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EDITED TRANSCRIPT

Q3 2018 Caterpillar Inc Earnings Call

EVENT DATE/TIME: OCTOBER 23, 2018 / 3:00PM GMT

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Caterpillar 3Q 2018 Analyst Conference. (Operator Instructions)

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

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

Thank you, Kate. Good morning, and welcome, everyone, to our third quarter earnings call. On the call today, I'm pleased to have our CEO, Jim Umpleby; our CFO, Andrew Bonfield; 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 express written consent of Caterpillar is strictly prohibited. If you'd like a copy of today's call transcript, we will be posting it to the Investors section of our caterpillar.com website.

This morning, we will be discussing forward-looking information that involves risks, uncertainties and assumptions that could cause our actual results to be different than the information discussed. Details on the factors that either individually or in the aggregate could make actual results differ materially from our projections can be found in our filings with the SEC and our forward-looking statements included in today's financial release. In addition, a reconciliation of non-GAAP measures can be found in the appendix of this morning's presentation and in our release, which is posted at caterpillar.com/earnings.

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

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

Thank you, Amy, and good morning. First, I'd like to introduce Andrew Bonfield, our new Chief Financial Officer. Andrew joined Caterpillar on September 1. Andrew has more than 3 decades of global financial experience. Most recently, he was Group CFO and board member of National Grid plc, a British multinational electricity and gas utility company. Prior to National Grid, Andrew was Chief Financial Officer at Cadbury plc and also served as Executive Vice President and Chief Financial Officer at Bristol-Myers Squibb. We're delighted to have Andrew on board. He's a welcome addition to our company and our executive office. Andrew will walk you through our financial results and -- after I provide a brief overview of our third quarter performance as well as our outlook.

We had an outstanding quarter, thanks to both higher sales and excellent operational performance. Many of our end markets continue to be strong. Sales and revenue were $13.5 billion, an 18% increase over the third quarter of last year. We also earned profit per share of $2.88, which is the highest third quarter profit per share in Caterpillar's 93-year history. This is the third consecutive quarter our company

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has delivered record profit per share. Adjusted profit per share was $2.86, up 47% from the third quarter of 2017.

Third quarter operating profit was about $2.1 billion, 41% more than the third quarter of 2017. Adjusted operating margin for the quarter was 16.6%. That's 260 basis points higher than the third quarter of 2017 and consistent with the first half of this year despite input cost headwinds. These profit levels and margins are due to the excellent work of our global team and demonstrate that our strategy for long-term profitable growth and our discipline on structural costs are delivering measurable performance improvements.

We finished the quarter with $8 billion of enterprise cash. That's after paying more than $500 million in dividends, repurchasing $750 million of Caterpillar common stock and making a $1 billion discretionary pension contribution. In the first 9 months of 2018, we've returned $3.4 billion to shareholders. Our solid operational performance gives us the flexibility to invest in growth and to continue returning capital to shareholders. We intend to continue doing both in a sustained and disciplined way.

Using the Operating & Execution Model as our guide, we will continue to invest in areas that represent significant opportunities for profitable organic growth, especially in services and new and enhanced offerings, which are key components of our strategy. We also continue to look at nonorganic growth opportunities, but we'll do so in a disciplined way.

Let me walk you through some examples of how we're investing for future growth. We continue to deploy more digital service offerings in autonomy and automation technology for mining. We're collaborating with a gold-mining customer in Nevada, supported by our local Cat dealer, to automate underground loaders and enable machine operators to work safely and efficiently from a control room on the surface. We're improving existing technology and accelerating deployment of new features.

We're also working with a mining customer in Western Australia, where we've secured a deal for the first commercial installation of a retrofit kit to enable autonomous operation of competitor mining trucks using Cat MineStar Command for hauling. With this Cat system, customers can operate different brands and sizes of trucks, both manned and autonomous, in the same space and scale up fleet size to meet the mine's needs. Our autonomous solutions are demonstrating significant productivity improvements for our customers.

We also continue to roll out expanded product offerings to meet the diverse needs of our customers. Last month, we expanded the articulated dump truck lineup by reintroducing the 40-ton size class with a new Cat 740 GC model that incorporates proven features and performance, including new controls and systems for transmission protection, stability assist and advanced traction control and a fuel-saving eco mode. Just last week, we unveiled several new Cat mini hydraulic excavator models in the 1-to-2-ton and 7-to-10-ton size classes. These mini HEXs are part of our next-generation excavator rollout that began in 2017. We believe these new models provide the best performance, versatility, safety, operator convenience and affordability in these size classes. With these machines, we're also reaching out to a broader customer base, to local and regional contractors who may be in the market for their first yellow iron Cat machine.

These examples of digital technology, services and expanded offerings are part of our mission to help our customers, both current and future, be more successful with Caterpillar than with any of our competitors.

Now for the outlook. Our profit per share outlook for the year is $10.65 to $11.65, and we've maintained the guidance given last quarter for adjusted profit per share in the range of $11 to $12. We expect normal seasonal patterns for sales growth in the fourth quarter and also expect to continue our strong operational performance.

As we discussed with you last quarter, Caterpillar participates in diverse end markets. Many of our end markets are in the early stages of recovery, while others are experiencing robust demand. We feel good about the state of our business. We continue to monitor end market fundamentals and will provide 2019 guidance in January.

Currently, we believe favorable commodity prices, strong economic growth and the global need for infrastructure will continue to drive strong end user demand across many of our end markets. More specifically, we believe economic fundamentals, attractive oil prices and the need for oil and gas infrastructure are positive for construction industries in North America.

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For Asia Pacific, while sales for CI remain strong across the region, we continue to monitor China demand to determine the trajectory of future sales. For the remainder of 2018, we expect normal seasonal trends for China. In EAME and Latin America, we are seeing positive signs for CI in most countries, but there have been some recent areas of weakness, which we believe will be contained.

For Resource Industries, robust economic growth and infrastructure investments are driving strong demand in heavy construction applications, which we expect to continue. While our global mining customers' sales are improving, the recovery is still in the early stages, and we expect higher demand for new equipment moving forward.

Energy & Transportation is our most diverse segment and serves a wide variety of end markets. Current oil prices are positive for E&T. Sales in the North American compression and well service applications remain very strong. While there have been takeaway capacity issues in the Permian Basin, we are seeing increased activity across other basins and expect production in the Permian to grow after the capacity issues are addressed. Demand for new equipment for onshore and offshore drilling as well as offshore oil and gas production remained weak.

We continue to see positive momentum in power generation. The North American rail market is also showing signs of recovery. Total carloads improved, and stored locomotives are down from a year ago. We are seeing an increase in activity for new locomotives as well as demand increases for rail services and locomotive rebuilds.

In summary, we feel good about the fundamentals of many of our end markets despite the presence of geopolitical risks and global trade tensions. We're focused on a strong finish to 2018, and we'll share more about our 2019 outlook in January.

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

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

Thank you, Jim, and good morning, everyone. First, I just wanted to say how excited I am to join Caterpillar. In particular, it's great to be here today to share such an impressive set of results with you.

Let's start by turning to Slide 3, and I will discuss the third quarter financial results in a bit more detail. Sales and revenues were $13.5 billion, up 18% from last year, with continued growth across all 3 of our primary segments. While many of our end markets continued to improve, North American economic strength and oil price stability drove higher levels of construction activity as well as higher demand for well servicing and gas compression equipment. In addition, Resource Industries machine sales were up significantly.

Third quarter profit per share of $2.88 and adjusted profit per share of $2.86 are up 63% and 47% from a year ago on higher sales, improved operational performance and disciplined resource allocation. As Jim noted, this was a record third quarter profit per share performance, and these results demonstrate that our strategy is working.

If we move to Slide 4, I'll walk through what drove the 41% increase in operating profit. As you can see in the chart, higher sales volume contributed $793 million more operating profit compared to last year. Price realization was $155 million or about 1% higher than the third quarter of last year. Manufacturing costs increased by $205 million due to higher material and freight costs. In all, material costs were up about 2% on higher steel prices and the impacts of tariffs.

Freight costs continue to be elevated due to a variety of factors, including higher rates, less efficient loads and expedited freight costs as we ramp up production to meet increased demand. Even though the midyear price increase had only a partial impact in the quarter, the drag of higher input costs and tariffs was just $50 million more than price realization. We are also continuing to look for operational efficiencies to reduce the impact further. We expect that this effort plus the benefit of the midyear price increase will further moderate the impacts of material and freight costs in the fourth quarter.

SG&A and R&D costs were up $77 million in the quarter. That's an increase of 5% compared to an 18% increase in sales and revenues. Jim gave a few examples of how we are investing that money to drive long-term shareholder return, but this cost discipline is a key factor in improving our operating margins.

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Financial Products was favorable by $36 million as the core business continues to perform well with higher financing rates, a favorable impact from returned or repossessed equipment and higher average earning assets in North America and Asia Pacific. While past dues increased this year, this is largely isolated to a few customers in Latin America experiencing economic challenges and in the Cat Power Finance portfolio. Overall, we believe the portfolio remains healthy.

The adjusted operating margin for the quarter was 16.6%, which is on the high end of our Investor Day range and 260 basis points higher than the third quarter of 2017.

Now let's look at the performance of each segment, beginning with Construction Industries on Slide 5. Sales were $5.7 billion in the third quarter, an increase of $0.8 billion or 16%. CI sales increased across all regions, except Latin America. Sales in North America were up almost $0.5 billion, and North America drove about 60% of the total third quarter sales growth. Much of this was driven by oil and gas-related projects, including pipelines, and other nonresidential construction growth.

Asia Pacific sales were up 19% or $239 million, with the most significant increase continuing to be from China. In the quarter, our dealers in China were able to restock from very low to more normal levels of inventory. We continue to expect industry sales for 10-ton-and-above excavators to be up about 40% for the full year. Since there has been some speculation about our level of sales in China, I wanted to clarify that the Construction Industries sales in China range from 10% to 15% of total segment sales, and China accounts for 5% to 10% of total company sales and revenues. Outside China, most of the countries in the Asia Pacific region had higher sales on broad economic strength.

Overall EAME sales were up 10%, and Latin American sales were down slightly. While higher demand for infrastructure and building construction activities in both of these regions were broadly favorable, isolated economic uncertainties in Turkey, South Africa and Argentina did have a negative impact on these markets in the quarter.

Turning to profit. CI segment profit increased by 20% over last year to $1.1 billion. Operating margin was 18.6%, which is higher than the Investor Day range as Construction Industries continues to demonstrate the power of the Operating & Execution Model to allocate resources to grow profitably and control costs.

Let's move to Slide 6. The Resource Industries team also turned in another great quarter. RI sales were $2.6 billion, up 35% from the third quarter of 2017. Sales for new equipment increased across all regions, and demand for aftermarket parts remained strong to support overhauls and maintenance. In fact, this was the highest quarter for sales since the fourth quarter of 2013.

Our mining customers are placing orders for new equipment as commodity prices remain above investment thresholds. However, our customers globally continue to focus on improving the productivity and efficiency of their existing machine assets, thereby delaying full fleet replacements. In addition to the recovery in mining, strong global economic growth and infrastructure investment also contributed to higher sales for heavy construction equipment.

Segment profit of $414 million was up 81% versus third quarter of last year. Segment operating margin improved to 15.7%, at the top end of the Investor Day range of 12% to 16% and up 400 basis points from 2017. RI's improved performance and margin expansion is primarily due to higher sales, improved price realization of more than 4% and the operating leverage gained through significant restructuring and the team's disciplined cost management. These gains were partially offset by higher manufacturing costs, including freight and material costs, and higher SG&A and R&D expenses to invest for profitable growth.

Now let's turn to Slide 7, where we will discuss Energy & Transportation. E&T sales in the third quarter were $5.6 billion, 15% higher than the same quarter last year, with sales increasing across all applications, except industrial. Sales into oil and gas applications were up by $297 million or 28% as we continue to see strength in onshore activity in North America, especially for gas compression and well servicing applications.

Power generation sales increased by $204 million or 23%, driven primarily by sales of reciprocating engines to support data center and

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power plant applications as well as higher aftermarket parts sales. Industrial application sales were down 2% largely due to economic activity in Turkey. However, sales in North America and Asia Pacific increased slightly over the third quarter of last year. Transportation sales were up 12%. The sales growth continues to be driven by recent European and Australian rail service acquisitions and higher North American rail traffic.

Segment profit for Energy & Transportation was $973 million, up $230 million from the third quarter of last year. The segment margin improved by 210 basis points to 17.5%, which is also at the high end of the Investor Day range. E&T's profit improvement was mostly due to the higher sales volume, but this was partially offset by higher manufacturing costs and increased SG&A and R&D expenses.

I want to spend a few moments discussing cash flow, which is shown on Slide 8. Our ME&T operating cash flow was about -- was $848 million for the third quarter, and we finished the quarter with $8 billion of enterprise cash on hand. Operating cash flow in the quarter was $237 million higher than last year, reflecting the higher profits but after taking into account a $1 billion discretionary pension fund contribution. This pension contribution gave rise to a favorable tax deduction and also provides cash flow flexibility for the next 3 years.

As Jim mentioned, we continued to return capital to shareholders, with $511 million of dividends paid and the repurchase of $750 million of Caterpillar stock in the quarter. We remain committed to investing to profitably grow our business. Our current operational performance has provided the added benefit of strong operating cash flows to a solid balance sheet. We intend to use this flexibility to both invest for growth and to continue returning capital to shareholders in a disciplined way.

Resource allocation with long-term profitable growth will remain the highest priority. One of the many reasons I came to Caterpillar was my belief that the discipline created by the Operating & Execution Model is the right way to evaluate opportunities and lead us to drive long-term profitable growth. In addition to profitable growth, our capital allocation strategy will remain focused on sustainable dividend growth and being in the market for share repurchases on a more consistent basis. We expect share repurchases in the fourth quarter to be at least $750 million, bringing the total buyback to at least $2.75 billion for the year. As we have said in the past, we will be more opportunistic and look to go beyond that, depending on market conditions and investment priorities.

Let's move to Slide 9. Our profit per share outlook for the year is $10.65 to $11.65, and we are maintaining our second quarter guidance of $11 to $12 for adjusted profit per share. We have not updated the adjusted profit per share outlook range because nothing material has changed since we updated the outlook in July. Since our assumptions have not changed and the third quarter came in about where we expected, we believe it makes sense to maintain that outlook for the full year.

Order rates and the backlog remain healthy, with the backlog up almost $2 billion from the third quarter of 2017. Construction Industries remains on managed distribution, and production rates for large machines and large engines continue to increase with demand. We believe the increase in dealer inventory in the quarter reflects current end user demand and, in some regions and in some products, was necessary to improve availability to the end customer. As measured by months of sales, dealer inventory ended the quarter at the low end of historical averages. So in short, we feel good about the state of our business.

And with that, I will turn it back to Amy to begin the Q&A portion of the call.

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

Thank you, Andrew. Kate, it is now time to begin the Q&A portion of the call. (Operator Instructions) .

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question today is coming from Joe O'Dea.

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

It's Vertical Research. First question. Jim, your comments across end markets were pretty constructive and encouraging. And I think we see kind of a disconnect in where we're seeing a stock reaction to what seems like kind of an outlook right now that would continue to

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support further growth moving forward. I guess one question just on backlog and seeing that nudge down a little bit sequentially. Any commentary across segments and whether or not some of this is lead time-related, some of this is just general macro uncertainty, but seeing a slight softening there versus what sounds like otherwise pretty strong end market conditions?

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

Maybe it makes sense just to spend a few minutes expanding upon how we're doing in each of the markets. We talked about Construction Industries and that we continue to see very strong demand in Asia Pacific, particularly in China, but also in North America and EAME. Again, in Energy & Transportation, very strong activity in onshore gas compression, well servicing. Industrial is also strong. We don't see -- we haven't experienced a slowdown. Much have been written about the Permian, but we have not experienced a slowdown in our business. It's still going quite strong. And people have talked a lot about the fact that there are takeaway capacity issues. And of course, whenever pipelines are built, that's a good thing for our CI business as well. So again, we feel bullish about that business. Heavy construction in Resource Industries continues to be strong. In rail, we've seen an increase in locomotive rebuilds and modernization. We've also seen higher service and parts sales. Rail traffic in North America certainly increased, and we've seen a year-over-year reduction in the number of idle locomotives and railcars. So we expect new locomotive orders to continue to improve. We've seen some business from outside the U.S. as well. We have talked about the fact that Latin America is a bit slow to recover in Construction Industries, and offshore oil and gas production has been slow. But again, we feel good about the state of our business. We feel that the business continues to be strong in most of our end markets. And we're not, frankly, concerned about dealer inventories or backlog, and I want Andrew to comment on that.

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

Yes. So -- I mean, obviously, we did see the backlog go down by about $400 million in the quarter. But remind you that for the year-to-date, it is still up nearly $2 billion since the third quarter of last year. At the same time, obviously, we were building inventory into dealers. We still are at the bottom end of normal ranges, so -- even though the dealer inventory has gone up over $2 billion since the beginning of the year. So that's all indicative of dealers having confidence. And obviously, the $800 million stock build or inventory build in the quarter was a lot less than the drop in order backlog. So that does mean that strong demand -- overall, dealers are still sitting positive about end consumption.

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

Appreciate those details. And then just a follow-up related to price/cost and general outlook for price/cost moving forward, whether or not price/cost should actually shift more favorably moving forward, looking at pricing announcements next year into dealers, material costs stabilizing and whether we see any kind of improvement on some of the constraints with supply chain and materials and whether all that translates to a little bit more favorable price/cost situation moving into the end of year and then into next year.

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

Yes. On pricing, we are starting to see the impact of the midyear price increase, and we expect price realization to more than offset material cost and freight expense for the full year. We recently communicated to our dealers a 1% to 4% price increase that will be effective in January of '19. We are working our way through supply constraints. And again, we feel good about the environment for pricing, as I mentioned, moving forward.

Operator

Our next question today is coming from Ross Gilardi.

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

Bank of America. Jim, how do we think about the retail numbers that came out last night? I mean, you were up 21% in September, but your comp, I think, goes from being up 13% in September to up 34% by the end of the year in December. So as you exit 2018, are we looking at low to mid-single retail -- low to mid-single-digit retail sales growth? And is that what's implied at the midpoint of your guide?

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

I'm not going to make a comment and give you a forecast for retail stats. But I've talked about the end state of our markets and the fact that we feel good about those. Based on everything we see today, we expect our business to continue to improve in 2019.

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

Okay. What's the feedback you're getting from the miners on some of the elevated uncertainty in China? I mean, are there any RFPs out there that have been put on the back burner until things settle down with the trade situation? And what are you seeing on large mining equipment demand from non-China emerging markets as well?

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

Again, as I mentioned earlier, the Resource Industries business continues to improve. Truck levels are now at the lowest level they've been since 2012. There are still more trucks to bring back online, but it's contributing to strong aftermarket demand. And we're seeing strong parts demand to support increases in machine utilization. So we certainly feel good about the trajectory of our mining business. Commodities such as copper and gold have been strong. RI has experienced growth across all regions. So again, we do feel good about RI. Market fundamentals seem to be improving and are quite solid.

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. I know on China, you said you expect the normal seasonal pattern for the rest of 2018, but really curious how you're thinking about China in 2019. It seems like we're heading back in infrastructure stimulus mode there. So do you see any evidence of that having a positive impact on sales or quoting it? And does what they have announced so far in this regard sound meaningful enough to support ongoing growth in the construction equipment business there for you?

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

Just a few general comments about China. Certainly, it's an important market for us. It averages 5% to 10% of total company sales and revenues. And for CI, it's about 10% to 15%. There's a lot of different scenarios, of course, forecasting what's going to happen in China. Based on everything that we see, we believe that the China market will continue to be healthy. Excavator demand is up significantly this year after it more than doubled last year. And again, we feel good about China for next year.

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

Okay. And in terms of the resource business, how should we think about the margin trajectory there going forward as the original equipment sales continue to pick up? I mean, you didn't really call out the margin mix on the margin result this quarter, which came in a little bit lower than our expectation. So has that mix shift even noticeably started yet? And if it does, can that be offset by any more advantageous price versus cost?

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

Yes, I'd urge to caution both in -- particularly in RI and in E&T, in looking at quarter-to-quarter margins. Both of those businesses tend to be very lumpy, so we expect quarter-to-quarter variations in margins up and down. And so what we really suggest you look at is our year-to-year improvement, which is what we're really focused on doing. We talked about our targets for margin expectations at Investor Day, and we're towards the top end of those or above those. So again, we feel good about that as well.

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

But have you seen that impact yet -- start yet on the mix shift between OE and aftermarket? Or is that still mostly ahead of us?

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

I would say that in terms of new equipment, we expect that to improve moving forward. So we are certain to see activity for new equipment, and we expect that to continue to improve. And if you step back and think about where we've been from a historical perspective, we are still below averages. Not much as comparing to the peak, but we have a long way to go to improve on OE for mining.

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

Okay. So the margin mix might change, but you're going to still see bigger dollars ahead, it sounds like.

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

Yes. And one of the things also, keep in mind, is for next year, we have -- we're going to have a STIP tailwind that's going to have a positive impact in all of our segments as we reset STIP for next year. That's also out there as well. It's another tailwind to keep in mind.

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***

And Andrew, welcome to the fun world of industrials. I guess 2 questions. One, Andrew, for you specifically. Can you just talk about sort of what your top priorities are as CFO of Caterpillar and, while Cat's answered some questions on short of share repurchase, how you guys are thinking about being more opportunistic on share repurchase given where your stock price is today and, perhaps, the market's view of what's going on with the macro versus yours and your ability to earn a higher-trough EPS? And then my second question, Amy, or I'll try -- you guys sound fairly constructive as we think about '19 and in terms of volume without specifically stating a number. But are there any material positives or negatives we should think about, whether it's stock comp, repo, restructuring benefits, dealer inventories, as we think about '19 versus '18?

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

Yes. So thanks, Jamie, and yes, it's great to be here. And yes, it is always exciting to see such a good set of results be put out in front of you guys today. Priorities, I think you shouldn't be surprised. Obviously, the things about making sure that we execute the O&E Model particularly well as we move forward. Resource allocation, in particular, obviously needs to be something we keep a focus on to make sure we drive that profitable growth that we're trying to target and achieve, so working with Jim and the other members of the executive office to do that. Obviously, again, you mentioned about capital allocation. That is something which, again, obviously, I know a lot of investors have a lot of focus on. Obviously, we have the $10 billion buyback approved by the board. That will obviously be a key focus as we move forward. Obviously, we need to think through how we manage the balance sheet through the cycle. That's something which I will work on and look to as we move forward. But obviously, as we've said and we indicated again, we will be opportunistic and go above the $750 million, obviously, at times where we think the share price is below intrinsic value, which is what it is at the moment.

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

And I'll jump in, Jamie, and take on the question you had for Amy. So on '19, obviously, it's too early for us to provide a lot of specifics. As I mentioned earlier, we expect our business to continue to improve in '19 versus '18. There's a lot of puts and takes, where we take price realization along with the reset of STIP and continued cost discipline to offset cost headwinds. And we have a healthy backlog, good order rates, and we're taking orders for some products well into 2019. We feel good about the state of our business, and frankly, we expect both the top and the bottom line to improve in 2019 versus 2018.

Operator

Our next question today is coming from Ann Duignan.

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

JPMorgan. My question is around dealer inventories. I know you said we're at the low end of months of supply or -- based on historical metrics. But historical metrics may not be the right way to look at dealer inventories for Caterpillar because in prior cycles, dealers double ordered and ordered just in case, and then we were delaying strategy, et cetera, et cetera. So Jim, how do you reassure investors that this cycle is different, that your dealers are not double ordering or ordering ahead of price increases or ordering because just in case?

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

Yes. We've worked very hard over the last couple of years on getting more lean internally and also have looked at our supply chain. Obviously, our dealers are independent businesses, so they make their own decisions as to what they do. But we do feel, based on the strength of the markets, that we don't have an issue in terms of dealer inventory. I'll let Andrew jump in here as well.

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

Yes. And just to, yes, give you a comment, I mean, I'm actually really impressed by the amount of data that the company actually does have on dealer inventory. You might want to go back to look at my background at Bristol-Myers and why I would be very focused on that because that was the wholesalers in that particular point in time. But I do think, a, first of all, the visibility is important. Actually, in absolute dollar terms, it's -- things look relatively low versus other parts in the cycle, and it is something that is very well monitored, so I think -- as best as it can be, as Jim said, because, obviously, the dealers are independent. But it does give us confidence that there isn't any excess inventory build. In fact, actually, what's happened in the last 3 months is as we've ramped up production effectively, we are now getting into a situation where dealers actually have enough inventory that they are able to sell-through. So that's an important part of what we've been doing.

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

And much of CI still is on managed distribution, as you probably know, and much of the CI increase, restocking in China, for example, is off of very low levels. So again, we feel comfortable with what we see.

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

Good. That's helpful. And then is there any color you could give us as we look at Europe and the Middle East? How much of that region is Middle East? And any changes that you're seeing due to political unrest in the Middle East that's currently going on? Is that -- anything we should be concerned about going into 2019?

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

At this stage, I mean, the bit where we did see some impact in the Middle East area is really around Turkey. And that was -- obviously, they've had a fair amount of economic uncertainty. Elsewhere, actually, through rest of Europe and most of rest of the Middle East, actually, things were pretty much okay. So it's really, really been Turkey that's been the big driver of uncertainty around that region.

Operator

Our next question today is coming from Andrew Casey.

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

Wells Fargo Securities. If I could go back to Ann's last question there in EAME, did you see any moderation in any of the EU countries? And then separately, can you explain why you think the weakness, and it sounds like it may just be Turkey, why do you think that will be contained?

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

Well, firstly, I mean, obviously, the -- Turkey has been, obviously, going through a fair amount of economic uncertainty. Obviously, with U.S. sanctions as well being applied, that has had some impact on the broader economy in Turkey. I think we saw it -- hopefully, see that moderate now as we move forward and hopefully start seeing Turkey recover. Around rest of Europe, if you look around rest -- I mean, U.K. sales were sort of flattish in the quarter as would be expected with uncertainty there. But Jim really -- actually, the rest of EAME actually was pretty good, and Europe was actually pretty strong as well.

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

Okay. And then I just wanted to confirm something. So we've had several quarters where construction remains on managed distribution. Can you comment on whether the constraints you may be still encountering are part of Cat's internal suppliers? Or is it mainly external? And really, what I'm trying to get to is if there's any change in past comments about CapEx remaining beneath depreciation.

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

Andy, there is no change. And so Construction Industries has plenty of bricks-and-mortar capacity to meet demand, and the issue has been with suppliers. And I'm sure you know it isn't just Cat and our competitors, but manufacturers in many different industries have struggled with just the general increase in economic activity and what that's driven in terms of demand. So no, it's not internal, and you shouldn't take anything away from a capital investment perspective based on that.

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Operator

Our next question today is coming from David Raso.

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

Evercore ISI. Basically, I'm just trying to figure out the confident comments that you seem to be having about 2019 that you've made. I'm trying to understand why we still have $1 EPS range in the fourth quarter. I'm just trying to understand. You obviously seemed fairly comfortable in your production schedules moving forward. And if I heard you correctly, it seems like the fourth quarter sequential versus third quarter, you would expect some normal seasonal patterns in your sales. So I guess maybe first, if you can confirm that. Because the dollar range in the fourth quarter, I appreciate the comment, nothing's changed since our prior review, so we just figure we maintain it. But it does, at least, raise the question. Your confidence in '19 to leave $1 range for the fourth quarter is interesting. So I guess, first, can you confirm that you expect normal sequential sales patterns, third to fourth? And then...

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

So David, let me be as clear as I can be. Obviously, yes, we do expect normal seasonal sales sequential patterns in the fourth quarter. If you look at our margin structure for the year, year-to-date, it's 16.6%. In the third quarter, it was 16.6%. We expect margins to be broadly similar as well. So that is very much in line with where we've been expecting. And on the range, I think changing the range would have sent some sort of message about something had changed since July. We were very clear in our thought process, but we actually just wanted to be very clear to you all and say nothing's changed. Our expectations of our outlook have not changed, and so we just wanted to reflect that through the guidance. Yes, it is a wide range, yes, but nothing really much has changed since where we were in July. So narrowing it may have created some noise either at the bottom end or the top end, so we just thought it'd be better to leave it as is and explain it on the call today.

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

No, I appreciate that. I'm just trying to think of a launching pad into '19 because if your sales are up their normal 6% to 7% sequentially third to fourth and the margins are the same, that means the fourth quarter EPS is above third quarter. And your guidance implies it's not. So I'm just trying to understand. You sound comfortable. It's just the numbers don't fully back it up. And you're just saying you're still within the range. It might be the high end of the range, but you decided to just keep it as a wide range.

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

Yes. I mean, we -- yes. If you do the math as you've done it, then you would see the quarters being up. I think that our view is the range is wide. Yes, we don't expect to be at the bottom end of the range. So I think that's -- and based on what we're expecting, we expect the normal sales pattern and operating margins to be broadly in line with where they've been all year.

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

And lastly, on the price increases announced to start 2019, the impact of those, can you just help us a little bit? I mean, if there -- it seemed to be they're not price-protected shipments. So I'm trying to get a sense of the price/cost as we start 2019. Can you help us a little bit with that on the timing of the cost versus the timing of the price as we start '19 for a run rate?

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

Yes. I mean, I think we are -- obviously, we did get quite a long lead time partly so that we can actually put it into effect. We expect a significant proportion, a majority of that portion to stick, obviously, into 2019. But obviously, when we're doing a sort of initial guidance for next year, we're taking into account that not all of that will be fully realized in the 2019 time frame. So we'll give you a bit more of an update and a bit more color then. And also, don't forget, we will have the full year benefit of the midyear price increase in 2019 as well.

Operator

Our next question today is coming from Jerry Revich.

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

It's Goldman Sachs. Can you talk about the M&A pipeline and the relative attractiveness of M&A versus buyback to you folks at this point? You mentioned stocks below the intrinsic value, but how does that stack up versus your M&A options? And as you folks look at the balance sheet today, the cleanest it's been in over 30 years, what do you think is the right level of leverage for this business longer term?

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

Yes. This is Jim, and I'll start it off and let Andrew jump in at the end if he would like. But you mentioned M&A and buyback. So the other thing we can also do is invest in organic growth, which we are very much doing. So all of our businesses continuously evaluate M&A opportunities. We're continuing to do that. We're not excluding anything. We're not saying that there's a definitive plan for a big M&A either. We are very focused on organic growth, particularly in areas of services and digital. We're increasing our capability there. And I'll let Andrew take the buyback question.

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

Yes. Jerry, on the sort of what's the right level of leverage. I'm 7 weeks in, so I think if you would excuse me just patching that out for a little bit longer because, actually, it's one of the things I want to work through and work through how do we think about this through the cycle, which is what we do have to do. We do want to maintain the Mid-A rating through the cycle, so we have to think through that and how that capital allocation works. Obviously, at the moment, we do have more cash than we inherently need. So therefore, we are, as you've seen, accelerating the buyback program. And that is, obviously, the key at the moment.

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

Okay. And you folks gave us good color on new dealer inventories of new equipment. Can you just talk about what you're seeing on the used equipment side? I guess we're seeing used inventories inching up in North America construction equipment. Are you seeing that as well? Can you just talk about your comfort level on the used side?

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

Yes, Jerry. I think if you looked at used equipment, the inventories are quite tight, and we're seeing increases in used equipment prices continue.

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

Any color by region, Amy?

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

I don't have any specific color by region. It's certainly the case in North America, where I have most of that data.

Operator

Our next question today is coming from Stephen Volkmann.

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

It's Jefferies. Just a couple quick follow-ups. Just back to the resource, if we actually do sell more equipment next year than parts, can you still have up margin?

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

Yes. I'm not sure we said that we'd sell more new equipment than parts. I mean, what we said is that equipment mining and Resource Industries, correct?

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

Yes, that's the question.

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

Yes. So both are improving. So our parts sales are increasing as are the opportunities for new equipment as well. So I'm not going to make a -- we're leveraging -- obviously, leveraging period costs. We're seeing higher volume, and that's a good thing. So I'm not going to make any comment on margins, new versus parts.

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

Okay, fair enough. And then just a couple quick ones on tariffs. I know you've been managing that quite well so far. What happens when and if, it looks like more of an if -- sorry, when, the tariffs go to 25% on the Section 301? What type of impact would that have? And then are you either doing or seeing from your customers any kind of prebuy activity around that whole issue?

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

So we previously stated that our -- we would -- in the last 6 months of the year, we'd have cost headwinds of $100 million to $200 million. We're going to be at the lower end of that range, we believe. We haven't seen a big prebuy, but of course, we're in a situation where, as you know, we've had some constraints. And so we've been on managed distribution. So the -- we don't expect a major impact as, quite frankly, we were already hit with the earlier tariffs. So we don't think a later change will have an impact on us. It was already baked in for us.

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

And are you buying any parts ahead of changes in pricing?

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

Well, again, we're in a situation where, as we talked earlier, there's a supply constraint challenge not only for Caterpillar and our competitors but for many other manufacturers as well. So I don't think anyone has, honestly, has the luxury of making a lot of big prebuys, so no.

Operator

Our next 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 Research. And thank you for the prior answer. If I could just get a little bit more specific on it. I mean, obviously, tariffs are remaining big uncertainty for the market and estimates. Is it -- what you just said, is that meant to suggest that if there is 25% on the additional $200 billion of goods tariff, that that would be at or smaller than the impact you had this year? We just sort of can't see all the different things you and your sub-suppliers buy. So obviously, you've got a lot more information on qualifying that than we do.

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

Yes. So the impact would be quite minor in the bigger scheme of things for Cat's results.

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

Okay. Okay, perfect. And are you doing any material sort of production mitigation where you produce more in Brazil or elsewhere to offset that? Or is it just straight minor on a gross basis, like either the stuff with tariff isn't as large in the second round for you?

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

We're not making a lot of production shifts. I mean, our team is obviously continuously monitoring the situation. And as you know, it can -- with politics you get together, the situation can change dramatically day to day. So we have not made production shift decisions based on this. But just expanding on that, we have a global footprint, so we have the luxury of -- unlike some other companies. We manufacture products in Asia, in the Americas, in the EAME, so that does help us mitigate this somewhat because we do have a global manufacturing base.

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Operator

Our next question today is coming from Sameer Rathod.

Sameer Rathod ***Macquarie Research - Analyst***

Macquarie Research. Just one quick question on labor cost. It seems like there's growing political pressure for $15 per hour, and we've seen some response to that already. Can you quantify how much of an impact, if any, it would be on cost in terms of Cat if Cat paid at least $15 an hour to its manufacturing staff?

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

Yes. For the most part, it's not going to have an impact on us. And we are above $15 in the vast majority of places here in the U.S., so I don't see an impact on us.

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. So just 2 quick ones. You guys are running now near the top end of your Investor Day margins, and I just wondered if there's more kind of like leaning toward raising those targets. Or are we kind of passing the maximum point of the internal efficiencies and you're more comfortable just leaving them in place?

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

So as we talked about, we're focused on growing our business as well. So while our teams are continuously focused on making our operations more efficient, we're also investing for growth. So there's always a balance there between those margins and growth. But we're pleased that we are ahead of where we said we would be from a time perspective. And our team has a laser focus on those margins. But again, there's a balance between investing for growth. We just don't want to continue to bring that higher margins every year at the expense of growth. However, right, if we can both grow and have higher margins, then that's fine as well. So again, it's a balance.

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

Okay. And then just...

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

I mean, if volumes -- sorry, so one comment. I mean, certainly, if volumes go up, obviously, that gives us an opportunity to have higher margins because we're leveraging that overhead across a higher volume. So that opportunity certainly exists.

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

And then, Andrew, there's always been kind of this historic, inside of Cat, a push and pull between growing market share and having more pins in the map and profitability. And I just wondered, based on your experience and history and all that, if you -- what would be your initial input into that to be?

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

Yes. I think let me just say we've -- the history is littered and -- of companies who've either gone for market share at the expense of margins and/or they've gone for margins at the expense of market share. Ultimately, at the end of the day, we want to do both, and it's all about trying to do profitable growth. I think that is really one of the reasons why I joined. I love the term profitable growth and the fact that it does mean that you actually have to do focus not just on growth and profits but actually sustainable long-term profitable growth. So ultimately, at the end of the day, you want to do both is the simple answer.

Operator

Our next question today is coming from Chad Dillard.

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

From Deutsche Bank. I just want to go back to the $800 million increase in dealer inventory. Can you give a little bit more detail by segment and by region where the increase came from? And then where do you expect that to exit 2018?

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

Yes. I mean, I'm not going to break down the $800 million for you by region. But as we said, one of the biggest areas where it was, was in China. And as a result of the selling season in second quarter, there was a very strong pull in, in China. Overall, across all segments, we are comfortable, but we still remain at the low end of the range. And then obviously, as with the production ramp ups, we are starting to get to a situation where dealers have adequate inventory on hand. So again, I think rather than getting to the sort of then start and to give you an update exactly where the inventory is, the inventory is across all the segments. There was build across all segments in the quarter. But generally, we are comfortable with where we've ended.

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

That's helpful. And then just switching over to the price. You mentioned a 1% to 4% increase in 2019. How does that break down across your various segments? And then also, the thing that jumped out at me with was the 4% price increase in Resource Industries. And I was just curious whether it's more of a mix issue or you're actually getting price on an apples-to-apples basis, and if so, has the market tightened up, so that's sustainable?

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

Yes. So at this -- yes, again, the price realization in RI is a lot due to mix and -- versus the prior year. With regards to the 1% to 4%, we're not going to break it down by segment, but basically, it depends geographically, and it depends on business segment as to what the price increases were put through.

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

Kate, that's going to have to be our last question. Jim, do you have a couple of wrap-up comments?

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

Well, just thanks, everyone, for your time this morning. I just wanted to end by saying I'm very, very proud of the Caterpillar global team for the record profit per share for the third consecutive quarter. And we continue to deliver record quarterly profits even while many of our end markets are still in the early stages of recovery. We'll continue with the relentless execution of our strategy, supporting our customers' success, very focused on profitable growth and total shareholder return. We look forward to speaking with you all next quarter. Thank you.

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

Thank you, Jim.

Operator

Thank you, ladies and gentlemen. This does conclude today's conference call. You may disconnect your phone lines at this time, and have a wonderful day. Thank you for your participation.

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