OVERVIEW:
Co. reported 4Q19 total sales and revenues of $13.1b, operating profit of $1.85b and adjusted profit per share of $2.63. Expects 2020 profit per share to be $8.50-10.00.
CORPORATE PARTICIPANTS

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D. James Umpleby  Caterpillar Inc. - Chairman of the Board & CEO
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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Caterpillar 4Q 2019 Analyst Conference. (Operator Instructions)

It is now my pleasure to turn the floor over to your host, Jennifer Driscoll. Ma’am, the floor is yours.

Jennifer K. Driscoll  Caterpillar Inc. - Director of IR

Thank you, Paul. Good morning, everyone. Welcome to Caterpillar’s fourth quarter earnings call. Joining us today are Jim Umpleby, Chairman of the Board and CEO; Andrew Bonfield, CFO; Kyle Epley, Vice President of our Global Finance Services Division; and Rob Rengel, Senior IR Manager.

Our call today expands on our earnings release, which we issued earlier this morning. You’ll find slides to accompany today’s presentation, along with the release, in the Investors section of caterpillar.com under Events & Presentation. For retail stats, look at our 8-K filed a few minutes after that.

As shown on Slide 2, any forward-looking statements we made today are subject to risks and uncertainty. We also make assumptions that could cause our actual results to be different than the information we discuss today. Please refer to our recent SEC filings and the forward-looking statements reminder in today’s news release for details on factors that individually or collectively could cause our actual results to vary materially from our forecast.

Let me remind you that Caterpillar has copyrighted this call. We prohibit use of any portion of it without our prior written approval.

As previously indicated, today we’re reporting adjusted profit per share in addition to our U.S. GAAP results. Our adjusted profit per share for the fourth quarter excludes a pension OPEB mark-to-market adjustment for the remeasurement of pension and other post-employment benefit plans.
The adjustment was $0.65 per share in the fourth quarter or $0.64 per share for the fiscal year. Our adjusted profit per share for the full year also excludes the $0.31 discrete tax item from the first quarter of ’19.

In the 2018 fiscal year, adjusted profit per share excludes restructuring costs, in addition to both tax-related and pension OPEB mark-to-market adjustments. Our U.S. GAAP-based guidance for 2020 profit per share includes estimated restructuring costs for the year and continues to exclude pension and OPEB mark-to-market impacts.

Now let’s turn to Slide 3 and turn the call over to Jim for his perspective on 2019 and our outlook for 2020.

D. James Umpleby - Caterpillar Inc. - Chairman of the Board & CEO

Thanks, Jennifer. Good morning, everyone. Thank you for joining Caterpillar’s fourth quarter earnings call. I plan to cover 3 topics this morning: First, I’ll summarize our fourth quarter and full year 2019 results. I’ll also provide an update on the progress of our enterprise strategy as well as some color on how the year ended versus our Investor Day targets. I’ll finish with our expectations for 2020.

I’m pleased with the way our team is executing, notwithstanding the difficult economic environment, which led to a decline in sales to users during the fourth quarter. I'll describe the segments later in here in the call, but just to give you a brief overview: Sales to users for all 3 segments were lower than our expectations. In Resource Industries, we continue to see strong quoting activity in mining as most commodities remain at investable levels, but customers are being cautious due to global economic conditions. While we experienced a decline in mining sales in the fourth quarter, we continue to believe there will be a gradual recovery in our sales to mining customers. Our mining sales are lumpy, so there can be significant variation between quarters.

Energy & Transportation was a mixed bag due to the diversity of our end markets. North American onshore oil and gas activity remained depressed. As we expected, both solar and rail had a solid fourth quarter. In Construction Industries, end-user demand has softened, particularly in North America. As our earnings guidance indicates, we see some slowing across all 3 primary segments. We are ready to respond quickly to positive or negative developments in our end markets.

We’re doing what we said we would do at our Investor Day in May by achieving our financial targets, continuing to invest in services and expanded offerings and returning cash more consistently to shareholders. Sales and revenues for the fourth quarter declined 8% versus our assumption of down mid-single digits. Volume, primarily caused by changes in dealer inventory, drove a majority of the decline. Dealer inventory for the quarter decreased $700 million compared to an increase of $200 million in the prior year’s quarter. End-user demand, which we released this morning, was also softer than we anticipated, down about 4% versus our assumption of flat end-user demand for the quarter. Price realization and currency were unfavorable for the quarter as well.

Our fourth quarter operating profit decreased 2% driven primarily by the lower volume. We increased our operating profit margin percent through disciplined cost control and stronger results from financial products. For the fourth quarter, adjusted profit per share was $2.63 compared with $2.55 in 2018.

Turning to Slide 4. Sales and revenues for the full year declined about 2% mainly driven by the movements in dealer inventory. Dealer inventory increased $800 million in 2019 versus an increase of $2.3 billion in 2018. End-user demand increased about 2% for the year. The other 2 sales drivers, namely favorable price realization and unfavorable currency, essentially offset each other.

For the full year, operating profit was flat on nearly $1 billion lower sales and revenues. The volume reduction was offset by strong cost control. Favorable price realization more than offset manufacturing cost increases.

Turning to profit per share. We ended 2019 at an adjusted profit per share of $11.06 compared with $11.22 for 2018.

Now I’ll summarize our 2019 results versus our Investor Day targets and the progress we made this past year executing our strategy, as shown on Slide 5. In operational excellence, we’re pleased to report we achieved our best safety performance on record. We delivered a solid operating
margin of 15.4% on $53.8 billion of sales and revenues. Our operating margin finished well within the target ranges we set at our Investor Day last May, which you may recall was an improvement of between 3 and 6 percentage points above the historical margins we delivered in the 2010 to 2016 period. Our free cash flow of $5.3 billion was also within our Investor Day target range.

We returned $6.2 billion or about 115% of our 2019 free cash flow to shareholders in dividend and share repurchases. That includes the 20% dividend increase we announced at Investor Day, which reflected our confidence in the company's ability to deliver improved cash flows through the cycles and our intention to return substantially all free cash flow to shareholders. We reduced our quarterly average diluted shares outstanding by about 9% since the first quarter of 2018.

Our services revenues increased 2% and were around $18 billion in 2019. We indicated during our Investor Day in May that our path to doubling services revenues to $28 billion from our 2016 baseline would not be linear. And we continue to invest in services, including expanding our digital capabilities to meet this target by 2026.

Please turn to Slide 6. At the center of our strategy is profitable growth. We made good progress this year on all 3 elements of the strategy: operational excellence, expanded offerings and services.

Beginning with operational excellence. As I mentioned earlier, we achieved our best safety performance on record. Yet even one injury is one too many as we want all of our employees to go home safely every day. We're proactively managing our production levels, and our lead times are now at targeted levels for the majority of our products. This allows us to respond more quickly to both positive or negative changes in demand. Shorter lead times also allow our dealers to carry less inventory, which helps dampen the overall impact of economic cycles.

Turning to expanded offerings. One of our most successful areas in our GC line, where we've launched 6 new models in 2019 or 11 new models to date. These new GC products, including excavators, articulated trucks, motor graders, wheel loaders and paving products, have broadened our product line to provide customers a full range of choices when determining the best machine for their various applications.

In Energy & Transportation, the team launched large generator sets that burn lean methane created as a by-product of the mining process. The CAT G3516C uses methane that could otherwise be vented to the atmosphere, thereby reducing the mine's greenhouse gas emissions. These engines are capable of burning relatively low concentrations of methane while reliably providing the engines full power at high efficiency. Customers appreciate the value of uncompromised engine performance over a wide range of gas quality.

Finally, we reached some significant milestones with autonomous solutions in 2019. We continue to believe we're at a tipping point for adoption of autonomy in mining. In 2019, the number of mining trucks running Cat's autonomous solutions rose to 275, an increase of 48% over 2018. Our autonomous solutions are now working for 7 customers across 11 sites on 3 continents. Some customers have reported productivity benefits of up to 30% and have also reported positive enhancements to safety. Our customers are focusing on improving performance across their sites, so we expanded our automated solutions to include a broader portfolio of trucks, drills, tractors and underground mining products.

We know many of you will be in Las Vegas at CONEXPO in March and at MINExpo in September. We look forward to showcasing many of our new products and services at these exhibitions.

Services are a very important element of our strategy. In 2019, one of our primary goals was to improve parts availability to minimize customers' downtime. We are helping dealers better forecast customer demand through advanced analytics, which enables them to improve parts availability. Services are a key differentiator for many of our businesses, particularly when we help customers avoid unplanned downtime.

In 2019, we achieved our target of connecting 1 million assets by year-end. Thanks to investments we've made during the past several years, we now have one of the largest fleets of connected assets that's in the industries we serve. Connected products, such as Cat and non-Cat assets provide rich data, including operating hours, location and product health, enabling customers to better manage and plan their maintenance. Having critical mass in connectivity enables us to work with customers in a very personalized way. Connecting assets also improve dealer capabilities, such as remote troubleshooting that can reduce technician time and provide increased customer uptime. We'll continue to connect new products coming out of our factories.
Turning to Slide 7. Today, we established 2020 profit per share guidance of $8.50 to $10 compared with our 2019 adjusted profit per share of $11.06. Our planning assumptions for Machinery, Energy & Transportation are that dealers will reduce their inventories by about $1 billion to $1.5 billion, that end-user demand will decline by about 4% to 9% compared to 2019 and that services sales will grow modestly. Global economic conditions are very fluid due to a variety of factors. We will continue to closely monitor our environment and be ready to respond quickly to positive or negative changes in demand.

Our 2020 outlook includes normal restructuring as well as a $200 million placeholder for strategic restructuring actions. We plan to address a small number of products that are not delivering sufficient OPACC and to ensure we’re allocating resources towards those areas with the best opportunity for future profitable growth.

Meanwhile, we will continue to invest in services and expanded offerings to improve the value Caterpillar and our dealers provide to our customers. Andrew will provide more details on the outlook assumptions later in the call.

Our cash flow remains strong. During 2019, we paid dividends of $2.1 billion. As we said at our 2019 Investor Day, we expect to increase our dividend by at least a high single-digit percent during 2020, continuing our heritage as a dividend aristocrat. We repurchased $4 billion of common stock in 2019. We expect continued strong cash flow in 2020, and share repurchases should be roughly similar to 2018 and 2019 levels. This is in line with our commitment to more consistently return substantially all free cash flow to shareholders.

In 2020 – turning to Slide 8. In 2020, we continue to execute our strategy for profitable growth. In the area of expanded offerings, we plan to roll out 5 additional GC models this year as we continue to invest in new products. Within operational excellence, we are focused on improving our cost structure with a focus on back office and procurement costs.

Finally, in services, we will continue to invest in our digital capabilities so we can fully leverage our connected assets and are investing in other areas such as customer-focused designs.

Now let me close by sharing our industry expectations for 2020 on Slide 9. In Construction Industries, we expect slowing end-user demand. In North America, while we expect stable spending on state and local infrastructure, residential and nonresidential construction is expected to decline.

Turning to Asia/Pacific. We expect our sales in China to be flat to down 5%. We are actively monitoring the coronavirus for any potential impact. We expect EAME construction activity will be flat to slightly up, with growth in Europe slowing and Africa and the Middle East beginning to recover from low levels. The recovery in Latin America should continue, although from a low base, led by Brazil. As a result of these conditions, we expect that dealers, particularly in North America, will further reduce their inventories.

For Resource Industries, we expect end-user demand to be roughly flat. In nonresidential construction, we anticipate lower 2020 end-user demand. In mining, we expect mid- single-digit growth for end-user demand as quoting activity continues to be positive and commodity prices generally remain supportive of investment. Customers remain cautious and have more flexibility on order timing due to our improved lead times.

We continue to believe there will be a gradual recovery in sales to mining customers. We anticipate Resource Industries sales will be softer in the first half of 2020, with possible upside in the second half as mining confidence improves. As a result of these conditions, we expect dealers will further reduce their inventories.

Turning to Energy & Transportation. We expect modestly lower overall demand. In oil and gas, we expect end-user demand to weaken in North America for well servicing, recip gas compression and drilling. Oil price volatility and capital discipline by our customers are both contributing factors. Solar sales are expected to be flat to slightly up in 2020. Industrial demand is expected to decline modestly mainly led by Europe. We expect power generation and transportation to grow modestly this year.

With that, I will turn the call over to Andrew for a closer look at our financials.
Thank you, Jim, and good morning, everyone. I'll begin on Slide 10 with total company results for the fourth quarter. I'll cover the segment results for both the quarter and the full year. Then I'll walk you through our 2020 guidance and close with some comments on cash flow and capital deployment.

In total, sales and revenues for the fourth quarter declined by 8% to $13.1 billion. Operating profit decreased less than sales and was down 2% to $1.9 billion. Adjusted profit per share for the quarter increased by 3% to $2.63, mostly reflecting the benefit of the lower-than-expected tax rate. Note that this year's adjusted profit per share results include restructuring expense whilst last year's excludes it. Mark-to-market adjustments were similar in both periods, about $470 million in 2019 and about $500 million in 2018.

As you see on Slide 11, sales decreased by $1.2 billion in the quarter. This result was below our expectation of a mid-single-digit decrease in sales in the quarter. While price and currency was slightly unfavorable, the primary factor was a 7% decrease in volume.

As we've discussed in the third quarter, we expected dealers to reduce their inventories partly due to our improved lead times, which allow dealers to hold less inventory; and partly due to uncertainty in the global economy, resulting from trade tensions and other factors.

This morning, we released the quarter's retail sales data, which showed a decrease in retail sales to users of 4%. We had anticipated that retail sales across all 3 primary segments would be flat, but Construction Industries sales to users declined by 3%, Resource Industries declined by 10%, and Energy & Transportation sales to users declined by 3%. This weaker-than-expected end-user demand meant that whilst we cut back our shipments to dealers, dealer inventories came down by $200 million less than we expected or around $700 million in the quarter.

This $700 million reduction in dealer inventory compares to a $200 million increase in dealer inventories in the fourth quarter of [2018] (corrected by the company after the call). The movement in dealer inventories, together with the reduction in end-user demand, explain the volume decline in the quarter.

Order backlog was weaker at the end of the year, down $900 million across the segments. I know many of you focus on backlog. However, I want to remind you that except for our direct businesses, mainly solar and rail, the backlog represents dealer demand. That means it takes into account dealers' view of what inventory they need to hold in addition to their expectations of end-user demand. We view our retail sales data as a better indicator of demand over backlog. And whilst there's a lag, we believe retail sales data better represents underlying customer behavior.

In addition to sales to users, we have other indicators of customer health. For example, we look at past dues at Cat Financial, which actually improved in the quarter. That said, we saw a small uptick in repossessions of equipment in units and in dollars. Auction prices and used prices are seeing downward pressure. These factors, plus the low retail sales, gives us a very mixed picture. We will, therefore, stay prepared for an acceleration or deceleration in demand.

Moving to Slide 12. Operating profit for the fourth quarter fell by 2% to $1.85 -- $1.85 billion. These figures are on a like-for-like basis as both years include restructuring expense.

Let me walk you through the changes in operating profit before discussing the changes in operating margin. Volume was the largest reason for the decline in operating profit. Price was also negative due to geographic mix and programs we started to stimulate demand. Favorable material and freight costs were offset by adverse warranty expenses, which continue to impact us. As we said in October, we had some targeted product quality issues, which we're continuing to address.

Favorable short-term compensation expense and better cost control had a positive impact on operating profit in the fourth quarter. Finally, Financial Products had a strong quarter too. These tailwinds more than offset the negative impacts on operating margin I mentioned a moment ago. This meant that the operating margin improved by 100 basis points quarter-over-quarter.

Now let me discuss the individual segment's results for the fourth quarter and full year. First, on Slide 13. Fourth quarter sales of Energy & Transportation declined by 5% driven by weakness in oil and gas and lower intersegment sales. Slowing demand for reciprocating engines in North...
America, used to power gas compression applications, and lower turbine project deliveries contributed to an 11% decrease in low oil and gas sales. We saw a 5% increase in transportation as marine sales in EAME improved. Power generation and industrial sales also improved slightly in the quarter.

The segment’s fourth quarter profit increased by 8% driven by lower short-term incentive expense and lower manufacturing costs, which more than offset the impact of the volume decline. Segment operating margin improved by 240 basis points to 19.6%.

For the year, Energy & Transportation sales decreased by 3%, reflecting slower sales in oil and gas and lower intersegment sales. However, segment profit remained about flat in 2019 as the lower sales volume was offset by reduced short-term incentive expense. The segment margin improved to 17.7%, an increase of 40 basis points versus 2018.

Now turning to Slide 14. In Construction Industries, sales decreased by 12% in the fourth quarter due to lower volume. Dealers in North America and EAME carried on adjusting their inventories. We continue to see Latin American sales increase off a low base, while Asia/Pacific remained about flat. Within Asia/Pacific, unfavorable price was mostly offset by higher volumes in a few countries. Sales in China rose in the fourth quarter driven by dealers’ desires to build inventory ahead of an earlier Chinese New Year.

The segment’s fourth quarter profit margin were 170 basis points to 13.1%. The volume decrease and low price realization were partially offset by savings from material costs and short-term incentive expense. The unfavorable price realization reflected changes in geographic mix that we had anticipated, including reductions in dealer inventory in North America and some programs we put in place to stimulate end-user demand.

On a full year basis, Construction Industries declined by 3%. Margins finished at 17.4%, a healthy level, yet a decrease of 60 basis points versus 2018. The decline was driven by the impacts of volume, manufacturing inefficiencies and an unfavorable mix of products, partially offset by favorable price realization.

Changing to Slide 15. Resource Industries sales decreased by 14% in the fourth quarter due to reductions in dealer inventories and lower end-user demand. Dealers decreased inventories in the fourth quarter of this year after increasing their inventories in the same period of 2018. The inventory reductions taken in the fourth quarter were primarily related to nonresidential construction to better to align end-to-end user demand.

Turning to mining. We’ve seen continued disciplined CapEx spend by miners and have experienced longer delays between deal signings and the placement of orders. Lower volume was the primary driver of the 340 basis point decrease in the segment’s profit margin to 10.9% for the quarter. For the full year, Resource Industries sales were about flat. Profit margin improved by 30 basis points to 15.9% as favorable price realization offset the impact of increased manufacturing costs, including high warranty expense.

Moving to Slide 16. We were pleased with the results from Financial Products, which increased its profitability by $181 million in the fourth quarter versus a challenging quarter a year ago. A lower allowance rate in 2019 was the main driver of the improvement. Past dues were down at the end of 2019 as well. The Financial Products segment’s profit rose by $327 million for the full year to $832 million.

Free cash flow for the quarter remained strong at $1.9 billion. We saw a significant reduction in our inventory levels in the fourth quarter as we reduced production levels in our plants. For the full year, free cash flow was $5.3 billion, excluding the discretionary pension contribution made in the third quarter.

Now I’ll talk about the outlook on Slide 17. I’ll share the full year outlook, a few key planning assumptions and some observations on phasing in 2020. We anticipate profit per share of $8.50 to $10 in 2020 compared with an adjusted $11.06 in 2019. The range reflects current uncertainty in the global economy, which is causing customers to delay or defer purchases of large capital goods. We no longer give sales guidance, but I would like to share a few of our planning assumptions which we have used to drive our profit per share guidance for 2020.

First, we’re assuming low end-user demand of between 4% and 9%. We expect ME&T services revenues to increase modestly as we continue our journey towards $28 billion in 2026. The full year guidance we put together also assumes that pricing is about flat and that dealers would decrease their inventories by between $1 billion and $1.5 billion in 2020. Keep in mind that dealers are independent entities and control their own inventories.
Given the slowdown in customer demand and the increased availability of product due to lower lead times, we do expect dealers will reduce their inventory levels further. This reduction is expected to be led by Construction Industries but will also impact Resource Industries. I will talk a little bit more on how we expect dealer buying patterns to impact our phasing in 2020 in a moment.

As Jim has said, we will make sure production is scaled to meet demand, and we are ready to respond to signals from the market positively or negatively. The top and bottom end of the profit range roughly correspond to the top and bottom of the ranges for declines in sales to users and dealer inventories. We expect material costs to decline this year, including the impact of lower steel prices, procurement savings and lower freight. We also expect the increases in warranty costs to moderate in 2020. We're committed to doing all we can to maintain a competitive and flexible cost structure, and we’re tightly controlling discretionary spending.

As part of that, we’re moving toward the outsourcing of some of our back-office functions, which is expected to produce run rate savings beginning in the fall. We’re also working to improve our procurement processes as a way to reduce direct and indirect spending. These changes are not immediate as we realize benefits after new contracts begin and better prices flow through into inventory.

Last year, restructuring expense was $236 million, slightly above our expectation. This year, we expect normalized level of restructuring expense. In addition, we’re looking at taking strategic restructuring actions relating to certain products that are not realizing sufficient OPACC. We put a $200 million placeholder for that in our guidance, and we’ll keep you updated through the year as we gain more certainty around the actual costs. Keep in mind that we also expect a headwind from normalized incentive compensation expense in 2020.

We’re committed to delivering our Investor Day targets of improving operating margins by between 3 and 6 percentage points throughout the cycle compared with our historical performance in 2010 to 2016. We believe that our 2020 plan will enable us to deliver this, while at the same time, continuing to invest in the greatest opportunities to drive long-term profitable growth. Based on the lower tax rate in 2019, we now expect the effective tax rate for 2020 to be around 25%.

As you build your quarterly earnings models for 2020, I want to remind you of a few things that may impact our normal seasonable patterns. Overall, dealers increased their inventory by $1.8 billion in the first half of 2019. This occurred principally in Construction Industries and Resource Industries. We expect a modest increase in dealer inventory in Construction Industries in the first quarter ahead of the normal selling season. That will be worked down by the end of the first half. In Resource Industries, dealer inventories rose in the first half of 2019, but we expect a modest reduction in the first half of 2020.

Energy & Transportation has a different seasonable pattern with sales and revenues in solar and rail being more back-end loaded. We expect oil and gas sales to be impacted in the first half as we had a significant backlog of orders at the beginning of 2019, which is different from the current situation. As a reminder, reduced volume also impacts leverage so that will be a factor in the first half of the year.

Moving on to cash flow and capital structure on Slide 18. Working capital improved in the fourth quarter as we reduced levels of inventory held by the company. We expect working capital to be neutral to positive in 2020. The reductions in Caterpillar inventory, together with an expected lower payout of short-term incentive compensation, should help offset the lower operating profit. Recall that the 2019 payout was against the results for 2018, which was a record year. We also do not anticipate any U.S. pension contributions in 2020.

CapEx in 2019 was $1.1 billion. We expect CapEx in 2020 to be around $1.2 billion. Our commitment at the Investor Day was to improve our free cash flow by between $1 billion and $2 billion through our historical performance in 2010 to 2016. This, together with a strong cash position, which was $8.3 billion at year-end, has enabled us to increase the quarterly dividend by 20% this year and be in the market more consistently for share repurchases. As Jim noted, we’ve returned $6.2 billion of cash to shareholders in 2019 through dividends and share buybacks. We remain committed to returning substantially all of our free cash flow to shareholders through the cycles. As we look ahead, we expect to increase the dividend by high single digits in 2020 and the next 3 years after that, and based on our expected strong cash flow, to repurchase a similar level of shares in 2020 as we had done in 2018 to 2019.
So finally, let’s turn to Slide 19 and recap today’s key points. 2019 sales and revenues declined by 2% to $53.8 billion. Operating profit was down 2%, and profit per share totaled $10.74 or $11.06 on an adjusted basis. We’ve established a 2020 outlook range of $8.50 to $10 profit per share based on expectations for end-user demand to decline between 4% and 9%.

Our top line modeling assumption reflects $1 billion to $1.5 billion of low inventory -- low revenue from dealers further reducing their inventory levels. We’re keeping a close eye on production so we can respond quickly. We’re working on the competitiveness of our cost structure, and our operating and execution model remains at the center of everything we do.

We will continue to invest in services and expanded offerings. Our overall financial position remains strong, and we expect strong cash flow in 2020 as well. We remain committed to our strategy of profitable growth and deployment of capital back to shareholders through a growing dividend and consistent share repurchases.

With that, I’ll hand the call back to Jennifer.

Jennifer K. Driscoll - Caterpillar Inc. - Director of IR
Thank you, Andrew. We will now move to the Q&A portion of the cost. (Operator Instructions) Paul, please begin the Q&A.

QUESTIONS AND ANSWERS

Operator
(Operator Instructions) And the first question is coming from Ann Duignan of JPMorgan Securities.

So many questions. I don’t know how to pick one. But I think I’ll focus on pricing. If you could just expand on your flat pricing guidance for 2020, where are you seeing pricing improvement versus pricing degradation? And then you said you increased your marketing programs in Q4 to stimulate demand, but it doesn’t look like it’s happened. So if you could just talk about pricing across the businesses and across the regions, I’d appreciate it.

Andrew R. J. Bonfield - Caterpillar Inc. - CFO
Yes. Thank you. It’s Andrew. Yes. So a couple of factors within Q4. As I mentioned, one, geographic mix was a factor as well. So obviously, if you think about the way we price, and particularly North America is a stronger pricing region, and so that geographic mix, given the reduction in inventory, came through on the price line. We expect that to continue as we do reduce deal inventory through 2020. That -- so that will have an impact on pricing, particularly as you look at that mix through the year. So probably, actually, in first half, pricing will be a little bit weaker than we see -- expected for the second half.

We have put modest prices increases through. Obviously, we need to see how much of that sticks again, and how much we have to put back into programs. Yes, your point about we didn’t see much demand being stimulated, yes, because we did see a reduction in sales to users on the fourth quarter. We believe that our having not actually put that pricing behind, that they may have actually been a little bit worse than that. So that was part of the programs being put in place.
I'm sorry. I didn't fully understand your North America question -- answer. You said pricing is stronger in North America or price reductions are greater in North America.

No. It's the geographic mix. So we have -- as you go through and if you look what's in our pricing line, it includes changes in geographic mix. We base it on a rate per unit. And obviously, North American units tend to have a higher price and prices are because they're higher specced than prices across the rest of the world. So therefore, you do tend to then see a negative price variance coming through as a result of that with low new North American sales.

And just so I'm clear, China pricing is down year-over-year? Is that the expectation going forward? And is it contained to China?

I don't think we've said anything about China pricing. We're talking about China sales. We said we expect China sales to be down to flat to slightly down in 2020. We haven't talked about pricing by territory or market.

And the next question is coming from Joe O'Dea of Vertical Research Partners.

I wanted to ask about retail sales. And when we look at the trends, it looked like a rather sharp sequential slowing from 3Q into 4Q. And you commented that it was a bigger step-down than you expected. But just in terms of how you interpret those trends and based on conversations you're having with customers and dealers, the degree to which you're able to parse out how much of that is a bit of a spend freeze at the end of the year, the degree to which you have any insight based on January versus noting kind of December demand levels is something that we should be extrapolating going forward.

So really, you have to look at it by our various industries. There's no kind of one answer that covers all of those. And we talked about the fact that in mining, that business can be quite lumpy, and that can be reflected in both our sales and our retail stats as well. Activity in mining continues to be strong, a lot of discussions with customers, lots of quotes. But our customers are being cautious, as we mentioned earlier, but we do expect that slow gradual increase to occur in mining. And we're expecting a stronger 6 months than -- the last 6 months of the year to be stronger than the first 6.

In oil and gas, we do anticipate the depressed market conditions in North American onshore production to continue in well servicing, recip gas compression and drilling. We do expect that to continue.

CI is a bit of a mixed bag. Again, we talked about our expectations there for CI. I really don't have anything to add on top of that.
And the next question is coming from Ross Gilardi of Bank of America Merrill Lynch.

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

Jim, you know this oil and gas business that Caterpillar has a bit better than anybody. And I'm just wondering how your spare parts and service for E&T, both upstream recips and turbines, how they're behaving? I mean were they stable in the fourth quarter? And are you expecting them to be stable within your outlook? I mean, clearly, the new equipment outlook is very soft. But solar has traditionally been able to weather a lot of these downturns. And I'm wondering if you expect the parts and service components of your oil and gas business to remain resilient, particularly in an oversupplied natural gas market.

D. James Umpleby - Caterpillar Inc. - Chairman of the Board & CEO

Yes. Starting with solar. As we indicated, solar had a solid fourth quarter, both on the OE and on the service side. And we do expect their service sales going forward to remain resilient. That's been proved many, many times. So we do expect that to be the case.

We had mentioned a number of times over the last year that there's a bit of a pent-up demand for oil and gas parts for rebuilds that resulted in increased sales in 2017 and 2018. So with the pressure on North American oil and gas, that business will remain challenged through 2020.

And the next question is coming from Jerry Revich from Goldman Sachs.

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

I'm wondering if you could just expand on your decremental margin assumptions. It looks like you're embedding 35% decrementals, give or take, in the '20 outlook. And when we look at your decrementals in the last sales downturn, they were generally in the 20% range. So I'm just wondering if you could just bridge that. Is that to give yourselves room to execute in a challenging environment? Can you just share the pieces just to bridge us between the historical decremental margin performance versus the target for '20?

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

Yes. Great question, Jerry. It's Andrew. Thank you very much for it. The -- this is exactly why we don't talk about incrementals and decrementals anymore. What we have done obviously through the last downturn, the company took out a significant amount of structural cost. And as we've gone through the last couple of years, where we've seen an up-cycle, we have not put that cost back in the business. What that meant, obviously, as margins improve, absolute margins improve over time, which is why we gave the Investor Day targets of improving margins by 3% to 6% against historical performance.

On the way down, obviously, you are -- because we are not -- we don't -- haven't put a lot of structural cost back in, there's not a lot of structural cost to cut. So you will see obviously higher deleverage as you go down. Also, because we're expecting this relatively to be a pause rather than some fundamental change in the market, we are continuing to invest in both services and in R&D, particularly for new NPI, new product introductions. That is important for us because that drives long-term growth. So we maintain the flexibility.

How we are managing it is we are managing against those margin targets. We look at the absolute margin to make sure we stay within that 3% to 6% range against the level of sales and revenues we’re expecting next year. And we do believe the plan we've got does do that.
And Andrew, can you just expand maybe a little bit on the variable cost structure part of that discussion? Because more variable cost structure would suggest lower incremental and decremental margins. So I appreciate the comment on we have less restructuring opportunities now. But maybe you can expand on that point because that would sound like it would reduce the cyclicality in operating leverage?

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

Yes. So obviously, volume is going to have a major impact next year as we go through. Obviously, that is the biggest single factor. And obviously, operating leverage is a factor in the margin.

With regards to the other parts, so -- I mean, obviously, we're expecting pricing to be about flat next year. We are expecting some favorability in material costs, as I mentioned, particularly around steel and also because of some of our programs we put in place. How much of that feeds through into margins next year will depend about how quickly we get those programs through out of inventory and actually into sales.

We're also expecting lower freight next year. Freight costs have been high for the last couple of years, and partly because of obviously trying to meet end-user demand. But now with lead times being in a better place, we don't expect as much premium freight to occur.

D. James Umpleby - Caterpillar Inc. - Chairman of the Board & CEO

And maybe just to expand on that answer just a bit. One of the things that Andrew mentioned earlier is we're really paying a lot of attention to end-user demand. And our dealers are independent businesses, but we're working with them to ensure that we don't have too much dealer inventory. And in the past, I'd argue that some of our cyclicality has been exacerbated by movements in dealer inventory. So by shortening our lead times, having dealer inventory that is appropriate for market demand, we believe that we will have a dampening effect on our cyclicality, which is part of what we're trying to accomplish.

Operator

And the next question is coming from Seth Weber of RBC Capital Markets.

Seth Robert Weber - RBC Capital Markets, Research Division - Equity Analyst

I wanted to ask about the China construction market. I know you mentioned your expectations for the market to be kind of flat to down. Cat has been picking up share there recently over the last few months. I'm just -- can you speak to your expectations for Cat, particularly what's been driving the market share gains? Have you sort of changed tack with some of your marketing programs? Is there a new product that's kind of gaining good acceptance? And can you just talk broadly about your expectations relative to the market?

D. James Umpleby - Caterpillar Inc. - Chairman of the Board & CEO

Yes, what we indicated, I believe, is that we expect our sales to be flat to slightly down in 2020. We talked earlier about the fact that we're continually introducing new products as part of our expanded offering strategies, GC products. And certainly, a big part of that targeted customer audience is in China. We continue to build out our dealer network, continue to build out our footprint there, along with connected assets and all the other things we're doing. We believe that we're well positioned to compete in China moving forward.
Seth Robert Weber  -  RBC Capital Markets, Research Division - Equity Analyst

Okay. Sorry. So Cat is flat to down. Is that better than what you’re seeing for the market then? I thought that was a market commentary.

D. James Umpleby  -  Caterpillar Inc. - Chairman of the Board & CEO

I believe it’s roughly similar.

Operator

And the next question is coming from David Raso of Evercore ISI.

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

My question’s about EPS guidance, but can I go about it related to the dealer inventory swings? So the inventory reduction this year, you’re targeting midpoint, $1.25 billion. But the headwind for you is actually greater on a year-over-year basis, right, because the inventory went up $700 million last year. So we’re looking at a $1.95 billion drag year-over-year. But the way you spoke to the inventory sequentially, it appeared, and correct me if I’m wrong, almost all of that $1.95 billion, a very large majority of it, that year-over-year drag is really concentrated in the first half of the year. Is that correct?

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

David, it’s Andrew. Yes, that is correct.

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

So when I think about the EPS cadence, right, pricing a bit of a struggle to start the year, the big inventory swing for the full year is really focused on the first half. That sort of sets up for the inset. I’m just trying to figure out then -- I mean, normally, the first quarter, the last, whatever, 20 years, the median, it’s up a little bit from the fourth quarter. Your fourth quarter was on the high side. So is it fair to say it’s -- that’s not the case this year? We start low in the first half. The first quarter’s below 4Q and then it climbs from there? I’m just trying to get a sense of how much is the main and...

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

Yes. So part of the reason why I tried to talk a little bit about the phasing for next year is, yes, do not expect the historic trends to prevail. Yes, as you know, normally, first quarter is a relatively strong quarter, always a strong quarter from a margin perspective as we build inventory heading into selling season. And then, obviously, the second half is slightly weaker than the first half. But that is the normal pattern, both from the sales and revenue and also from a profitability perspective.

Your assumptions you’re making are fairly accurate based on what we’re seeing. We do expect deal inventory to have an impact on the first half. As I said, CI will see some build in Q1, but that should be broadly flat by Q2. RI will see a steady decline through the first half of the year versus a build last year. So that is the likely outcome as we move. And so yes, you can’t just -- you won’t be able -- just to be able to use the seasonal trends as a plug-in new model, I’m afraid.

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

And just to be clear, Jim, last year, obviously, the inventory reduction was a little disappointing. The management’s commitment to take care of this inventory in the first half of the year, I just want to be clear. I know they’re independent dealers, but are we looking to take out the year-over-year
swing, right? Completely avoid the normal seasonal build, you're not looking to build inventory at all in the first half of the year, and that's that big year-over-year drag. I'm just making sure from the prior, let's say, disappointments on the inventory the last couple of quarters, is there a firm commitment to address this in the first half and not let this linger into the back half?

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

Yes. David, I mean, obviously, always, as we work with our dealers, but they are managing their businesses themselves. So we are -- we can't manage their inventory for them. However, based on our expectations on order patterns we're seeing from dealers, we do expect that they will be working hard to reduce their inventory in the first half of the year. We can't make it a 100% commitment. But obviously, we do expect the vast majority of that to happen in the first half.

D. James Umpleby - Caterpillar Inc. - Chairman of the Board & CEO

And one of the reasons that our fourth quarter inventory didn't decline as much as we anticipated because end-user sales were lower than our expectations. So obviously, end-user sales has an impact on inventory in the quarter.

Operator

(Operator Instructions) Your next question is coming from Rob Wertheimer of Melius Research.

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

Let's see if this works. Just a quick clarification on North American construction. You have residential and nonresidential construction to decline. Is that industry dollars spent on construction? Or is that construction equipment for the industry? And if I can, my question is really, I mean, the reduction in lead time is a fantastic thing for Cat, and reduction in volatility would be a great thing for Cat. Any color around just the work you've done to achieve that? And if dealers are starting to recognize it and wanting to hold structurally lower inventory.

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

So with regards to residential and nonresidential, there's construction equipment relating to that is what we're expecting to see the decline in.

And then as regards the inventory, let me hand it back to Jim.

D. James Umpleby - Caterpillar Inc. - Chairman of the Board & CEO

Yes. In terms of lead times, we've been working on this lean journey for a long time. And obviously, if we can find ways to reduce our lead times, it helps us both in the up-cycle to respond more quickly to increases and changes in demand and also allows us to cut back more quickly so we don't have an overhang, which helps to dampen the impact of the cycles.

And that, again, we've got our total team focused on reducing cycle times, all part of that lean journey and really trying to synchronize across the value chain. I think we're doing a better job of that than we have in the past. But it's a never-ending journey.

Operator

And the next question is coming from Ashish Gupta from Stephens.
Ashish Ravi Gupta - Stephens Inc., Research Division - Research Analyst

I was wondering if you could expand on your GC comments related to China. Maybe you can give us a sense of what went right or where you’re looking for incremental improvement in 2020. I guess I’m just referring to sort of the market share losses through most of the year, although it did improve in the end. Just kind of trying to think about, how much of a contributor that could be in 2020 and beyond? Where the successes were? And where you could see some incremental improvement?

D. James Umpleby - Caterpillar Inc. - Chairman of the Board & CEO

Yes. Whether it’s China or any other part of the world, the competitive landscape is continually changing. As we introduce new products, our competitors introduce new products, so that’s nothing new. And so we – again, you look at anywhere in the world over time, we see changes in the competitive situation. I mean we have demonstrated our ability to successfully compete in China. We’ve localized. We have a local leadership team. We have dozens of factories. We have localized our supply chain, and we continue to build out our dealer network and increase services and connectivity and introduce new products.

So again, it’s – competitive situation in China or anywhere in the world that’s fluid. But we’re very committed to be successful in that market, and I believe it demonstrated we can be successful competitively.

Operator

And the next question is coming from Jamie Cook from Crédit Suisse Securities.

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

If you could -- a clarification, if you could just elaborate. You talked about the normal restructuring of $200 million. And then the -- I’m sorry, normal restructuring, which I assume is $200 million, and then the strategic stuff you’re reviewing, another $200 million. I’m just trying to understand what’s in the EPS guide that you’re not adjusting out. And then I guess my question is, are there – you talked about reviewing products. You talked about some cost cutting, realizing it’s not what we had and there’s not the opportunity in prior cycles. But as we get to the back half of the year, I’m just trying to understand, are there any savings associated with these measures? Or does that play more into 2021?

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

Yes. Okay, Jamie. So we have said that we would -- this year, we expected -- beginning of the year, we said for 2019 that we expect the restructuring costs now to normalize between $100 million and $200 million a year. We were slightly above that. You will have heard me say, we were at $236 million for 2019. We expect a normal level in 2020. So between the $100 million to $200 million is the sort of normal level we would have.

The $200 million, actually, yes, you’re correct. It does relate to some products, which aren’t delivering OPACC. They will -- some action we’ve got to go through. We’re doing the evaluation of the actions we can do. And at the moment, our guidance does not take into account that there would be any savings associated with these measures in 2020. We think most -- more likely that will be in 2021 anyway.

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

And is there any way to think about a savings associated with that or just too early? And to confirm, repurchase is in your EPS guide, right?
Andrew R. J. Bonfield - Caterpillar Inc. - CFO

Yes. Yes, repurchase is in the EPS guide. And yes, we will keep you updated on this. Because I think as the charges come through, we'll pick it up. And then we'll talk to you about what we're expecting from a benefit perspective.

D. James Umpleby - Caterpillar Inc. - Chairman of the Board & CEO

And we're also -- just give me -- to add in there, we're also continuing looking at ways to reduce our structural costs, particularly in the areas of back office and procurement and all the rest. And we do expect again, over time, to have improved performance as a result of that. Again, relatively limited impact in 2020, but we're really trying to take the right steps in 2020 to set ourselves up for the future with a lower structural cost.

Operator

And your final question is coming from Stephen Volkmann from Jefferies & Company.

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

Andrew, thank you for all the comments relative to sort of the EPS cadence. But I'm wondering, Jim, if I can ask how you're thinking about the markets. You talked about this earlier. I think you sort of characterized it as a pause. So the down 4% to 9% in end-user demand, is that sort of significantly lower in the first half and then maybe kind of closer to breakeven in the second half? Or just do you think this kind of runs its course, and the fourth quarter run rate could actually be kind of back to growth again? Or are you just sort of predicting kind of steady, continuous weakness in end-user demand?

D. James Umpleby - Caterpillar Inc. - Chairman of the Board & CEO

Yes. I think you really have to look at it by segment. So in Resource Industries, in mining, in particular, we believe that the second half will be stronger than the first half. Again, we are -- we feel there's a slow, gradual recovery occurring in mining. Our customers are cautious. But just based on the quoting activity and the amount that's going on, we do anticipate that there'll be a stronger last half of the year than first half.

In construction, don't anticipate any dramatic changes first half to second half. In oil and gas onshore, we expect that to be -- remain depressed throughout the year. Solar and rail typically have strong fourth quarters. That's -- it's that way almost every year, and we -- no reason to think that wouldn't happen again.

Jennifer K. Driscoll - Caterpillar Inc. - Director of IR

Okay. With that, let me turn it back to Jim for his closing remarks.

D. James Umpleby - Caterpillar Inc. - Chairman of the Board & CEO

All right. Well, thank you all for joining the call and appreciate your questions. Cat faced several challenges in 2019, and I'm very proud of our team of employees, how they met those challenges with determination. They've allowed us to meet our operating margin targets that we set at our Investor Day and do the other things we said we would do. And we continue to advance our strategy for profitable growth. We are investing significantly in services, expanded offerings and working on that operational excellence, record safety year, shortening lead times, working on the cost structure. And certainly, 2020 will bring its own set of challenges and opportunities, but we remain focused on delivering additional value to our customers and our shareholders. And we'll continue to execute our strategy for profitable growth. Thanks for your time.
Thanks, Jim. Thanks, everybody, who joined us for our call today. If you missed any portion of the call, you can catch it by replay online later this morning. We will post a transcript on the Investor Relations site within 1 business day. If you have any follow-up questions, please reach out to Rob or me. Rob is at R-E-N-G-E-L_rob@cat.com (sic) [rengel_rob@cat.com]. I'm at driscoll_jennifer@cat.com. And the general phone number and Investor Relations is +1 (309) 675-4549.

And now let me ask Paul to conclude our call.

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.