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EDITED TRANSCRIPT

CAT - Q4 2017 Caterpillar Inc Earnings Call

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OVERVIEW:

Co. reported 4Q17 sales and revenues of $12.9b and loss per share of $2.18 and adjusted profit per share of $2.16. Expects 2018 profit per share to be $7.75-8.75 and adjusted profit per share to be $8.25-9.25.

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Caterpillar Full Year and 4Q 2017 Results Conference Call. (Operator Instructions)

It is now my pleasure to turn the floor over to your host, Amy Campbell, Director of Investor Relations. Ma'am, the floor is yours.

Amy A. Campbell - *Caterpillar Inc. - Director of IR*

Thank you very much, Kate. Good morning. I'd like to welcome everyone to our Fourth Quarter Earnings Call. I'm pleased to have on the call today our CEO, Jim Umpleby; our Group President and CFO, Brad Halverson; and our Vice President of Finance Services, Joe Creed.

Remember, this call is copyrighted by Caterpillar, and any use, recording or transmission of any portion of the call without the expressed written consent of Caterpillar is strictly prohibited. If you'd like a copy of today's call transcript, we will be posting it in the Investors section of our caterpillar.com website. It will be in the section labeled Results Webcast.

This morning, we will be discussing forward-looking information that involves risks, uncertainties and assumptions that could cause our actual results to differ materially from the forward-looking information. Discussion of some of these factors that either individually or in the aggregate could make actual results differ materially from our projections can be found in cautionary statements filed with the SEC and is also in our forward-looking statements language included in today's financial release and the presentation.

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

We're going to start the call this morning with a few words from Jim, and then Brad will walk us through fourth quarter and full year results and our 2018 outlook, and then we will begin the Q&A portion of the call. Jim?

D. James Umpleby - *Caterpillar Inc. - CEO & Director*

Thank you, Amy. Well, good morning. First, I'd like to thank our team for delivering strong results throughout 2017. After 4 challenging years, many of our end markets improved, and our team capitalized on the opportunity and achieved excellent results. As demand improved during the year, we stayed disciplined and maintained control of our structural costs. In addition to responding to the increase in volume and delivering strong financial results, we developed and began to implement our new strategy to deliver profitable growth by focusing on operational excellence, expanded offerings and services.

Economic indicators are positive at the moment, and we expect a strong start to 2018. Our focus on operational excellence will not waver as we work to develop a more competitive and flexible cost structures, including implementing lean manufacturing principles. We are positioned to capitalize on continued sales momentum or quickly adjust should conditions change. We also plan to profitably grow the company by investing in expanded offerings and services, the 2 additional major focus areas in our strategy.

Let me give you some examples of the progress we've made thus far. In 2017, we introduced our first model of our next generation of excavators. This is our first major excavator redesign in 25 years and just one example of our focus on expanded offerings to provide a range of products to better serve the diverse needs of our customers. We also increased our focus on services, including aftermarket support and digitally enabled solutions. We continue to grow our connected asset population and recently acquired 2 rail service companies.

We're in the early stages of implementing our strategy for profitable growth. In 2018, we expect to make additional investments in the expanded offerings and services that are important for Caterpillar's long-term success. And we'll use our Operating & Execution Model to bias resources to areas that represent the greatest opportunity for return on our investments. I couldn't be more proud of what our team accomplished in 2017, and I'm looking forward to the opportunities ahead.

With that, I'll turn it over to Brad.

Bradley M. Halverson - *Caterpillar Inc. - CFO & Group President of Finance, Human, Global Information Services Division & Corporate Auditing*

Thanks, Jim. It really was a great quarter, with improved sales across all regions and nearly all end markets. The team delivered strong margins while also investing in targeted initiatives to help us grow the business profitably. Today, I'm going to walk through both the quarter and full year 2017, and then I will move on to discuss our outlook.

Let's start with Slide 4. On the top line, sales and revenues of $12.9 billion were up 35% from the fourth quarter of 2016. The largest driver of the sales increase was volume, driven by an increase in end user demand for new equipment across all of our regions. We saw the largest increase in North America, with improved demand for construction equipment as well as onshore oil and gas equipment. For the bottom line, we lost $2.18 per share in the quarter versus a loss of $2 per share in 2016. And adjusted profit per share was $2.16 in the current quarter, up $1.33 from the fourth quarter of 2016. It's important to note that adjusted profit per share excludes several large adjustments, including the impact of U.S. tax reform, restructuring cost, mark-to-market losses for the remeasurement of pension and OPEB plan, state deferred tax valuation allowance adjustment and a goodwill impairment charge we took in 2016. The largest of the adjustments to profit per share was the estimated impact of the U.S. tax reform on our 2017 results. I will talk more about the impact of U.S. tax reform in a few minutes, but you can also find more detail on each of these adjustments on Page 14 of the press release.

Let's turn to Slide 5, and we'll look at a reconciliation of operating profit for the quarter. As you can see, fourth quarter operating profit was $1.2 billion compared with a loss of $1.3 billion in 2016. The positive changes in operating profit came from several areas, with the largest being higher sales volume. We saw higher end user demand in all regions and in our 3 primary segments. About half of the sales growth was in Construction

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Industries, led by strong end user demand in North America and Asia Pacific. And about half of the increase in Asia Pacific was due to higher sales into China. EAME and Latin America sales were also up.

For Energy & Transportation, the strength of the North American onshore oil and gas continued to be the largest driver of sales growth. In addition, sales were up across all applications in E&T. We saw higher shipments of locomotives, higher rail services driven by increased rail traffic, strong economic fundamentals for industrial engine applications and several large Power Generation deals that were in the fourth quarter.

Resource Industries had their strongest quarter for sales to users in over 2 years as miners began to increase capital expenditures. Aftermarket parts demand remained high to support increased mining activity and also to support overhauls and rebuilds. Favorable changes to dealer inventories also impacted our sales. Despite higher end user demand, dealer inventory was about flat in the quarter compared with an $800 million inventory reduction in the fourth quarter of 2016. However, with increased global demand, we believe dealer inventories for machines remain lean at 3.1 months of sales. This is up slightly in terms of months of sales from the end of the third quarter of 2017 but still below historical norms. As we expected, price realization was less favorable than the third quarter of 2017 but was still positive $213 million. The favorable change was primarily due to Construction Industries and was largely the result of a weak pricing environment a year ago and price action taken in 2017.

Variable manufacturing costs were favorable $170 million, largely due to cost absorption as inventories remained about flat versus a significant reduction in inventories in the fourth quarter of 2016. Coming off 4 years of decline, the production increases we saw throughout the year challenged our suppliers. We are working closely with them to reduce lead times and raise production levels. However, we have seen lead times extend on some products. Despite these challenges, we remain focused on getting product to customers quickly, but also efficiently executing on the lean principles that we are continuing to implement across our factories.

Total period costs were higher by $482 million. The largest driver of this increase was higher short-term incentive compensation expense. However, costs were also up as we increased spending on targeted investments aimed at profitable growth initiatives as well as to support higher production levels. Other positive factors on the profit walk for the quarter were favorable moves in restructuring cost, mark-to-market and goodwill. Restructuring costs were $150 million favorable versus the fourth quarter of 2016. Mark-to-market losses on the remeasurement of our pension and OPEB plans were $301 million, which was $684 million less than the loss we recognized in 2016. And we saw a favorable impact from the absence of a goodwill impairment of $595 million that Resource Industries recognized in the fourth quarter of 2016.

Now let's move on to review the full year, starting on Slide 6. We started 2017 by preparing for what could have been another down year. However, we quickly saw increased demand in a few end markets, which spread as the year progressed. Then, by the end of the year, all regions and the 3 primary segments saw increases in sales. That's the first time in a very long time that we can say that. For the year, sales and revenues were $45.5 billion, which is up 18% from 2016. A strong start to the year for construction in China, North America and gas compression and mining rebuilds ended with increases in construction demand across all regions, mining fleets being put back to work, orders for new mining equipment increasing and strong demand for onshore oil and gas equipment in North America.

Profit per share for the full year was $1.26 versus a loss of $0.11 in 2016. Adjusted profit per share was $6.88, about double 2016's adjusted profit per share of $3.42. Again, adjusted profit per share for the full year excludes several large adjustments, and we provided a reconciliation of those in Q&A #1 of the release.

Let's turn to Slide 7. We'll look at operating profit for the full year. 2017 operating profit was about $4.4 billion compared with about $500 million in 2016. By far, the most significant driver to profit was the higher sales volume, with nearly half that increase in Construction Industries, led by China but followed by improvements in North America.

Resource Industries and Energy & Transportation contributed about equally to the remaining sales growth. For Resource Industries, aftermarket parts demand was strong for rebuilds to put mining fleets back to work and to support higher fleet utilization. Changes to dealer inventories were favorable, and end user demand for equipment improved in the second half. The increase in sales for Energy & Transportation was led by strong demand for North American oil -- onshore oil and gas. However, for the full year, sales were up across all 4 Energy & Transportation applications.

2017 was also a good year for price realization, although keep in mind 2016 price realization was significantly negative. Most of the price realization in 2017 was in Construction Industries.

When we look at variable manufacturing cost, we saw favorable $433 million, largely due to cost absorption as we increased inventory to support higher production levels in 2017 as compared to reducing inventories in 2016.

For the full year, material costs were just slightly unfavorable, with most of the impact coming in the second half. Material cost reduction actions did not completely offset the headwinds from higher steel cost. Total period costs were higher by $928 million. However, excluding short-term incentive compensation expense, period costs were favorable for the year, largely a result of continued cost reductions and restructuring actions. Restructuring costs were unfavorable $237 million. In 2017, restructuring costs were $1.3 billion, with about half due to the decision to close the Gosselies, Belgium facility. The full year results also benefited from a decrease in mark-to-market losses and the absence of a goodwill impairment that I discussed earlier.

We ended the year with a strong balance sheet. Our year-end debt-to-cap ratio was 36.7%, and enterprise cash balance was $8.3 billion. In the fourth quarter, we made a $1 billion discretionary contribution to our U.S. pension plans, and we retired $900 million of debt that was due in December 2018.

Before I discuss our capital allocation priorities, first, I want to cover the impacts of the U.S. tax reform bill that was passed in December. Let's move to Slide 8. As I discuss U.S. tax reform, I will break it into 2 sections: the impact on our 2017 results and the long-term benefits of the bill.

First, let's talk about the impact on 2017 results. The fourth quarter provision for income taxes included a charge of about $2.4 billion as a result of the enactment of U.S. tax reform. There are 2 primary components of this charge: The first is about $600 million write-down of our net deferred tax assets to reflect the reduction in the U.S. corporate tax rate from 35% to 21%. This is a noncash item. The remainder of the charge is largely the cost of the mandatory deemed repatriation of non-U. S. earnings. These charges reflect a reasonable estimate as of January 18, 2018. However, these estimates may change as additional guidance is issued, assumptions are refined and any potential actions that could be taken as a result of the legislation.

Now let's look at the long-term impacts of the new tax legislation. We believe that U.S. tax reform is positive for Caterpillar over the long term and that it provides a more competitive environment for us both domestically and around the world by creating a more level playing field against our non-U. S. competitors. The reform also provides greater flexibility to access our cash in order to deliver on our capital allocation priorities.

Finally, the new tax law lowers the U.S. corporate tax rate. We have included the estimated impact of U.S. tax reform in our 2018 outlook. However, it's important to stress that the new U.S. tax law does not change our cash deployment priorities.

I'd like to now discuss our cash deployment priorities as it's been a topic of interest recently. Our top priority continues to be maintaining a strong financial position to support our mid-A credit rating. Next, we will fund our operational requirements and our commitments. Then, we intend to fund profitable growth, aligned with our strategy, to include operational excellence, expanded offerings and services. Returning capital to shareholders through dividend growth and share repurchases remains important.

Now let's look at the 2018 outlook on Slide 9. Today, we are providing a 2018 outlook for profit per share in a range of $7.75 to $8.75 and an adjusted profit per share range of $8.25 to $9.25. We are moving away from providing a sales and revenue outlook range as our new company strategy is focused on profitable growth through the cycle. In 2008 -- or for 2018, we are beginning the year with strong order rates, an increasing backlog and lean dealer inventories. In addition, the global economy is the strongest it has been in several years, with nearly every region of the world expected to grow in 2018. However, we know that markets can change quickly. So while we are working in our factories and with our suppliers to support higher production levels across a number of products, we also remain committed to a flexible and competitive cost structure that can respond quickly if demand changes.

Now let's walk through some outlook assumptions in each of our 3 primary segments, if we move to Slide 10. For Construction Industries, the pie on the right breaks out our 2017 sales by region for Construction Industries. In 2018, we expect all regions to improve and segment sales to be higher. For North America, we expect improvement in both residential and nonresidential construction. And after many years of disappointing underinvestment in infrastructure, we expect demand to be up slightly in 2018. We have not incorporated any impacts from a potential U.S. infrastructure bill in our outlook. And if one were passed, it would be positive, but we would not expect it to materially impact our 2018 results. We expect Latin America to continue to recover, albeit off what continues to be a very low base versus historical trends. Europe continues to deliver stable and steady growth across most of the region. We believe stabilizing oil prices and attractive commodity prices should also be a benefit for Africa, the Middle East and the CIS countries. Lastly, we expect to see continued growth in Asia Pacific, led by China. Our forecast is for China to remain strong through the first half of the year, and then slow in the second half, which reflects normal seasonality. In addition to China, we expect most other countries in Asia Pacific to grow, largely driven by investments in infrastructure.

Now let's look at Resource Industries on Slide 11. For Resource Industries, all signals indicate continued growth in mining. Most commodity prices are above investment thresholds and are driving increases in mining production. Rebuild and aftermarket demand should continue as the parked fleet comes back online. And an extension of existing mines should drive demand for new equipment. In addition, we believe most miners have returned to profitability, and we expect their capital spending to increase in 2018, with a growing share spent on sustaining capital expenditures. In addition to strong mining activity, global economic growth should also be a positive for heavy construction equipment, which is included in Resource Industries.

Let's move to Slide 12 and look at Energy & Transportation. Again, the pie chart on the right reflects a breakout of 2017 sales by application. We expect sales for Energy & Transportation to be up for the full year. While we expect oil prices to remain volatile, we anticipate continued strength in oil and gas in 2018, led by demand for onshore oil and gas equipment in North America. In addition, we expect demand for drilling equipment to remain soft as it was for all of 2017. For Solar Turbines, the current backlog is healthy, largely driven by the midstream pipeline business. We also expect offshore oil activity to remain weak. Power Generation sales are forecasted to be up after a multiyear downturn. Sales into industrial engine applications are expected to be about flat. And transportation sales are expected to be up, largely due to recent acquisition in rail services. The locomotive and marine businesses remain challenged.

Now if we look to Slide 13, I'll talk about a few more items impacting our 2018 outlook. Higher sales volume is the largest driver of the improvement in the profit outlook. We are also expecting period cost, excluding short-term incentive compensation changes, to increase due to wage inflation as well as targeted investments in profitable growth initiative for expanded offering and services. We expect short-term incentive compensation expense to be about $900 million. Additionally, while market conditions are favorable, the pricing environment remains competitive. As a result, we expect slightly favorable price realization to be mostly offset by unfavorable material cost, largely driven by higher commodity prices. The 2017 gain on the sale of securities and financial products is not planned to repeat. We expect restructuring cost to be about $400 million for the full year. We have an estimated 24% tax rate, which includes the impacts of U.S. tax reform. As has been our historical practice, we have not assumed any share buyback in our outlook. We expect to continue delivering strong performance with improving operating margins as we execute on our strategy focused on operational excellence and profitable growth.

So to summarize, on Slide 14, we had a great fourth quarter and a great 2017. Our team managed cost as production ramped up. We delivered improved margins across the 3 primary segments and maintained a strong balance sheet. As we start 2018, we are seeing improving economic indicators across many of our end markets, and we are executing on our strategy for profitable growth with a focus on expanded offerings and services.

So with that, I'll turn it back to you, Amy.

Amy A. Campbell - *Caterpillar Inc. - Director of IR*

Thank you, Brad. Before we begin the Q&A portion of the call, I just want to take a minute to announce a slight change in the release of retail stat. So we will continue in the month where there's (inaudible) May 9. And if (inaudible) of the quarterly release, we're going to move the release of retail stats from before the market opens until after the market opens a day before the release. So in the month of the release, retail stats will be released after the market closes the day before the release.

So with that, Kate, I'll move it back to you to begin the Q&A portion of the call.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question today is coming from Andrew Casey.

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

Wells Fargo Securities. I wanted to ask about the Q4 segment margins. They declined sequentially in all 3 of the major equipment categories despite higher sequential revenue, and I know some of it is related to short-term incentive comp. But could you provide some further detail on really what drove that sequential margin performance?

Amy A. Campbell - *Caterpillar Inc. - Director of IR*

Sure, Andy, and I think a couple things. If we step back, keep in mind that we're playing operating margins over the long term and not quarter-to-quarter. There were a couple things in the quarter that did drive segment margins down. I think if you look at E&T margins, they were actually up. So I'll talk through CI and Resource Industries. At the consolidated level, the biggest driver was period cost absorbed. So if you look at Cat inventory growth through 2017, you saw inventory grow through the first 3 quarters and then actually come down in the fourth quarter, largely driven by turbine and rail shipments, but also in the other segments as well. So from a sequential perspective, there was less favorable cost absorption into inventory as inventories came down slightly in the quarter versus growing in the 3 quarters prior to that. And for Resource Industries -- and Brad talked about this in the script. For the first quarter, we really saw a significant increase in new equipment sales, which had a slight impact on margins. Still very good margins, strong margins for the year, the second highest quarter for the full year, but that did drive some of the sequential erosion in margins for Resource Industries.

D. James Umpleby - *Caterpillar Inc. - CEO & Director*

Andy, this is Jim. If I can just add, just expand upon Amy's comments. We're really trying to focus on the long term here, and we're focused on improving margins over time to achieve our long-term profitable growth objectives. So there'll be less emphasis on short-term incremental margins and more emphasis on the long term. Having said that, we do expect improved operating margins in all 3 segments in 2018 compared to 2017 on an annual basis.

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

Okay. And then one last one on the backlog growth. When we and others, and you mentioned in the call, do our channel checks, the order to delivery lead times are extending. It seems like some of that is concentrated in Construction Industries, but the backlog was pretty flat. Is there something else going on within Construction Industries that kind of offset the implied build in backlog?

Amy A. Campbell - *Caterpillar Inc. - Director of IR*

So sales for Construction Industries were up 47% in the quarter, and Construction continues to ramp up supply to meet demand. Many of Construction Industries' products are on managed distribution. So with that, they take orders for current month, plus 2 or 3, and so there's not unconstrained demand coming through the backlog. And so that's really the driver of why you didn't see a more significant increase in the backlog for Construction Industries. They do continue to ramp supply up to meet demand, and they're focused on getting every shipment to a customer order and making sure that the customer demands are being met. Does that answer your question, Andy?

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

For the most part. I'll take the rest off-line.

Operator

Our next question today is coming from Joel Tiss.

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

Bank of Montreal. I wondered if the -- if you could talk about the key focal areas of your operational excellence and the simplification. And maybe if you can comment in that same vein on maybe medium term, if that 25% incremental margin that you guys have targeted over the long term would start to change -- would start to move up a little bit.

D. James Umpleby - *Caterpillar Inc. - CEO & Director*

This is Jim. I'll take that one. Yes, as we look at our Operating & Execution Model and operational excellence, there's really a number of elements that we're focused on. In terms of operational excellence, it's safety, quality and lean. So we're very much focused on getting more production out of existing bricks-and-mortar. We talked about that a bit at Investor Day. So we don't anticipate investing in new factories. What we're really doing is meeting the increased demand through lean manufacturing advances. And also, frankly, we have plenty of bricks-and-mortar. And so we did talk about an operating range for all 3 segments at Investor Day. We're very still committed to meeting those ranges based upon the revenue levels that we stated at the time. There'll be fluctuations over time, and we're not just focused on increasing margins, although we're committed to meeting those targets. We also want to grow the business, and so we'll be investing to grow the business while staying within those ranges.

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

And then just a follow-up. Does the tax -- the new tax legislation help you guys reach a settlement any quicker with the government over your long-term tax dispute?

D. James Umpleby - *Caterpillar Inc. - CEO & Director*

Yes. We really can't comment on this. I'm sure you can imagine. It's an ongoing discussion with the government. We're cooperating, and we hope to get to a resolution in an expeditious manner.

Operator

Our next question today is coming from Timothy Thein.

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

Citigroup. Brad or Jim, you spoke earlier to the benefit to Cat's tax rate from the recent tax reform. I'm curious how you're thinking about the potential for some repatriation of what I believe to be is a $5-plus billion of foreign cash. So maybe just some thoughts around that.

Bradley M. Halverson - *Caterpillar Inc. - CFO & Group President of Finance, Human, Global Information Services Division & Corporate Auditing*

Yes, this is Brad. No, thank you. We're really happy with tax reform in a lot of different areas. There's been a lot of good momentum around smart regulation and now tax reform. As it relates to our cash, it gives us a lot more flexibility in our decision-making in terms of how to use that cash. And one thing that we had talked about in terms of U.S. competitiveness is that when you put an added tax on charge of using cash in the U.S., that tends to bias your investments. And so now, basically, that added tax has been removed, and so it provides really a level playing field for our cash. And so we're really happy with where our balance sheet was coming out of the downturn and what's happened this year. We were happy to make that contribution to the pension plan as well as to pay down some debt. It's in really good shape. And if you look at the outlook for 2018, that's positive. We're not going to give any details as to exactly when we will use that. But our priorities, as I outlined in the call, I think remain consistent with our strategy in terms of the credit rating, funding our business and then using it to grow. And the return to shareholders remains important. We've had a very long history of dividend growth, which we're proud of. That remains important. And we view share buybacks in the future. So you probably want a little bit more, but that's where we're at right now.

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

Okay, understood. And then the second is just on the backlog in resources and really what -- kind of the implied profitability of those orders. And I'm wondering if you're seeing any kind of signs of broadening out in terms of order trends by geography and really, by payload in terms of size of the machines. It looks, from an industry perspective anyway, that -- really in this little recovery period, more of the deliveries have been directed more towards regions where Cat's share won't wouldn't necessarily be as favored. So I'm just curious if you're kind of seeing a broadening out to more of the traditional mining regions. So any comments there would be helpful.

D. James Umpleby - *Caterpillar Inc. - CEO & Director*

Yes, this is Jim. So we are seeing increased demand really in all regions in -- for our mining products. That's a positive thing. So it is -- again, we're coming off of very low levels, as you know, but it is a broad -- it started to be broad-based in terms of showing improvement in regions around the world.

Operator

Our next question today is coming from Ann Duignan.

Ann P. Duignan - *JP Morgan Chase & Co, Research Division - MD*

JPMorgan. I'm curious philosophically why you have decided not to provide revenue guidance or at least, revenue guidance ranges by segment. I mean, this is an era where investors, I think, are looking for more transparency, not less. And then as a follow-on to that, I mean, what should we contemplate in our models to get to the low end of your guidance versus the high end of your guidance? Is it a range in revenue? Or is it a range of profitability? Or an inability to get the supply chain fixed? And if you could just talk about what's in the model that you're looking at to get to the low end and the high end.

D. James Umpleby - *Caterpillar Inc. - CEO & Director*

Ann, this is Jim. I'll start, then I'll hand it over to Amy or Brad. Again, consistent with what we talked about at Investor Day, we're moving away from providing sales forecasts, and we try to grow the company profitably over the long haul. And we believe that providing an EPS range is an appropriate way to go. Why don't you take it from there, Amy, and I'll jump back in?

Amy A. Campbell - *Caterpillar Inc. - Director of IR*

Yes. I think if you look at the range of adjusted PPS that was provided, Ann, and I think we were pretty clear about this, really the biggest driver in profit growth is sales volume. And so that's going to have the biggest impact on the sales range, and so your sales assumptions will drive you -- is a key component of driving you to different parts of that range. There's also lots of other variables around cost, price, material cost that could push you at different parts in the ranges as well. But volume is clearly the most significant driver of growth. I would say it's not supply constraints. While we talk about supply constraints and we continue to ramp suppliers and get production up, in the adjusted profit guidance that we provided, supply constraints are not an issue. And we don't expect them to be an issue, I should say. I will step back and say, though, if you look at the overall performance, we expect operating margin for the consolidated company and for all 3 segments to improve from where we ended 2017. And we're looking at, as Jim talked about, the long game, not quarter-over-quarter pull-throughs, but long-term margin performance. And for Cat, that actually puts the operating margin in the ranges we provided at Investor Day at lower volumes. And so I think that's really reflective of strong performance and delivering on the profitable growth that we're committed to.

D. James Umpleby - *Caterpillar Inc. - CEO & Director*

And again, we see sales increasing in all 3 segments. Again, as Amy mentioned, operating margins will increase in all 3 segments as well, 2017 to 2018.

Ann P. Duignan - *JP Morgan Chase & Co, Research Division - MD*

So the ranges in '18 -- I just want to make sure we -- I get this absolutely correct. The ranges for operating performance for each segment in 2018 will be within the ranges you gave at the analyst meeting on lower volumes?

Joseph E. Creed - *Caterpillar Inc. - VP of Finance Services Division*

Yes, this is Joe. So not each segment. I think what Amy was saying there is at the company level, the way it works out, we expect to be in the range, but not every segment will be there. We're working our way towards there by improving year-over-year.

Operator

Our next question today is coming from David Raso.

David Michael Raso - *Evercore ISI, Research Division - Senior MD, Head of Industrial Research Team & Fundamental Research Analyst*

Evercore ISI. The incremental margins for '18, what are you expecting in incremental margins?

Amy A. Campbell - *Caterpillar Inc. - Director of IR*

So we haven't provided an incremental margin guidance, David. If you step back -- and I think I'll repeat what I just said to Ann. It's strong operating performance overall. It's an improvement in operating margin for the company that puts the company operating margin in the ranges that we provided at Investor Day and shows improvement for all 3 segments into 2018. And for Construction Industries, they actually ended the year at the top end of that range. So they're showing a little bit of improvement on top of that.

David Michael Raso - *Evercore ISI, Research Division - Senior MD, Head of Industrial Research Team & Fundamental Research Analyst*

And I apologize to push, but I know that's a scripted answer. But incremental margins, in particular, they were 30% for the equipment company in the fourth quarter, 40% the prior 2 quarters. Can you give us, at least, a perspective of how you expect incrementals to be in '18 versus what they were of late?

Amy A. Campbell - *Caterpillar Inc. - Director of IR*

I think what I can say is that we expect them to continue to deliver strong performance. Early in the cycle, the pull-throughs are strong. And you see, if you look through quarter-over-quarter pull-throughs, they do start to slow down, which makes a lot of sense as you bring production back online. We are committed to investing in growth through the P&L next year, but we still expect strong performance and to continue to deliver good returns, good operational margin increases on the sales growth.

David Michael Raso - *Evercore ISI, Research Division - Senior MD, Head of Industrial Research Team & Fundamental Research Analyst*

And again, sorry to push. But versus the 30% for the fourth quarter, are we expecting to be higher or lower? I mean, it's a simple math. If the 20% -- if incrementals are 25% next year, you're implying sales guide up around 15%. I mean, we can do the math. Just if the incrementals are 30%, it's more like 12.5% top line. So we can do the math. We're just trying to think structurally. Is this more of a revenue year, where, hey, the incrementals are a little bit lower, we're investing in the business? Or maybe a little supply constraint and keep the revenues low, but will also give you a big incremental. I mean, that's -- we're just trying to get a feel. Is the -- are the incrementals similar to the fourth quarter or lower or maybe even higher?

Amy A. Campbell - *Caterpillar Inc. - Director of IR*

So I think it's clear that I'm not going to answer that question directly. Incrementals for the full year 2017 were 40%. That's pretty high. It is -- 2018 is largely a year of sales growth. That's clearly the biggest driver in the profit per share growth. And even with a nice, STIP tailwind, we are looking at investing in the business, investing through the P&L, growing our digital and online offerings, investing in products. And so I don't have an exact answer for you, David, but...

David Michael Raso - *Evercore ISI, Research Division - Senior MD, Head of Industrial Research Team & Fundamental Research Analyst*

No, I appreciate it. I mean, so -- I guess also on revenue growth, if, say, the framework is 25% incrementals, 15% top line and you have a little less Cat Financial income, we get that. The backlog in orders are up roughly about 30% year-over-year. If you can help us maybe with the dealer inventory for '18, what is expected for that so at least we have a sense of that swing?

Amy A. Campbell - *Caterpillar Inc. - Director of IR*

Yes. So dealer inventory, we've been pretty transparent. Ended the year lean. And dealers, we would expect, they would typically grow dealer inventory in the first quarter to get ready for the spring selling season. We'll see if that happens again this year. If you look broadly at the dealer inventory composition, I'd say, in total, we're pretty comfortable with it, but there are a few regions, most notably China, where dealer inventories are low. And so we would expect, in a few regions, for there likely to be some, but not that much material dealer inventory growth in 2018.

David Michael Raso - *Evercore ISI, Research Division - Senior MD, Head of Industrial Research Team & Fundamental Research Analyst*

So -- no, okay, so not that material. Let me go back to 2010 and '11 when you were building. The inventory would go up $900 million. Then, obviously, 2011 and '12 are up notably large. We should not assume $1 billion plus type dealer inventory increase? When you say moderate, sort of in the hundreds of millions. Is that fair?

Amy A. Campbell - *Caterpillar Inc. - Director of IR*

We would not assume as much as we had on those earlier years.

Operator

Our next question today is coming from Jamie Cook.

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

I guess 2 questions. Amy, sorry to push again on 2018, but is there anything you can help us with regards to mix in 2018 versus 2017? Because, obviously, that would have big impact on incremental margins. And then my second question, I know you guys had said some on capital allocation and haven't really changed your strategy. But also in your guidance, you do say our numbers don't assume any share repurchase, which you usually don't put in your guidance. That -- to specify, we're not including share repurchase. So I'm just wondering if you guys are trying to signal something.

Amy A. Campbell - *Caterpillar Inc. - Director of IR*

Yes. So for mix, I'll start there. So if you look at it, there are lots of puts and takes in the 2018 guidance. Really, they largely net out, and it is a sales story. For mix particularly, it's really not very meaningful. Probably slightly unfavorable as we see for Resource Industries, a move to a larger percentage of their sales base being new equipment as opposed to aftermarket parts. So there's just a shift in that sales. But overall, and even for Resource Industries, it's a fairly small negative. In terms of share repurchase, we -- I think we just put that in there to be clear that, in accordance with historical practice, we don't assume share buyback. And I think given the changes in U.S. tax reform and a lot of discussion, we just wanted to be clear on what our guidance is. We don't usually state that, but that's how we've always put the outlook together at the beginning of the year.

Operator

Our next question today is coming from Seth Weber.

Seth Robert Weber - *RBC Capital Markets, LLC, Research Division - Analyst*

It's RBC. I wanted to ask a couple questions on construction. It sounds like your messaging that -- I think in the last quarter call, you kind of messaged that you thought China would be -- had potential to be softer here in the first half -- or first part of the year. But it sounds like, today, you're sort of saying you think China is strong at least through the first half and maybe softens in the back half. Did something change there? Are you more confident on the Chinese construction equipment market?

Amy A. Campbell - *Caterpillar Inc. - Director of IR*

Yes. So -- yes. I'd say we are more confident on the Chinese construction market than we were a quarter ago. We've continued to see that market remain very strong. If you -- we are forecasting industry growth for the 10-ton and above excavator, which are the numbers we normally cite, to be up about 8% next year in the outlook. We were not there just a quarter ago. So I think that's reflective of our continued -- seeing continued strength in the Chinese economy. I will say, if you look at the 2017 sales cadence, it did not follow historical norms. We saw continued acceleration in the industry as the year progressed. And what we've highlighted in the release and in Brad's comments is we don't expect that to repeat, so we would expect China to revert back to more normal sales patterns, with 60% to 65% of sales in the first half of the year and then for that to slow down considerably in the back half of the year. We'll be ready if that's not the case, but that's currently our assumption. We do think that the Chinese market is currently above normal replacement demand and will slow at some point. But our current read on the market is that it's going to remain strong, at least through the first half of the year. Did that answer your question, Seth?

Seth Robert Weber - *RBC Capital Markets, LLC, Research Division - Analyst*

Yes, that's perfect. And if I could just, quickly a follow-up, the more positive view towards North American infrastructure. I think in your prepared remarks, it's the first time you've kind of been able to make that statement in a while. What's driving that? What are you seeing out there that's giving you confidence that that's going to get better?

Amy A. Campbell - *Caterpillar Inc. - Director of IR*

North America construction?

Seth Robert Weber - *RBC Capital Markets, LLC, Research Division - Analyst*

Sorry, infrastructure.

Amy A. Campbell - *Caterpillar Inc. - Director of IR*

North America infrastructure? So we've had FAST Act. That's been in play for several years now. We didn't see really much impact to that in 2017, but our channel checks look like that we're going to start to see some of that spending that was approved at the state and local levels start to come through and drive some infrastructure growth in 2018.

Operator

Our next question today is coming from Steven Fisher.

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

It's UBS. You guys called out the tightness in the supply chain. I wonder if you can just give a little more color on where exactly that tightness is. And what did you actually assume that the supply chain has to do to meet demand just so we're comfortable that you didn't get over your skis with the assumptions this year? Do they need to make some big structural or capacity changes? Or is it just adding shifts? Or what has to be worked out there?

D. James Umpleby - *Caterpillar Inc. - CEO & Director*

Steve, this is Jim. So as I mentioned earlier, we believe we have plenty of internal manufacturing capacity. But as is the case with previous ramp-ups, we are dealing with some constraints in -- with our suppliers, and we're working through those one by one. There isn't any one big issue. It's kind of across the board, and we're working with our suppliers to break our way through those. We do feel confident that supplier constraints will not be an issue that would prevent us from achieving the EPS range, which we put out this morning.

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

Okay. And then can you just frame the $1 billion to $1.5 billion of CapEx a bit more? Because at the midpoint, that would be about a 30% to 40% increase off of your, arguably, low levels. And I know it's still below your machinery depreciation, but you've also said and reiterated just now you've got plenty of capacity. So what's the increase therefore? Is that for automation or efficiency investments? Is it tax benefit-motivated? Can you just kind of frame that a little bit?

Amy A. Campbell - *Caterpillar Inc. - Director of IR*

Yes, Steve. So we have, I'd say, over the last several years, spent kind of $1 billion to $1.3 billion in CapEx. In 2017, it came in a little bit below $1 billion. So some of that is -- we spent a little less than we anticipated in 2017. We thought we'd spend closer to $1.1 billion, $1.2 billion. What's driving that, a lot of that is maintaining the capital, the machines and the facilities that we have. There are capital demands as we restructure and consolidate facilities to put lines in as we are moving production from one facility to another. Those are the largest drivers of the capital increases in 2018.

D. James Umpleby - *Caterpillar Inc. - CEO & Director*

And this is Jim. Maybe just to add some more color to that. Traditionally, we thought about growth at Caterpillar, investing in R&D and investing in capital in terms of building new factories. That's been really the push. And as we expand our horizons here and really push towards services, we'll be investing through the P&L as well. It won't just be capital to try to grow. So it's particularly important as we look at enhancing our digital capabilities and doing other things there as well. Again, we'll be investing through the P&L for growth.

Operator

Our next question today is coming from Jerry Revich.

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

It's Goldman Sachs. Jim, I'm wondering if you can talk about the operate and execute plan. So we really saw the sales variance allocation piece really move the needle for you folks in '17. And as we think about based on what you folks have in the pipeline, what should we look for as being meaningful improvements in the business in '18?

D. James Umpleby - *Caterpillar Inc. - CEO & Director*

Well, really -- again, this is a long-term game, so we're focused on long-term profitable growth. And as you heard us talk about before, it really comes down to us having a more detailed, granular understanding of by product, by application, by market, where we get the best return on invested capital, and we're biasing our resources to those areas that represent the best opportunity for future profitable growth where we get the best returns. And so it's going to be, I think, difficult for you to see -- for us to predict in '18 what you'll see. It's a long-term game. But again, that focus on services, as I mentioned, is very important and will be part of what we're investing in. But it is -- again, it's for the long haul.

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

Okay. And then on the supply chain, you folks were very clear within the contemplated range. You don't anticipate supply chain being an issue. Can you just give us confidence range? If sales are 10% above the high end of the range, would you still feel comfortable with that assessment? If you could just help us understand the confidence band that you have. And you spoke about in the press release improving material flows back half of '17 versus the first half based on your work with the supply chain. I'm wondering if you could just quantify the number of problem components that you're tracking. Or just help us quantify that improvement if you don't mind.

D. James Umpleby - *Caterpillar Inc. - CEO & Director*

Yes. I don't think it would be appropriate for us to give you -- quantify the number of suppliers. But again, I'll just repeat that we're confident that we'll be able to work with our suppliers to get within the EPS range that we've provided. This is not something that's unusual. We've gone through this in the past and will -- it won't be a major problem for us.

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

And sorry, Jim, what if demand is higher than the high end of the range? I guess what's the level of confidence that you could scale up to? Is it 10%, 15%?

D. James Umpleby - *Caterpillar Inc. - CEO & Director*

I'm not going to quantify it. But certainly, if there's more demand out there, we'll do our best to work with our suppliers to satisfy that incremental demand.

Operator

Our next question today is coming from Mig Dobre.

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

It's Baird. I just want to go back to Construction Industries, if we can. And maybe give your view on North American demand, maybe frame that as to how you're thinking about your 2018 outlook versus normalized demand or mid-cycle. And I guess, I'm wondering, in your comment in the slide here that talks about improvement in residential, nonresidential and infrastructure, where do you feel most comfortable that you're going to see the improvement in? What does that mean in terms of equipment mix for you in 2018?

Amy A. Campbell - *Caterpillar Inc. - Director of IR*

So Mig, I'll start with where are we in normalized demand. I think we're trying to get away from calling the cycles. North America sales were up in 2017, and we expect them to be up again in 2018. So we're at healthy sales levels. Where exactly that is in the cycle, I think we're going to hold back from trying to predict that. I would say exactly where are we going to see the strength in 2018, I don't have that broken out between residential, nonresidential and infrastructure. We do see strong demand signals across all 3. I'll say that infrastructure has disappointed us the last couple of years. Hopefully, it won't this year. We'll see how the year plays out. But there's certainly the need and there's certainly the funding out there to fund infrastructure growth. And the other area of strength in Construction Industries is pipeline build-out. And so we're seeing -- which requires a lot of heavy equipment, construction equipment, even some of probably the small-end or Resource Industries equipment. So as pipelines are getting built out in support of the oil and gas activity and there's been a lot of pipelines approved in the last year, that's certainly a key area of growth as well and an area we're seeing really good business.

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

Okay. And that's actually kind of a good segue on my second question. Moving to Energy & Transportation. Maybe a little bit more color on the oil and gas component of that business and your thoughts on Solar going forward.

D. James Umpleby - *Caterpillar Inc. - CEO & Director*

This is Jim. I'll take that one. So as we mentioned earlier, onshore North American oil and gas has been quite strong. It was quite strong in '17, and we expect that strength to continue. Drilling is relatively slow, but well servicing is certainly -- and gas compression is quite strong for us. As we also mentioned, there's a good backlog for solar for midstream gas compression as we look around the world in terms of offshore oil and gas. That's still fairly depressed, and we don't see a major increase in that business in '18. So offshore drilling and offshore Solar Turbines applications will be relatively muted again in 2018.

Operator

Our final question today is coming from Rob Wertheimer.

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

It's Melius. So the question is -- I mean, obviously, your corporate results have been very, very good, especially on margin. The question is on resources, where we, at least, think it's an exceptional business. You have good market shares, and the product runs a lot, so the aftermarket position is structurally good. And you had a great last quarter. Rebound in margin this quarter is down a little bit. I mean, I understand some seasonality to margins. I get it. But is there any abnormal investment in that business that's depressing margin, whether on automation or otherwise? Or what's the cause of that lumpiness that we've seen in the last 2 or 3 quarters?

Amy A. Campbell - *Caterpillar Inc. - Director of IR*

Well, the cause in lumpiness probably has a lot to do with the sales changes, although we did see a sales growth in the fourth quarter. We talked about a little bit of a negative mix there. They moved to a higher percentage of their sales being new equipment as opposed to aftermarket. We also talked about it in the third quarter, and we saw this translate, that they had some pickup in R&D spend for some product programs. We also typically see -- and you talked about this, fourth quarter seasonal cost heaviness as everyone tries to get all their cost out in the quarter. So at those sales levels, I think there is just some lumpiness to the margins. New equipment sales are still really low versus historical standard. We're managing margins, I'd say, to the full year and not to the quarter, and that's really where we're focused at. We expect RI to continue to see operating margin growth in 2018, in line with progressing towards achieving the margin numbers they put out for Investor Day.

D. James Umpleby - *Caterpillar Inc. - CEO & Director*

And just to add -- this is Jim. Certainly, mix has an impact here. So there's a mix issue between parts and OE. So as OE starts to improve, that can have a mix impact, and there's certainly a mix impact among different products within OE. So mix is certainly a big part of it, particularly when you're dealing with lower levels. It's easier to, I think, have a larger shift due to mix.

Amy A. Campbell - *Caterpillar Inc. - Director of IR*

And I think with that, Kate, I think that -- sorry, Rob, go ahead. You can follow up, if you had one.

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

Is it fair to interpret from your comments on resources again about the breadth of the recovery in the customer basis. Your order book kind of widening out as you see people -- I mean, more people bid or quote as opposed to patchy.

D. James Umpleby - *Caterpillar Inc. - CEO & Director*

Well, it's still at relatively low levels, but it's improving. So I'd say we've seen improvement, but it is -- and it is broadening out as well geographically, as I mentioned earlier.

Amy A. Campbell - *Caterpillar Inc. - Director of IR*

And with that, Kate, that needs to be our last question.

Operator

Thank you. Do you have any closing comments you'd like to finish with?

Amy A. Campbell - *Caterpillar Inc. - Director of IR*

No, I think we'll just go ahead. It's the top of the hour.

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.