Caterpillar
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>> JERRY REVICH: Hi, good afternoon, everyone. I'm Jerry Revich from Goldman Sachs and I'm delighted to host Caterpillar Chairman and CEO, Jim Umpleby, and Ryan Fiedler, Vice President of Investor Relations. Jim, Ryan, thank you very much for joining us.

>> JIM UMPLEBY: Great to be here. Thanks, Jerry.

>> RYAN FIEDLER: Thanks, Jerry.

>> JERRY REVICH: Let me hand it over to Ryan for the legalese sponsored portion of our program. Ryan, the floor is yours.

>> RYAN FIEDLER: Great. Thanks a lot, Jerry. Really appreciate it.

During today's meeting we will be making some forward-looking statements which are subject to risks and uncertainties. We will also make assumptions that could cause our actual results to be different from the information we are sharing with you today. Please refer to our recent SEC filings and the forward-looking statements reminder in our releases for details on factors that individually or in aggregate could cause our actual results to vary materially from our forecast. A detailed discussion of the many factors that we believe may have a material effect on our business on an ongoing basis is contained in our SEC filings.

In today's meeting we will also refer to non-GAAP numbers. For a reconciliation of any non-GAAP numbers to the appropriate U.S. GAAP numbers, please see the appendix of our earnings call slides.

Additionally, please note that Caterpillar policy does not allow for meetings to be recorded with smartphones or other devices unless specific approvals have been sought and granted prior to the beginning of this meeting.

Lastly, we will post a video and transcript on our website as soon as we can.

With that, I will turn it back to Jerry.

>> JERRY REVICH: Great. And our lawyers want a say in this too. We are required to make certain disclosures of public appearances about Goldman Sachs' relationships with companies that we discuss. The disclosures relate to investment banking relationships, compensation received, 1 percent or more ownership. We are preparing to read aloud disclosures for any issuer upon request. However, these disclosures are available in our most recent reports available to U.S. clients in our firm portals, that is gs.com/research/hedge.html.

With the legal portion out of the way, Jim, thank you so much for joining us. Really looking forward to our conversation.

>> JIM UMPLEBY: Great to see you again, Jerry. Thank you.

>> JERRY REVICH: Jim, you know, looking back, it's been about eight years since you became the CEO, the company's earnings power has tripled over that timeframe. You know, sales are up 50%, incremental margins up 40%. You know, looking back from your vantage point, you know, what would have been the two or three most significant drivers of delivering the sharply higher margins on that profitable growth trajectory?

>> JIM UMPLEBY: Jerry, you know, we introduced a strategy for profitable growth in early 2017, and we worked really hard to get it on one piece of paper so then everybody in the company could explain it and understand it. Obviously, there is a lot of details below it. But at a top level it's pretty simple. And, you know, our strategy really focuses on some key areas, operational excellence, which is safety, quality, lean, and a competitive and flexible cost structure; expanded offerings; services; and knowing, later added sustainability.

The Operating and Execution Model, the O&E Model, has really been a key part, I believe, of our success, that really requires that we understand the financial performance of our various products in a much more granular way than we did in the past. Maybe a way to illustrate that is, you know, it used to be at Caterpillar, let's say we had a division, that division had 12 products in it, and if, in fact, that division was performing acceptably, they would, okay, get a little bit more capital and a little bit more expense every year and they would kind of roll along. What we have really done over the last few years is, again, peel the layers off the onion so we can understand, of those 12 products in that division, by product, by market, by application, where we are creating shareholder value and where we are not. And what we often found is that oftentimes there were a number of products within the portfolio in that division that were not even an acceptable return on invested capital. And what that allowed us to do is really shine a light on those underperforming products and challenge our leaders to get the returns to an acceptable level. And in most of the cases they were able to do that.

And in a few cases, we determined that it didn't make sense for us, to continue to invest in those products, so we did have a small number of divestments as well, things we got out of. But, even more importantly what the O&E Model leads us to do, is to allocate our resources towards those areas that represent the best opportunities of future profitable growth. It sounds obvious. It's easy to say. I would argue that many big legacy manufacturing companies don't do a great job at it. We certainly didn't and we’ve gotten better, but we have a ways to go. And that really leads us to invest more in areas like services, which we...I'm sure we will talk about it more later, but those are the key areas. Again, just getting the whole organization focused on a strategy which has remained consistent for the last eight years; and it's really shown, I think, good results.

>> JERRY REVICH: And, Jim, in terms of the levers that you folks as an organization have pulled for those product lines that you just mentioned that were not getting there,

can you talk about some of them? I remember Building Construction Products that you folks made it essentially a logistics business instead of heavily vertically integrated given the velocity, other areas you pushed pricing. Can you just give us a flavor of any other ranges of actions that you've most commonly seen as you have taken businesses from not earning their return to generating the appropriate return?

>> JIM UMPLEBY: A whole variety of actions have been taken. You know, one of the things we have now is an enterprise component strategy. And, again, with the goal of increasing services, we have now tasked our leaders to think about every component that goes into a machine or an engine and to decide from a total lifecycle perspective what does it make sense to make and buy. In some cases, it makes sense for us, we design it, we build it. In some cases, we find that, you know, we don't have a scale to be competitive, so maybe it will be our IP, our design, we will get someone else to build it. And in some cases, we will just brand something from somebody else. And in some cases, we will just buy products but being very purposeful about that and thinking about how that positions us from a first-cost perspective, but also, importantly, in the aftermarket as well.

One of the things we have also done is, I think, we have better cooperation across the business in really integrating our engines, our hydraulics, machine designs to make them more efficient and to help make our customers more successful. We have invested significantly in our digital capabilities to help us increase services. I'm sure, again, we will talk about that a bit more later. But it really has resulted in a higher performing company. As you know, our measure of profitable growth is what we call OPACC, which is Operating Profit After Capital Charge. So, it's basically a return on invested capital. So, we look at what we call OPACC PV, which is the return that we receive on invested capital over the lifecycle of the products, the new equipment shipments, and what we perceive will come through services over the life of the product. And it really has changed the way we think about the business. That's the way we do our reviews. That's the way we really evaluate our leaders. And it's made a big difference. And, of course, it's allowed us to produce higher, more consistent ME&T free cash flows, higher operating profits. And, as you know, we have targets that we set up for both adjusted operating profit margin and ME&T free cash flow.

I think one of the things that is under-appreciated is our ability to generate cash. You know, since 2017 we generated $5 to $10 billion of ME&T free cash flow, except 2020 where we had a pandemic and more than 20% loss in our top line. But even that year we still produced $3 million of ME&T free cash flow. So, again, that focus on return of invested capital, the focus on increasing services, and getting very granular and understanding our business naturally yielded good results.

>> JERRY REVICH: Great. And, Jim, you alluded to this, the OPACC process, you are continuing to apply it today. Are you finding the same magnitude of improvement opportunities today that you were uncovering three, four, five years ago? Sounds like in

terms of investing towards the highest ROE opportunities, yes; but what about some of the lower-hanging fruit? Can you talk about those factors?

>> JIM UMPLEBY: Yeah. I see there are still opportunities, certainly, for us to improve. And, you know, we didn't have a big bang. It wasn't that we divested a very large underperforming division. We really did this through a lot of individual efforts. So not a lot of home runs but a lot of singles, doubles, and triples over the last seven or eight years and they all add up. So, we certainly have an opportunity. Again, I think we have done a good job, for the most part, taking care of underperforming products and businesses. But we know that we have an excellent opportunity to continue to profitably grow.

And one of the things, to step back for a minute, that, you know, when we set the strategy in 2017, one of the things that I was convinced about is that we had an outstanding opportunity to organically grow our business. I think you know our history. And we made some acquisitions in the past. A lot of them hadn't worked out. And, of course, the fashion was, if you go back ten years ago, people loved to make acquisitions. And, you know, a lot of interesting stories we can tell there about, you know, capital allocation gone wrong. We are open to acquisitions. We have made a few small ones. But we have such an opportunity to organically grow our business particularly around services and some other areas as well, and that is what we decided to focus on. And, again, I think it's really turned out well.

>> JERRY REVICH: And, you know, what is interesting about the company's historical performance and, you know, for the industry as well, you know, unpacking the volume disclosures that you and your finance team lay out for us in your annual reporting, you know, the past seven years have not been great from an end demand standpoint. You know, volumes have grown two to three percent, sort of CAGR, but the profit for every unit company sales has doubled over that timeframe. You know, as we look forward with rising labor costs, economy, data availability, you know, how do you think about for your equipment to continue to be more valuable to your customers over time and to drive a higher profit pool for your business?

>> JIM UMPLEBY: Well, again, just to repeat, our measure of profitable growth is absolute OPACC dollars. We believe that absolute OPACC dollars most closely aligns to TSR over time, so better return for our shareholders. So, again, we are focused on things like putting technology into our products to make sure that our customers are more successful with us than they would be with our competition. And we are continuing to invest in our digital capabilities, again, to help two things, like minimize downtime, maximize availability to help our customers to be successful.

So, some of the technology examples, you know, one of the challenges that many of our customers have, particularly in developed markets in the United States and Western Europe, is to find qualified operators. So now, due to the kind of the technology that we put into our products, things like CAT Grade Assist, it enables less skilled operators to perform like skilled operators. And so, you know, Jerry, we could take you and pretty quickly have you digging a really good basement for a house, right, if we got you one of our machines as an example. Just because of the automation we put into it, we, you know, we automate grading. We boosted precision, speed, and efficiency. So those kind of things, I believe, help differentiate us and really help us, again, grow those absolute OPACC dollars. We also have now more than one and a half million connected assets (engines, and machines). And that provides a significant amount of data points for us that we can utilize. Condition monitoring, again, trying to minimize downtime, maximize uptime. And it also helps us understand what's happening with the equipment. We can combine that with AI, with advanced analytics to help give our dealers leads on things that our customers might need. And also, we communicate directly with the customers as well. And we have things called Prioritized Service Events (‘PSEs’). So, again, we are quite excited about the opportunities here moving forward.

>> JERRY REVICH: I think we are going to need CAT insurance to sponsor me for that dig, Jim.

In terms of, you know, the downside of posting the performance and margins as strong as they have, you know, just mathematically, you are just well ahead of the high end of your margin framework this year. And so, the debate that investors have is whether that means the company's over earning and could see a price cost drag, drive the business down within the range. That feels unlikely considering the decisions that are made under the OPACC framework, but can I ask you to please weigh in on that topic?

>> JIM UMPLEBY: Yeah. And I'm, you know, I never tell our folks we are over earning, so we can always earn more. But, again, it's key to keep in mind that our focus is absolute OPACC dollars, not margin percent. Certainly, we provide adjusted operating profit margin targets to give investors a sense of where we expect to be. And, yes, this year we are doing better than those targets. And, as is always the case, we will revisit those at the beginning of the year and see if it makes sense to move them. But the key is that's OPACC dollar growth. So, we can, in fact, increase those absolute dollars on invested capital that we can produce, we believe that will drive TSR over time, and it certainly has so far.

So, again, we will continue to execute the O&E Model. We will continue to take action on underperforming products. We will continue to invest in those areas that we are quite excited about, continue to grow. I mean, services is a great example. You know, we still have an opportunity to grow services. We believe it's a big opportunity there, even when we get beyond the target we set for 2026. And I'm sure we will talk here about data centers and distributed generation as well. So, again, a lot of opportunity to continue to grow our business. But, again, our key is growing absolute OPACC dollars, that is our goal.

>> JERRY REVICH: Great. Great. Super. And, Jim, earlier you spoke about both on M&A, the Weir U.S. acquisition, particularly well timed, as well as other bolt-ons. You know, under what scenario could you envision a higher allocation of capital or acquisitions based on your strategic planning for the next five years?

>> JIM UMPLEBY: The good news is that we have a really strong balance sheet. And, you know, we have got a little bit of grease before COVID about, gee, shouldn't you be more levered or do you have too much cash. And I'm really pleased that we were in a really strong cash position, unlike some other businesses. I slept like a baby knowing that we would meet payroll when COVID hit. So, that is not a bad thing to have.

But, having said that, we are very open to M&A. But we are not out elephant hunting because we have to, to grow. As I mentioned earlier, we have, you know, we believe, a significant number of organic growth opportunities, which we are pursuing. You mentioned the one acquisition we made in the oil and gas space. I think when we bought SPM. I believe that as we are negotiating that and finalizing the deal, oil prices went negative. That was the week that that happened. So not bad timing. But we have made other acquisitions to acquire technology, to acquire some products we don't have. And things like Tangent, which is an acquisition we are really pleased we made, that Tangent helps customers that buy power generation assets monetize those assets. So, it helps monitor grid patterns, helps them understand when they turn on the units, when they turn them off, if they have a deal to sell electricity back to the grid, helps them with that.

A lot of examples. We bought Lithos. We bought CarbonPoint, which is a carbon sequestration technology. So, we will continue and we always task all of our leaders to be looking for opportunities.

And, back to the Wier-SPM example, we had that business on our radar screen for a number of years. And then, because of the changes in the marketplace, it became a great time to buy. And we moved at that time. So, again, we will, you know, we don't need big M&A to grow because we have so many organic opportunities. But we have the balance sheet, and we have the capability to be opportunistic if we see something that makes sense for us.

>> JERRY REVICH: Great. And, Jim, if we just transition to talk about parts and service. In 2019, you folks laid out the path to $28 billion in revenue by 2026, that's up from $14 billion in 2016. And you're essentially, as of 2023, you're at $23 billion, so really good progress so far. Can you talk about which initiatives had an outsized contribution to building out that business so far?

>> JIM UMPLEBY: Well, and the way I would say it is we don't break it out by area. But, what I will say, we have seen improvements across the business. We have seen it in Construction Industries and Resource Industries and Energy & Transportation. Again, part of that is just that purposeful focus on services. And traditionally at CAT our

culture has been to be very focused on having the best products, the most productive product, highest quality, and all the rest. And that's kind of a natural thing in our DNA, and also very focused on new equipment [opportunities], very important to us. But weren't as focused on services [in the past] (company clarified after the discussion). And we know that our, you know, dealers have done an outstanding job over the years taking care of their biggest customers, whether they are big oil and gas customers, their biggest mining customers, their biggest construction customers. But we recognize that we were losing a certain amount of...a significant amount of business, frankly, for those smaller customers, those small contractors. They have 8 to 12, 20 machines. And so, one of the reasons that we invested so much in our digital capabilities is it reduces our dealers' cost to serve, to go after that business. Think about connected assets. Think about the fact that there is now QR codes on machines and engines and an app on the phone. So, a customer scans a QR code, we know where they are, they know who we are. It makes it easier for them on their phone to buy the right part. It makes it easy for them to get service if they need it. So, again, we see a lot of opportunities there as well. So digital has been a big part of it and will continue to be a big part.

And one of the things we had to do in digital over the last few years is we really had to build a foundation which we didn't have. We had, kind of, we started fitfully over a decade or so before, you know, going back 20 years in digital. We've laid the foundation now. Now we are adding things on top of that and leveraging that strong foundation that has been built to allow us to really accelerate what we believe are opportunities for our customers, for us, and for our dealers utilizing those digital tools, utilizing AI, everything from VisionLink, CAT Inspect, all the rest. So, again, we are quite excited about that opportunity going forward. We identify that as one of our...still one of our key areas for future profitable growth even after we hit that 2026 target.

>> JERRY REVICH: Great. And, Jim, in our past conversations with Ogi, what was really interesting is that, you know, a couple of years after new digital initiatives have been rolled out, the growth rate in terms of adoption really hadn't slowed, so for some of the tools there are consecutive years of 50% user growth. Has that trajectory continued? Can you give us an update on how the end user and dealer uptake of CAT Digital offerings has trended?

>> JIM UMPLEBY: I don't have the exact number what he gave you. But I will say we continue to be very pleased at the progress we are making around digital in terms of customer uptake. So, you know, again, we are working really hard to make it easy to do business with us, making it easy to transact online. And, again, to the things that many of us do in our personal lives with all the apps that we have and then add the connectivity to that, it's a pretty exciting opportunity.

>> JERRY REVICH: Yeah. Great. QR code for my printer that took longer than I expected.

>> JIM UMPLEBY: Exactly.

>> JERRY REVICH: And in terms of, you know, the interesting thing about all of the data that you are gathering as part of CAT Digital is, sounds like there's additional opportunities that are being uncovered just by virtue of getting data and finding correlation between fault codes and subsequent breakdowns. Any areas of unanticipated benefits that have escalated to your level, Jim, that you are coming across just by virtue of the big data you are gathering?

>> JIM UMPLEBY: Well, you know, I don't know if we anticipated, or not. But we certainly knew that having those one and a half million connected assets would give us data that we could really use in our business. It has a whole variety of things, things like customer utilization levels, so it gives us a sense of what to expect from a service perspective. It also gives us a sense of what is coming in terms of the marketplace. We understand how heavily the equipment is being utilized by our customers, so that really helps us. You know, and that feeds into our Sales and Operations Planning ('S&OP') process, which allows us to anticipate and plan for future demand. The other thing, of course, is a lot of that data is useful to our engineering teams as they figure out, okay, how do we make our products more robust? What are some issues we potentially need to deal with? Again, I can go on and on about some of the advantages of having things connected. And everything from helping us have the right parts in the parts warehouse, by understanding utilization, and by understanding specifically what products are being used the most heavily in a certain region, that allows us, using our analytics tools, to ensure that we have the optimal number of parts in warehouses and with our dealers to be able to satisfy that demand. And, of course, then we have predictive capabilities. You know, an example would be the Construction Industries engine rebuild Prioritized Service Events, the PSEs, combined with our detailed understanding of a dealer-specific history. Historical customer repair behavior, we use something called Lens, which delivers specific part number level demand signals with the probability for parts ordering. And I don't think when we started all this, we understood how powerful this could be.

>> JERRY REVICH: Very interesting. And, Jim, earlier in our conversation, you mentioned designing machines with the services in mind in terms of a higher number of proprietary parts or CAT IP parts. Can you talk about how that looks in the field population? That sounds like the sort of initiative that grows exponentially years five plus as opposed to, you know, during the first five years, if I got that right.

>> JIM UMPLEBY: Yeah. It does take time. There is no question about it. So, you think about our design process. So, when someone makes a decision, a design decision, on the component on a machine, just given our NPI process, it takes time for that to get incorporated into the new machine. Then it also takes time for, obviously, you have to start selling those products and start getting hours on them and then you start realizing the benefit in that. So, you are right, that is something which is a longer-

term kind of benefit; but it really is important to set the stage for future, continued services growth over the next decade.

>> JERRY REVICH: And in terms of the proportion of parts going forward that are CAT proprietary IP versus prior, is it possible to get just the frame of reference at all, Jim?

>> JIM UMPLEBY: We don't quantify it. But, again, we focus on the right strategy for every part. And that could be anything from it's our design and we build it. It could be our design and somebody else builds it, so they can leverage their scale. In some cases, we say, do you know what, we don't have the scale to be competitive for that component and we are just going to buy it from somebody else and brand it. So, again, the key is having a specific thing in mind.

What used to happen previously is people were just focused on first equipment cost. And if they could outsource something and save 5 or 10%, people thought it was a good idea and they were doing the right thing because they really were not thinking about services in the right way. They were thinking about, okay, how can we reduce our first cost. And now, again, I believe we've got this ingrained in the culture so that everybody making those decisions, and we have formal reviews and formal processes in place, so you really think about, you're designing a new machine, what is the enterprise component strategy for every single component. And it takes time to see the benefit of all that. But we are well on the way. And, again, I think it's really embedded in our culture now.

>> JERRY REVICH: And the path to the 2026 parts, service target, roughly $5 billion off of 2023 levels, Jim, can you talk about any significant stepping or building blocks that stand out to you, that provide visibility on that path?

>> JIM UMPLEBY: Again, it's really just continuing to do what we have done, continuing to take advantage of our connected assets, continue to provide more value to our customers. And, again, done right, services provides value to our customers, our dealers, and CAT. One of the things that is required in culture change as well, and something that is occurring within the dealers. We have [over] 150 independent [dealers]. So, you are all aware of change management challenges within any organization. Now we are dealing with [over] 150 independent dealers (company clarified after the discussion). And we have some dealers that have done an outstanding job and are changing the way they run their dealership to leverage the digital tools, some that are laggards, and a bunch that are in between, doing okay. So, we are working really hard with our dealers to ensure that they have the right incentives in place, the right organizational structure, and the right kind of people to leverage these digital investments we've made to continue to grow services. Because it is a different ball game.

I will give you an example. If somebody comes in to the parts counter and buys a part, the person on the service counter needs to be incented to have that person, what we call, on-boarded, so that we know who they are, we have permission to market to them, they are part of our ecosystem. And if that person at the service counter thinks that they might hurt their own livelihood if they sign somebody up because they will start buying online, they may not do it. So, our most forward-thinking dealers have changed their incentives so that there isn't any kind of damage done to that service person's compensation if they sign up a customer. Maybe quite the opposite. So those are just some little examples of how, you know, again, culture eats strategy for breakfast, so, you know, making some changes in culture, really changing behaviors is really required to help us leverage those digital investments that we've made. And, really, it should reduce our dealers' cost to serve for those smaller customers. Dealers, obviously, can't provide the same level of service, support, and coverage for a really small customer as they would their largest mining customer. It doesn't make sense. But by utilizing these tools and QR codes, the connectivity, the eCommerce, the Prioritized Service Events, and all the rest, it allows them to reduce their cost to serve, to be able to capture more than aftermarket for those smaller customers.

>> JERRY REVICH: Very interesting, the democratization of service. And the buy-in, Jim, from dealers, I know it varies a lot, but what proportion of the network has a passing grade in this area?

>> JIM UMPLEBY: I won't give percentages, but our whole executive office have been attending dealer meetings this year. We were at one, two weeks ago overseas, and we've had a number of them. And this is one of the things we are really, really pushing. And, again, we had some dealers that have embraced it, that are leading the way, even some that are laggards, and a bunch of in between that are doing okay, that we want to get to be better. So, it's always the case when you're making change, same thing within our organization. We have employees that lead the way, some that are really slow, and a bunch in between. So, we are working hard; and the good news is that many of the dealers see the benefit. So, our economic interests are aligned here. If we do this in the right way, we provide more services to our customers, make our customers more successful, that's a good thing financially for the dealer and for us. And so, because our economic interests are aligned, and sometimes you will see manufacturers produce their products where their economic interests are not aligned with their distribution network, that is certainly not the case with us. It's good for everybody. So, it's just a matter of, again, going through the change management process to ensure that we can execute at a higher level and leverage those investments we made around our digital capabilities.

>> JERRY REVICH: And on the topic of dealers, Jim, any other changes in dealer incentives that you folks are managing, the business, too, or anything else that you're focused on from a distribution standpoint?

>> JIM UMPLEBY: Well, a number of the things we are always focused on, we talked a lot about services and how important that is, we are also working with our dealers on

rental. We believe that is a growth opportunity for us and our dealers. And we want our dealers to have a profitable growing rental business. You know, a couple of years ago we set up a separate division, run by one of our senior leaders, to help our dealers be better at rental, to help support them. And our dealers' rental revenue does continue to grow. And, of course, dealers are independent businesses and they make decisions based on a whole variety of factors and look at utilization and fleet age and all the rest. But we are excited about the opportunity around rental and think that is an opportunity for us. And one of the things we are doing is we are leveraging that CAT Digital ecosystem to help around rental as well. So, we think this is real opportunities.

>> JERRY REVICH: And earlier in the conversation, Jim, you spoke to longer term opportunity to grow the business beyond the $28 billion in terms of parts and services. So, I think you have grown it roughly 7% growth rate in parts and services over the past number of years. Is that how we should be thinking about the long-term trajectory? Can you expand on what you had in mind when you said longer term growth beyond that?

>> JIM UMPLEBY: We have a sense, based on our analysis, of customers that own Caterpillar products, and primarily they are smaller customers, that choose to get a significant portion of their aftermarket needs met by other providers, meaning other than the CAT dealer.

I can't tell you that number, but we know what that number is, and it's a big number. And so that's what we are after. We are after capturing more of that over time by, again, continuing to invest in our digital capabilities, working with dealers to see that, all right, here is a way you can potentially change the way you run the dealership to capture more of those opportunities. So, we are very excited about it. We still believe it's one of our biggest opportunities for future profitable growth even after we meet our 2026 target.

>> JERRY REVICH: And, you know, the growth that you see in the parts business has gone with pretty or really strong revenue growth in the new machine and engine business as well. Over time would you expect parts and services and percent of total to move higher? And, obviously, that will vary based on where we are on the cycle. But is the momentum on the parts and services side strong enough we could see it rising as a percent of the total?

>> JIM UMPLEBY: It certainly can, but I'm always very reluctant to talk about that because, as you said, it's driven a lot by what is happening in the end markets. So, what we want to do is profitably grow services and profitably want to grow Original Equipment (‘OE’) sales. That is our goal. We want both to grow. And so, I don't want to say we have a goal necessarily have a higher percentage, because I want both on an absolute basis to go up. And I want us to grow absolute OPACC dollars as well. But certainly, as we increase services, it does make us more resilient. And, you know, when we had our downturn in 2020 because of COVID, certainly, there was a drop in

services; but it was not as significant on a percentage basis as the OE drop. So, it does help dampen cyclicality, which is a positive thing, obviously, we are trying to accomplish.

>> JERRY REVICH: Super. Can we talk about Energy and Transportation? So, on the last earnings call you brought up the Titan 350, Jim. To frame the conversation for our audience, we think the incumbent generates about $2 billion in annual sales in the power range that Titan 350 would address. So, Jim, I'm wondering if you could just talk about the types of applications that your product will be a good fit for compared to an air derivative turbine? You know, as I understand it, the industrial frame turbine has a different maintenance versus upfront CapEx profile for the customer, so there should be a natural application fit where the product is better, I think?

>> JIM UMPLEBY: You know, from our perspective, there isn't a major difference in application between, you know, the products that are out there and our new Titan 350, so we will compete for the same business as we do today. You know, we think there is outstanding opportunities both in Oil and Gas and a whole variety of Oil and Gas applications, whether it's gas compression in large pipelines, whether it's on Floating Production Storage and Offloading (‘FPSOs’) offshore, offshore applications. But also in, excitingly, in Power Generation. You know, one of the things that there is a market for now, both in our existing gas turbine line and in the larger gas turbine line, which we really can't participate in because we don't have the right size which is trailerized units. And, you know, as I'm sure you're aware, just with data centers, not only is that creating an opportunity for us to sell standby generator sets, reciprocating engine generator sets, and that business is very strong. And you have heard us talk in a couple earnings calls this year about incremental investments we are making to increase the large reciprocating engine capacity. But those data centers are increasing base load energy demands in the developed world, which really have been more or less flat for about 12 years. That is a very exciting opportunity. And we are selling trailerized gas turbines. And we believe that there is a substantial market and will be one going forward for the Titan 350, whether it's sold to data centers or sold to utilities as peaking units. And some of it would be rental. Some of it will be, I call them more permanent than rental. Actually, customers purchasing units. But we are really excited about it.

And, you know, I was still at Solar and had the responsibility of selling the first Titan 250. And I remember how tough it was to get that first sale. I'm amazed by the amount of customer interest. And part of that is driven by, you know, someone's reputation in the marketplace. The lead time for our major competitors is pretty long, so people, you know, are looking for other alternatives. And, just based on the track record, we have supporting customers. I think that is a great opportunity. And we are very, very excited about it.

>> JERRY REVICH: Great. In terms of the product rollout plan, when did the first commercial unit come off the line and when do you expect to get the full production rate for the 350?

>> JIM UMPLEBY: I believe we expect early units to start shipping next year in 2025, and we will begin ramping up from there. Again, we are encouraged by the amount of customer interest and discussions that we are having. And the exciting thing is that, you know, turbines, I was a sales engineer in 1984 and sold a gas turbine. I was living in Asia, in Thailand, and it is still operating. That's been 40 years. And we have units that have run more than 50 years. And, of course, they have been overhauled and a lot of the parts have been changed. So, it's a great services opportunity. So, when you sell gas turbines, they typically run 24 hours a day, seven days a week, they remain in operation. So, you know, the OPACC PV on those units is very good because of the services opportunity. So, to answer your question, the early units will begin to ship next year and then we will go from there. But we are pretty excited.

>> JERRY REVICH: And in terms of the use of the trailerized units for a data centers, can you expand on that comment? Is that the next set of data centers that are being designed or are you starting to see data centers that are coming online, coming equipped with these trailerized units?

>> JIM UMPLEBY: So, it's a whole variety of things. So, I will give you an example. And these are not trailerized. These are permanently installed, if you will. There is a data center in Ireland that we have, I believe, it's ten Titan 130 generator sets that burn natural gas and produce power to provide the base load for the data center. So that is already starting to happen. And we are selling some units where data centers have concluded that the base power from the utility will not be sufficient for them to operate. So, in that case, in Ireland, they bought gas turbines to provide power for the data center. We believe that as base load demand increases around electricity, and if you talk to data center customers, you know, they talk about one of their biggest things, it's all very public in the press, or one of the biggest challenges and biggest concerns is will they have enough power, particularly in places like the United States. But it's a global issue to power those data centers. And there is a real interesting article on it just in the last 48 hours or so from Blackstone, that the focus is on this issue and just the data center opportunity and the power that is required, as more generative AI is used, it's a big opportunity. So, we believe that there will be an opportunity.

We talked about this a little bit in our Investor Day two and a half years ago when we talked about a distributed generation opportunity. So, given the fact that investments in the grid, and use the United States as an example, I mean, you know, again, investment demands were relatively flat. There has not been a lot of investment in the big, old, traditional power plants that used to be natural gas or coal-run, or nuclear, and the power used to be distributed throughout the grid. Now, many of those plants have been retired, more renewables have been added to the grid, solar and wind; but those are intermittent sources of power. At the same time now, you've got more power being required because the data centers in places that weren't traditionally big consumers of power. So, we believe that that is an opportunity for us that we are very excited about to sell smaller units. When I say small, our size range of power distributed throughout the grid, meaning small in those big power plants, so that is distributed generation for both our reciprocating engine generator sets and our gas turbine generator sets. And our reciprocating and our gas turbines can burn natural gas. They can burn biofuels. They can burn hydrogen blends. And so, we are very excited about that opportunity.

So, back to your question, you know, we believe there's opportunities. And we are starting to see some of that activity where utility might say, you know, what? We are worried about having enough power for a certain period of time. So, they will take out a trailerized unit, maybe as a peaking unit, and our customer can do that as well. And we are selling some units into third-party rental fleets, some Solar gas turbines, where those rental companies are positioning themselves and are providing rental power for a whole variety of end uses. But, again as power requirements go up, we are uniquely positioned, as I can't think of one of our competitors that has both reciprocating engine generator sets, and gas turbine generator sets. And oftentimes, if you think about the data center in Ireland, it has backup, reciprocating generator sets.
And has Solar gas turbines providing the prime power for the generator sets. So, we are really excited about this opportunity going forward.

>> JERRY REVICH: And the fuel economy and overall total cost of ownership of running a turbine versus paying for electricity, from what we hear it's within a stone's throw, pretty comparable; is that right? Or what are you hearing from your customers?

>> JIM UMPLEBY: It all depends on the price of natural gas. Let's assume the unit is burning natural gas, it varies, right? So, what is the price of electricity from the grid? What is the price of natural gas? Obviously, the customers look at the capital investment they have to make. But, in these times, based on conversations with data center customers, their big issue is will I have enough power. Will I have power for my data center? Not is it going to cost me one or two cents more per kilowatt hour? That's not the big issue. The big issue is will there be enough power for me? And, again, much has been written about this.

>> JERRY REVICH: Great. Very interesting. And, to go back to the last earnings call, you and the team spoke about Energy and Transportation backlog was up sequentially despite lead times shortening for gas compression. It sounds like a significant part of the backlog growth was data centers. Can you talk about how far out lead times extend now if a customer says to you, you know, I want a reciprocating engine for data center, I want turbine, how far out until they get a delivery at this point?

>> JIM UMPLEBY: For reciprocating generator sets are 18 to 24 months. You know, that backlog increase [in 3Q 2024] was driven, as you said, by Energy and Transportation (company clarified after the discussion). And that backlog increase was

driven by increasing backlog for those reciprocating generator sets, a lot of it for backup for data centers. But also, Solar turbines from both Oil and Gas and Power Generation, that backlog went up as well. So, it isn't just Power Generation; but certainly, the reciprocating generator sets for data centers is the primary driver of that. So, again, all driven by data center growth, cloud computing, generative AI, so again, exciting opportunity.

>> JERRY REVICH: And, Jim, what is interesting about your Energy and Transportation business is, because you're in all of these different markets, you have the ability to produce different products at a different point in the cycle. And, you know, upstream or well service demand for the industry has been pretty weak. How seamless is it for you when you're selling, you know, large reciprocating engines into Power Generation applications versus Oil and Gas applications, how easy or hard is that pivot in the field as opposed to in a spreadsheet?

>> JIM UMPLEBY: Well, we do it in our factory, so it's quite easy, right? So, let's take an example of a 3500 engine. It's the base engine, right? So, you know, it's pretty easy within our facilities to decide, okay, we're going to allocate this engine either towards a Power Generation customer or Oil and Gas customer or a large mining truck. C175 same story, you know, Power Generation or large mining trucks. So, you know, the site prep and packaging can vary, but one of the beauties of our business model is that those engines are used for a variety of end uses and a variety of end markets. So, as we think about making a capital investment, as we are doing, to increase the manufacturing capacity for those large engines, we know that they can serve a variety of purposes. It's not just data centers. It's also mining, big mining trucks. It's also oil and gas. And so, I think that diversity of our end market really positions us, positions us well.

>> JERRY REVICH: Great.

>> JIM UMPLEBY: And it's easy to do, is the short answer. It's easy. It's easy to redirect those engines, if, you know, when we are building them in the factory.

>> JERRY REVICH: And, you know, it's interesting that lead times are, you know, 18 to 24 months while, you know, the well servicing market is at a trough and, you know, mining truck demand is certainly not an elevated level either. How much capability would your team have to grow capacity beyond the 125% that you outlined on the last call? If you decide to pull the trigger, are we at a point where we need a significant new roof line? Or, you know, could we find, if we decide to pull the trigger on additional capacity, you know, that that number could continue to move higher?

>> JIM UMPLEBY: To reiterate, the 18 to 24 months number is for reciprocating power generation. And, you know, a lot of those go into data centers. So, certainly, we continually evaluate our capacity and what we see happening in future demand. And you saw it happen this year. You saw that, you know, we announced earlier in the year that we were making a major capital investment that would last about four years, , to

double our capacity compared to what we produced in 2023 for large engines, for both new engines and parts. And then we said in our last earnings call, okay, just given the strength of the opportunity we see, we are going to invest more. So now we are at 125%. So, we certainly have the ability to increase. And we will do that. Again, we have a very strong balance sheet. We have plenty of cash available. We have the ability to invest for future profitable growth.

And one of the things that also that we have the ability to do, you talked about switching between applications. We are doing a bit of that now while still meeting the needs of our Oil and Gas customers. Just given the state of the markets and the strength of that data center market, we are able to redirect some of those engines to satisfy the Power Generation need while still meeting the needs of our Oil and Gas customers. So that has happened as well as we speak.

>> JERRY REVICH: Great. Great. And, Jim, can we switch gears to talk about Resource Industries and autonomy? So, you folks have been focused on making autonomy economics work for small mines. Can you update us on your efforts, what size fleets are economic today; and, you know, any significant milestones that we should keep in mind just as you continue down that journey?

>> JIM UMPLEBY: Yeah. When we first started to deploy autonomy on customer sites back in about 2013, a little more than ten years ago, we were really focused on sites with a fleet size of 70 trucks or more, because it really took that to really pencil out if a customer was making a capital investment. We've worked really hard to bring that investment down. And so now we are in a situation where it can be economically viable with fleets as small as 10 to 12 trucks. And we are starting to deploy at sites of that size. So, as you think about it, I mean, there are a relatively limited number of mines that have 70 plus trucks. There's a lot of mines that have 10 to 12 trucks. So that does broaden the opportunity for that.

And we, you know, we recently announced an agreement with a company called Luck Stone, which is a family-owned quarry in the United States. And that one will be our first autonomous deployment, in what we call the aggregates industry. And that opportunity will have us, you know, expand the model of trucks with autonomous capability to our 100-ton, 777 model. So, we have successfully demonstrated a solution at Luck Stone earlier this month, and we are very excited about the opportunity to continue to expand autonomy.

>> JERRY REVICH: And then, from a production standpoint in Resource Industries, you mentioned that, essentially, supply has caught up with demand, post-COVID customers got their deliveries, and so we had a production adjustment for the industry this year. Can you talk about where your lead times today for large trucks are and, you know, how would you characterize end demand based on customer inquiry levels?

>> JIM UMPLEBY: Certainly, utilization of our equipment is high. The number of parked trucks is relatively low. And the age of the fleet is relatively elevated. So that's

positive. You know, as you mentioned, we had a really strong backlog coming out of COVID and the supply chain challenges on two products, on articulated trucks and off highway trucks. And, as we discussed in our quarterly calls, that created a bit of a comparison issue because it was so strong in 2023. For large mining trucks, to answer your question, the quotation activity and the order activity remains healthy. Commodities are at investable levels. Again, part of the product utilization is high. And that's all positive. So, we feel good about what we are seeing around large mining trucks. And we continue to believe that the energy transition will support increased commodity demand over time. I think, you know, there is different opinions as to how quickly EVs will replace internal combustion engine vehicles. But we probably would all agree, everybody in this call would agree, there will be more EVs on the road ten years from now than there are today. We believe that does expand our total adjustable market and provide further opportunities for profitable growth. Think about all the copper that needs to get produced to do that. So, you know, plus, the other thing we have been talking about, data centers, all the rest, all that requires those commodities as well.

>> JERRY REVICH: And the elevated backlog that you mentioned due to supply chain constraints, is it now at normalized levels in your view?

>> JIM UMPLEBY: So, it depends on the product. I believe that for machines, yes, we have largely got back to normal for machines. As we have been talking about, and it's not because of a supply chain problem, it's because the demand is so high for those reciprocating generator sets, that is still an issue. Those lead times are longer than we like them to be, which is why we are making those incremental investments both at Caterpillar facilities and our suppliers to increase our capacity. Again, it's not a situation where we are producing more than we ever have. It's just the demand is increasing so dramatically.

>> JERRY REVICH: And excellent profitability in Resource Industries, you know, we are looking at industry data, so Parker Bay, it looks like your truck unit share has declined. I think it's a function of just the move towards smaller units given to your geographic mix of demand. But would love your perspective, Jim, on what the industry data shows and how do you feel about your market share here?

>> JIM UMPLEBY: We feel good about, certainly, our ability to compete. And, you know, there's different data sets you can look at. And the Parker Bay data focuses on trucks of a certain size. And so, it excludes a lot of the things that we do. So, you have to be careful when you draw too many conclusions based on any one data set. But, again, we feel good about our ability to compete. We feel good about our PINS. We always like to have more. There is no question about that. But, again, we are quite comfortable with our ability to compete.

We strongly believe that we have the strongest autonomous solution. And we are seeing an increased acceptance of that. You know what we are doing around helping our customers meet their sustainability objectives. So, batteries and large mining trucks and early learning program we think works very well with our autonomous solution. So, again, we feel good about where we stand in the mining business.

>> JERRY REVICH: Great. And, Jim, if we could just shift gears and talk about Construction Industries. Earlier in our conversation you mentioned the focus on free cash generation and the really strong and improved free cash flow targets that you folks laid out within the past year. I think part of it has been you folks have cut production and construction equipment earlier in this cycle than what we've seen in the past. Can you talk about how you've taken the approach to making sure we don't have as much of a bullwhip effect that we have seen in the past in this industry?

>> JIM UMPLEBY: That is a great question. So, one of the things we have been very focused on is performing better at different levels of business. So, you know, in my view, the pain that we experienced between 2012 and 2016 was somewhat exacerbated by there being too much equipment in the channel. It was, you know, and it's natural when business is strong. People come to our dealers to buy a lot. And they are independent businesses. But we are an independent business as well. So, one of the things that we can do is, again, in the right values-based way, kind of look at how much inventory is in the channel, have conversations. And we are working very hard with our new S&OP process to ensure that we don't find ourselves in a situation where there is way too much inventory in the channel. We feel comfortable with our inventory levels as we stand today; and it's something we are very, very focused on.

I would argue, over the last eight years, we have performed better at different levels of business. And so, we have taken that into account. I think 2020 is, I think, a proof point of that, still meeting our adjusted operating profit margin target even though we had a more than 20% unexpected drop in [sales and revenues] and still producing $3 billion of ME&T free cash flow that year (company clarified after the discussion).

>> JERRY REVICH: And for Construction Industries, you know, customer value agreements have been a key focus for you folks. I'm wondering if you can just update us how performance has tracked since you gave us an update at the analyst day, have we seen a step move higher in terms of the cross selling?

>> JIM UMPLEBY: We have. We generally see about a 30% more services to sales for machines when there is a CVA. And so, we are certainly selling more CVAs. It's been a big focus. At a total company level about two-thirds of our new equipment comes with a CVA attached, that was certainly the case in 2023. And our goal is to provide CVA coverage globally, to provide a more consistent customer experience, and really provide more value to our customers by providing hassle-free ownership and proactive care. And the smaller customers are starting to realize the benefits of CVAs and promoting uptime and productivity gains. So, we are pleased by how that is going.

>> JERRY REVICH: Great. Great. Great. The topic of tariffs is one that comes up. Obviously, CAT's stated view is a proponent of global trade. You know, when we had

tariffs last implemented on steel, you folks were able to pass through higher steel costs seamlessly. You know, in the scenario that whole, good tariffs are implemented, can you talk about just your level of confidence that higher costs would be passed through to and customers since, obviously, Caterpillar doesn't control tariffs?

>> JIM UMPLEBY: We certainly believe in free and fair trade. And one of the things that helps us is that, unlike some other companies, we don't manufacture all of our products in one country. So, certainly, our largest manufacturing presence by country is in the United States. And we are a net exporter out of the U.S. But, as you know, we also have large manufacturing presence in a number of other countries like Mexico, like Brazil, like China, like Japan, a bit in Germany, India, UK. And so that helps us, I believe, the fact that we are a global manufacturer. We try to mostly produce in region for region, not completely. Certainly, we have things that move around. And but, you know, we feel confident in our ability to continue to profitably grow to meet our adjusted operating profit margin target. And, you know, not going to get into, all right, well, if tariffs are X, how much of that you pass along. We will have to see how that all plays out based on market conditions and what actually happens. And it's a bit early now. I mean, I always like to wait to see what actually happens as opposed to making too many predictions before a new administration even gets in power.

>> JERRY REVICH: Great. Fair enough. So, the last question, given the time constraints here, Jim, you know, in our discussion we focused on how CAT has really transformed over the past seven, eight years and grown earnings power and free cash flow and performance. Can you just spend a few minutes to wrap up and talk about your vision for CAT going forward?

>> JIM UMPLEBY: Certainly. You know, again, I believe we have excellent opportunities to continue to profitably grow our business organically. As I mentioned earlier, an outstanding opportunity to continue to grow services. We are very excited about the opportunities we see around distributed generation and data centers. So, again, that is very exciting as well. We do believe that over time increased commodity demand around electrification, electric vehicles, and all the rest, will drive opportunities in mining. So, our customers, obviously, our mining customers use our products to produce the commodities, that fuel that transition. So, I have never been more excited about our future. I mean, I cannot think of a time when I have seen some secular trends occurring in our marketplace like power demand, like data centers, that we are uniquely positioned to satisfy both, again, given the fact that we have a combination of gas turbines and reciprocating engines. So, my vision is that we will continue to profitably grow our business primarily organically going forward, and we have great opportunities to do that.

>> JERRY REVICH: Super. Jim, thank you very much for your time and insights. Jim, Ryan, thank you both for making time for our group. Have a great day, everyone.

>> JIM UMPLEBY: Thank you, Jerry. Take care.