact of cost absorption in the first quarter, which we do not expect to recur, we anticipate margins in the remaining quarters of the year will be lower than the first quarter level, while underlying demand and end markets remain strong.

Also, despite the slower-than-expected start, we anticipate the spend related to strategic investments within SG&A and R&D will ramp through the year. We expect price to continue to be favorable, although the absolute dollar value of the year-over-year price increases will moderate as we lap through the increases put through in 2022.

We also expect the relationship between price and manufacturing costs for machines to normalize as the year progresses, as we've now caught up to the manufacturing cost increases, which have outpaced price in late 2021 and early 2022. This means that the benefit to margins of price outpacing manufacturing cost inflation will moderate tempering the possibility of further margin expansion.

Keep in mind, similar to the first quarter, we still anticipate a headwind of about \$80 million per quarter at the corporate level related to pension expense. We also continue to anticipate restructuring expenses of around \$700 million this year, with around \$100 million remaining following the first quarter. And the global effective tax rate should be around 23%, excluding discrete items.

Now on to our assumptions for the second quarter. We expect higher sales in the second quarter compared to the prior year on strong sales to users and price. Following the typical seasonal pattern, we expect higher sales in the second quarter as compared to the first.

We expect Energy & Transportation sales will accelerate given strong sales to users, which are supported by healthy demand. We expect to report flattish sales levels compared to the first quarter in Construction Industries and Resource Industries. Both segments are expected to report positive sales to users.

In the second quarter of 2022, we saw a decrease in dealer inventory of \$400 million. We expect a smaller decrease in the second quarter of 2023. Specific to second quarter margins versus the prior year, adjusted operating profit margins at the enterprise and segment level should be substantially stronger than the prior year on favorable price and

volume. However, we do expect to see a return to the typical seasonal pattern of lower second quarter margins compared to the first quarter, despite higher sales.

We expect the year-over-year benefit of price realization in the second quarter to moderate compared to the benefit we saw in the first quarter, as we lap prior year increases.

In addition, SG&A and R&D investment spend should increase, as we continue to accelerate our strategic investments in areas like autonomy, alternative fuels, connectivity, digital and electrification.

Finally, we do not anticipate that the favorable absorption impact that we saw in the first quarter will be repeated. At the segment level, in Construction Industries, we expect lower second quarter margins compared to the first quarter largely due to the lack of a favorable impact from absorption and a ramp-up in strategic investment spend.

Likewise, second quarter margins in Resource Industries were likely to be lower than the first quarter as is the typical seasonal pattern. Conversely, Energy & Transportation should see a slight margin improvement compared to the first quarter levels, supported by stronger sales volume as demand remains healthy.

Now turning to Slide 17, let me summarize. Sales grew by 17% led by strong price realization and volume gains. The adjusted operating profit margin increased by 740 basis points to 21.1%.

ME&T free cash flow was strong at \$1.4 billion, and we expect to be at the top half of our ME&T free cash flow range of \$4 billion to \$8 billion for the full year.

After a strong first quarter, we currently expect our 2023 adjusted operating profit margins will be in the top half of our target range.

The environment remains positive with improving supply chain dynamics, a strong backlog and healthy underlying end markets. We will continue to execute our strategy for long-term profitable growth. And with that, we'll take your questions.

## QUESTIONS AND ANSWERS

Operator<sup>^</sup> (Operator Instructions) Your first question comes from the line of Rob Wertheimer with Melius Research.

Robert Wertheimer<sup>^</sup> My question is really on North American construction, where -- I'm curious whether your end users have seen infrastructure dollars starting to flow have started to make orders based on that, whether your dealers make orders in anticipation of that or whether a lot of that is still ahead. So I'll stop there.

James Umpleby^ Yes. Rob, we have seen some positive impact of those infrastructure dollars start to flow. The projects that don't require a lot of permitting, things like resurfacing roads, that kind of activity has already started, and we're seeing a positive benefit of that.

And one of the things, of course, when customers believe there's a pipeline of projects coming, they're more likely typically to make that capital investment to make a purchase of a piece of new equipment. But yes, it has started, and we expect it to continue for some time.

Operator^ Your next question comes from the line of Tami Zakaria with JPMorgan.

Tami Zakaria^ Just to clarify the operating margin expectation for the year, I think you said you're expecting it to be at the top half of the target range.

So can you remind us what that range exactly is? Are we talking about the 18% to 21% that we saw in the prior quarter's presentation? What exactly is that range you're talking about?

Andrew Bonfield^ Yes. So Tami, to be clear, and I realized as we were saying it, they could be interpreted in 2 ways. One, which is could it be the 10% to 21% range. No, that is not what we're referring to.

If you remember, we have a range of a 3% range based on different levels of sales and revenues. That is where we're talking about. So for example, if you're assuming a certain level of revenues, if you remember the graph we produced, we've given you that will show a margin range. We expect to be in the top half of that 3% range at that level of sales revenues for the year.

Operator^ Your next question comes from the line of Michael Feniger with Bank of America.

Michael Feniger^ The market is worried about dealer destocking and the impact to construction margins. In prior cycles, margins came under heavy pressure when there was a big destocking event.

Is there anything different in terms of how CAT is managing its production, your strong pricing dynamic, inventory management with you and your dealers that we should be thinking about this cycle compared to prior cycles?

James Umpleby^ Yes. So certainly, one of the things we've done is worked hard on our S&OP process over the last few years to really minimize the impact of that kind of an issue.

Firstly, to keep in mind, the way we are -- the market is positioned now, we have strong sales to users, and we feel good about the underlying demand in our end markets. So I'll

start with that. During a period of supply constraints, which really has occurred because of all the issues you're aware of during the last few years, it's not unusual for us to have dealers ordering a bit more, and they couldn't really get the kind of dealer inventory that they would like to have.

They've been able with some easing in supply chain, although we still have areas of real constraint. They have been able to start to increase dealer inventory. Having said that, we have talked about the fact that we expect dealer inventory to end the year about flat as to where it ended in 2022 and expect a slight decrease during the year.

But again, with our S&OP process, the way we look at that now, the way we work with our dealers, we're comfortable in that process that we've really improved it.

Andrew Bonfield^ Yes. And let me just add, because, obviously, one of the concerns -- we talk about dealer inventory in terms of the global dealer inventory number where we talk about the 3 to 4 months. There are some areas with some products, which are actually below the bottom end of that range.

And so we do not see at this stage anywhere apart from potentially with excavation where there is actually any level of stocking, which even gets close to the top end of that range. So it's really -- you have to look at it product by product.

And again, just to remind you that last year's build in dealer inventory, about 60% of that related to RI and to Energy & Transportation, of which 70% of that -- more than 70% of that is covered by firm customer orders.

This is -- I think, with respect a little bit misunderstood by the market. We are not in a situation where we are allowing or expecting dealer inventory to become a headwind for us at any time in the next few quarters.

James Umpleby^ And dealer inventory is within a typical range of 3 to 4 months. And again, we have strong market conditions.

Operator^ Your next question comes from the line of Jamie Cook with Credit Suisse.

Jamie Cook^ Congratulations on a nice quarter. I guess, my question, Jim, just the market, I think, is going to be worried at the performance this quarter is backward-looking. So can you like speak to how you're thinking about backlog or book-to-bill in the back half of the year?

Can that continue to be positive? Do you think backlog will be higher at the end of this year versus where we were this quarter?

And then just my second question, Andrew, on the margins, can you talk to margins in the back half of the second half versus first half? Just trying to understand how much

lower the margins would be in the second half and what's being weighed down by strategic investment.

James Umpleby^ Yes. Certainly, Jamie. First to answer your first question on backlog, we are encouraged by the very strong backlog that we have. It's flat compared to last quarter, but it's at a very healthy level. Again, we have a healthy level of demand as well.

As I mentioned earlier, our -- some supply chain constraints have started to ease. And when, in fact, availability improves, dealers often wait a bit longer to place orders for new equipment, and that is part of what happens.

But again, Oil and Gas is strong. We have -- I mentioned earlier that our Solar Turbines business is strong, Cat Oil and Gas is strong. But again, we feel good about the market conditions, and the backlog reflects that.

Andrew Bonfield^ Yes. And again, just to add to that before talking about margins, just a reminder, backlog is one of the metrics we look at -- to look at where we think about demand as a demand signal. It really does often reflect availability from -- and therefore, often there's one part of that equation. Other things we look at is STUs order rates and also our conversations with dealers, which give us optimism rather than just purely focusing on the backlog per se.

With regards to margins, as we said, in the second half, you would normally see we're probably returning more to a more typical pattern within construction. We didn't expect that. If you remember last in January, we didn't expect to see the normal increase from the fourth quarter to the first. We did. We would now expect to see the normal pattern of margins being declining as we go through the year. That's a function of production. Obviously, as the year progresses, we produce less, which impacts on absorption, in particular, and also factory efficiencies.

Within RI, that tends to bounce around a little bit more and obviously is impacted by the level of sales and revenues. And in E&T, we expect margins actually will progress as we go through the year as per the normal pattern.

Operator^ Your next question comes from the line of David Raso with Evercore.

David Raso^ First, just a clarification. When you speak to the second half of dealer inventory destocking, I know it moves around a bit year-to-year, but isn't the historical pattern that the dealers do take inventory down in the second half of the year, roughly about \$1 billion?

Just making sure I understand the commentary that it's a destock versus there's some normal seasonality to it. I know you hinted excavators, if that really might be a destock. I know it's really hard to get dozers right now to Brazil. So I'm just trying to understand. Is it a destock? Or is it sort of normal seasonality first? But then I have a different question. It's a clarification on that.

Andrew Bonfield^ Yes. So just to clarify, David, obviously, versus last year where we saw an increase. So remind you, there's a \$700 million increase in both the third and the fourth quarter. We would expect to decrease this year.

Yes, it's not unseasonable, but it is a decrease versus the year-over-year. So just that does create a gap between overall. So that's part of the reason we're just highlighting it now just to remind everybody.

James Umpleby^ Yes, there's a normal spring selling season. Sorry, David, you're exactly right.

David Raso^ Yes. Okay. That sort of wasn't something unique the behavioral pattern is to take it down in the second half, but...

James Umpleby^ Yes, correct. Correct.

David Raso^ Real simple question, '24, I know lead times in some areas are getting better, some are still challenged. But it does appear the dealers are willing to order a little earlier for next year than a normal at this time of the year ordering for next year. Just any early signs you have on order books for '24, I think would be very helpful.

James Umpleby^ Yes. It is still too early to certainly predict 2024. As I mentioned, because availability is improving, that gives dealers the opportunity for some products to wait a bit longer when they place their orders. And that's not the case for every product. But it is too early to really make a call on 2024.

Operator^ Your next question comes from the line of Jerry Revich with Goldman Sachs.

Jerry Revich^ I'm wondering if we could just talk about the margins for you folks are now at the high end of your framework range and supply chain performance. Looks like it's improving from here and for the rest of the industry. The margins are at the very high end of their ranges as well.

How do you think about the risk of pricing concessions for the industry from here, as supply improves further? Obviously, we haven't seen discounting from you folks in the past, but I'm wondering if you can talk about it if this cycle is different at all given just the more complexity.

James Umpleby^ Yes. Of course, as you know, we serve a variety of industries, and there's -- it's not a one size fits all. So we look very carefully at the market conditions and the competitive situation for each product that we sell into the various markets that we have.

Certainly, in some areas, product is still constrained, and it's still quite challenging to get product. And in others, as we mentioned, like in excavation, there is more availability. So that has an impact as well.

But really, what we do is, as you can imagine, look at -- we always take into account our cost inputs, and then we look at the competitive situation for each product in each market, and we make a decision based on that.

Operator^ Your next question comes from the line of Steve Volkmann with Jefferies.

Stephen Volkmann^ I wanted to go back, Jim, I think I heard you say that you thought North American commercial construction was like 1% of CI. Correct me if I got that wrong, but it made me wonder what you think really the key drivers are of that business, so that we can sort of monitor those going forward?

James Umpleby^ What are the key drivers of commercial construction?

Stephen Volkmann^ No, I'm sorry, I understand -- if commercial is only 1% of CI, what's the other 99%?

James Umpleby^ Yes. So we talk a lot about nonresidential, and we've talked about the fact that we are quite encouraged by legislation that has passed, whether it's IJJA, the CHIPS act, the IRA.

So again, looking at that activity that's being supported by that legislation, we feel good about residential in North America. One of the things we wanted to do was because there had been a lot of commentary, frankly, about commercial real estate, we wanted to just clarify that it's a very small portion of CI because it seems to be getting a lot more play than it deserved, quite frankly.

Andrew Bonfield^ Yes. And sorry, just I want to clarify one point that I responded to in question, yes there will be dealer inventory destocking occurring in the second half of the year, but it will not impact us.

We will still see positive sales momentum in those quarters. So it does not have an impact where it takes us down year-over-year at any point in time in the next few quarters. Just to clarify that.

Operator^ Your next question comes from the line of Chad Dillard with Bernstein.

Charles Dillard^ A couple of questions. So first, can you comment on your lead times in construction today versus 6 months ago? And then can you just clarify your comments about the second half?

You talked about destocking and factory maintenance. Does that mean that 3Q and 4Q will be at least only weaker than normal on a sequential basis?

James Umpleby^ Yes. So lead times -- so because of easing supply chain constraints in some areas, lead times have improved. We still really have challenges in certain areas. Earthmoving is a great example.

We have challenges around availability and lead times around some BCP products as well. Excavation, as I mentioned earlier, has in fact eased. But we are making some changes in the second half.

Actually, we're going from a third-party engine to a Caterpillar engine in some products. So as we make that change over, that will, in fact, have a bit of an impact on production. And it's obviously temporary, and it's a positive thing for us long term to get our own engines in those products. So we'll be making that change later in the year.

Andrew Bonfield^ Yes. I mean -- and obviously. Sorry, carry on.

Charles Dillard^ Yes, I was going to -- can you just clarify your comment about the second half you talked about destocking some maintenance in the second half? So I just want to know, does that mean that 3Q and 4Q will be seasonally weaker than the normal on a sequential basis?

Andrew Bonfield^ Yes, back to the comment of this I said to David earlier, we did have inventory builds in the third and fourth quarters of last year. So you're running against a comparative, which has a build versus a decrease. So year-over-year, that does impact what would be the normal seasonal pattern.

Obviously, while other factors come into that price and also what underlying volume demand is, but that will have an impact on our reported sales in those quarters. So we're just highlighting that, so that as you think about your models, you don't build the normal seasonable pattern into those models as you look out for the next several quarters.

Operator^ Your next question comes from the line of John Joyner with BMO Capital Markets.

John Joyner^ And sorry to ask another question about the dealer stocks. But I guess, if demand and sales to end users have stayed strong, and inventories are not elevated, why would there be dealer destocking and not some restocking? I mean does it possibly imply a bit of hesitation among dealers when looking ahead?

James Umpleby^ I don't believe that's the case. And again, as I mentioned, as availability improves and lead times decrease due to easing supply chain challenges, it's not unusual. As we looked in the past, it's not unusual for dealers took to -- they can wait longer to place orders, and they need a bit less in inventory because we can respond more quickly. So it's not surprising to have that happen.

Andrew Bonfield^ And also, if you recall, we've talked about the new sales and operations planning process and one of the things we're trying to avoid through that process is dealers holding more inventory than is really necessary.

They are independent businesses. They make their own decisions about inventory, but we try to work with them to avoid any overstocking, which then has an impact later on where you have to destock. So we're trying just to be more proactive in that regard than we have been historically.

James Umpleby^ And again, when we can respond more quickly to dealer orders. The dealers feel comfortable holding a bit less inventory.

Operator^ Your next question comes from the line of Matt Elkott with TD Cowen.

Matthew Elkott^ So I know the backlog was unchanged. But how has the timing of the backlog changed? I mean, does it go out further? Did any orders get pushed out because of all the macro uncertainty? And did you have -- you guys have any major cancellations that were offset by new orders?

James Umpleby^ No, we have not seen any major cancellations, and we feel quite good about the quality of the backlog that we have. Of course, much of it is for Solar Turbines, for Oil and Gas, for Mining.

So again, we feel quite good about the quality of that backlog, and we haven't seen major cancellations.

Operator^ Your next question comes from the line of Kristen Owen with Oppenheimer.

Kristen Owen^ I'm going to switch it up here a little bit and ask you to talk about the NMG announcement that you recently made for the zero emission fleet. Looks like that includes some related infrastructure. So just a couple of pointed questions there.

First, how do you see the rollout progression of a product -- a project like this? And then second, how should we think about this in terms of a blueprint for future mine site decarbonization opportunities? Like how do you price for that? How do you think about packaging that sort of deal?

James Umpleby^ Yes. So certainly, we've had a number of requests from many of our mining customers, and NMG is one of them to help them decarbonize their operations. And so we are working with NMG specifically to help to provide battery powered machines to allow them to execute that project.

So again, it's a collaborative process. We're working closely with them. We're working through commercial issues with them. But again, we feel quite good about where we are. We demonstrated in November to a number of our customers a fully loaded battery-powered -- large mining truck operating at diesel power performance in terms of speed,

fully loaded -- on the flat going up the hill. So again, we feel good about where we are. But it is a process. It's a multiyear process that we're working with our customers.

Operator^ Your next question comes from the line of Tim Thein with Citi.

Timothy Thein^ The other question just on this -- the improvement, whatever improvement you are seeing in the supply chain and a little bit better visibility and thus your ability to react faster, how does that -- Andrew, how do we think about that, the interplay with that as we go through the year and Cat's own inventory?

And I know there's some -- there's been flattered somewhat probably by inflation and other factors. But -- and just thinking of that impact as you go through the year and, ultimately, the impact from an absorption standpoint, if, in fact, we start working that down.

Andrew Bonfield^ Yes. So obviously, some of our assumptions are that we do not expect the absorption impact to continue. And obviously, yes, some of that will reverse as we move our product out of the plant into the dealer channel, and that's forecasted within our expectations for margins as we go through the remainder of the year.

The other factor, obviously, to take into account is the potential benefit to cash flow. As we've said, we did see a very strong ME&T free cash flow in the first quarter, despite an increase in Caterpillar inventory.

Obviously, over time, we expect, as the supply chain improves, to start working that inventory down and start to see a full benefit of that from a cash perspective and converting that back into cash. So that is part of the reason why we're expecting obviously strong cash flow as we go through the remainder of the year.

Operator^ Your next question comes from the line of Mig Dobre with Baird.

Mircea Dobre^ Jim, I appreciate your comment earlier about taking a proactive approach to sort of managing this dealer inventory dynamic. But I'm sort of curious here, as you look at the last, call it, 18 months to 2 years, do you get a sense that there's been some ordering on a part of dealers that was just a reaction to elongated lead times, and that those sort of patterns are subject to see some pretty meaningful shifts now that your lead times in the supply chain are getting better?

And as you -- as the year progresses, if it's the destock that you're expecting sort of fails to materialize at the pace that you're anticipating, are we to understand here that you're going to take a proactive approach to adjusting production in the back half of this year?

Andrew Bonfield^ Yes. So Mig, it's Andrew. Let me just try and reiterate again what we do within our sales and operations planning process is we work closely with the dealers to understand what the level of orders is.

We use machine learning to try and understand what we think the actual real order rate is based on customer demand versus speculative demand. So one of the things that does do is we obviously don't accept orders for what we would call speculative demand.

That helps us try to manage production. Obviously, the focus for us is to manage production as smoothly as possible over time because that's the most efficient and effective way of doing it. Obviously, as we think about the remainder of the year, and we're looking at inventory and we're looking at the outlook for the year, just to remind you, we still expect end-user demand to be positive for the remainder of the year.

So that will impact us to actually make – that we will continue to actually probably still be ramping production for the remainder of the year, even though we do take - you may see a small reduction -- relatively small reduction in dealer inventory over the next couple of quarters.

We're just trying to highlight that to you as a result of the fact that it will impact reported results for some of the individual segments. Basically, overall, as we also said, we are not necessarily at the bottom end of the range for all products and all categories.

So there still will be areas where we are still trying to ramp up production. For example, large engines is an area where we're still constrained. That obviously is an area where we will still be ramping up production, rather than adjusting production in any other way.

Operator^ Your next question comes from the line of Steven Fisher with UBS.

Steven Fisher^ Question about a couple of elements within E&T. I thought it was interesting that your Industrial retail sales within E&T accelerated, but your own Construction sales were relatively steady.

So I'm curious what markets drove that Industrial acceleration. And then on the Power Gen side, to what extent are there other elements besides data centers that are driving the strength in that segment?

James Umpleby^ Well, we sell Industrial engines for a whole variety of applications, not just the other construction equipment. So part of it is Power Gen , and we sell Industrial engines to drive everything from cement mixers. It's a whole variety of applications.

So again, a lot of strength there. That business is doing quite well. There's a lot of momentum.

In terms of Power Generation, we provide generator sets for a whole variety of applications. Data centers is one of them, and we've highlighted data centers because it has been quite strong over the last few years. And if we look forward, we feel good about that continuing.

Just thinking about AI, thinking about the cloud, thinking about all of the data center users, we feel good about that. But we provide gen sets for a whole variety of applications. But the one that is really driving a lot of the growth at the moment is data centers, which is why we highlighted it.

Ryan Fiedler^ Emma, we have time for one more question.

Operator^ Your next question comes from the line of Dillon Cumming with Morgan Stanley.

Dillon Cumming^ Just wanted to ask one on the kind of financing environment. I think you just called out the opportunity for Cat Financial maybe having some more flexibility to finance customers that might have more difficulty getting this kind of financing from smaller banks.

Just curious, first, you can kind of with some numbers around that and what the kind of share opportunity there is. And secondarily, if you're actually seeing evidence on the ground with regards to customers not being able to get financing at the moment over the last 3 months or so.

Andrew Bonfield^ Yes. Obviously, it's way too early to see any impact yet from any tightening credit conditions within the regional banks. But obviously, our expectation is that, may have an impact.

We tend to vary. It can probably be between 5% and 10% of machines financed that we could add in times where we are more competitive from a financing perspective with regional banks. So that's probably -- we're probably at the lower end of our normal range at the moment.

So we could add 5% to 10% of machines without any problem whatsoever from a capacity perspective, which would be very strong for us and very positive at Cat Financial.

James Umpleby^ Okay. Well, thank you all for joining us. We appreciate your questions. We are proud of our team's performance in the first quarter. And as we mentioned earlier, we believe that 2023 will be even better than we had previously anticipated on both the top and bottom line due to the healthy demand across our end markets, and we remain focused on executing our strategy and continuing to invest for long-term. Again, thank you for joining us.

Ryan Fiedler^ Thanks, Jim, Andrew. Yes. Thanks, Jim, Andrew and everyone who joined us today. A replay of our call will be available online later this morning. We'll also post a transcript on our Investor Relations website as soon as it is available.

You'll also find a first quarter results video with our CFO and an SEC filing with our sales to users data. Click on [investors.caterpillar.com](https://investors.caterpillar.com) and then click on Financials to view those materials.

If you have any questions, please reach out to Rob or me. The Investor Relations general number is 309-675-4549. Now we'll turn the call back to Emma to conclude the call.

Operator^ Thank you for attending today's conference call. You may now disconnect.