

>> MICHAEL FENIGER: Welcome, everyone. I'm Michael Feniger, the Machinery Engineering and Construction Analyst at Bank of America. We are fortunate to host Caterpillar for a virtual headquarter meeting with Andrew Bonfield, the CFO. We're going to have a wide-ranging discussion with Andrew around Caterpillar's earnings profile for cash flow, product offerings, and end market commentary including construction, mining, energy and power generation. Before we jump into it, I'm going to pass it over to Ryan for a few words.

>> RYAN FIEDLER: Thanks, Mike. Really appreciate you hosting us here today. On today's call, we'll be making some forward-looking statements which are subject to risks and uncertainties. We'll also make assumptions that could cause our actual results to be different from the information we're sharing with you on this call. Please refer to our recent SEC filings and the forward-looking statements reminder in 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'll also refer to non-GAAP numbers. For reconciliation of any non-GAAP numbers to the appropriate U.S. GAAP numbers, please see the appendix of our earnings 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'll post a transcript available on our website as soon as we can. With that, I'll turn it back to Mike.

>> MICHAEL FENIGER: Thanks, Ryan. Thanks everyone for joining. Andrew, I would love if we could kick off this conversation really talking about Caterpillar relative to prior cycles. Your sales and revenues this year based on estimates is again nearing that prior peak sales and revenues observed over a decade ago, yet unit volumes are still below that period, suggesting strong pricing. Just to help provide context for everyone on the line, how far below are volume units now from that prior peak? What areas of the portfolio have fully recovered? What areas of the portfolio are still operating below those prior peak levels?

>> ANDREW BONFIELD: Yeah. So, Mike, as you know over the last couple of years, price has been a very significant driver of sales and revenues growth, particularly in 2022 and 2023. Overall volumes still in total are still below the 2012 levels, the peak

of the last cycle as you referred to. And most of that, is in Resource Industries. If you remember, at the time, Resource Industries' sales and revenues were nearly double the size they are today, even taking out price. So, that is the major change. Both from a Construction Industries and an Energy & Transportation perspective, they're broadly more likely in line with where they were in that 2012-timeframe. Obviously, there's mixed effects in there. There's lots of other things which you have to take into account.

I think one of the things that has been the biggest change though versus where we were in that 2012-timeframe is really around profitability. And if you look at the significant improvement in margins and free cash flow that we are able to generate today, that reflects the benefit of the Operating and Execution model, which has enabled us both from a margin perspective and also from a free cash flow perspective to really more than double performance [ME&T Free Cash Flow] over that timeframe (company clarified after the discussion). And that's probably the most significant change.

Other factors in there are things like ability to drive more services revenues. Services revenues are higher today than they were back in that time period. That focus on services is important because it helps to dampen cyclicalities and actually helps us to generate a more consistent stream of revenues and margins as we move forward as well.

>> MICHAEL FENIGER: Great. And, Andrew, you alluded to this before, but CAT's reporting some of the strongest pricing in its history. Investors believe most of the pricing is due to inflation. I mean, bigger picture, is there a change going forward in terms of how CAT views pricing in some of its markets? For example, if we look at Resource Industries and Energy & Transportation, are market dynamics different now which may drive pricing stronger longer term? Do you see any inflection where your customers are paying up to replace fleets with certain features and technology that maybe was not there in years past?

>> ANDREW BONFIELD: Yeah, I think that's a really important thing. I mean, obviously, the most important thing, and you will have heard us consistently say this, is we price for value. We have to be able to provide customers value in order to be able to justify any price we are selling for a machine. And that value is really what we call, and focused on, is total cost of ownership. And that total cost of ownership comes from a number of things through that time period. It is not purely just the upfront price; it's about the productivity that the customer can have over the lifetime of the machine. It's the services that we are able to provide and it's the value that we are able to give to the customer by that quality and durability of the machine that enables the customer to see

that total cost of ownership being lower than it would be from maybe a machine which has a lower price point. So, that's always been the focus, on our ability to price.

Obviously, there are some great technologies we're now adding to machines. A lot more sensors, for example, which enables us to track data. I mean, all the digital tools we've done, which enables us to do things like our Prioritized Service Events, which is really the start of condition monitoring, which is like really helping a customer say, "Wait, you've been using this machine for X number of hours. You need to think about servicing, or your oil needs to be changed." Tie the different pieces of data together to enable them to actually operate their machine more efficiently. And then there's technologies on the machine, things like grade assist which enables a relatively novice operator to actually be able to dig or create holes, big extractor of dirt in a way that they wouldn't have been able to do it unless they were a much more skilled operator. And then there's the things like, obviously, where you've got a CAT Command, which it actually enables you to do things and operators, particularly in an environment where skilled operators are, a premium to actually operate different pieces of equipment from the same position to actually make the job site more efficient rather than walking in and out of the machine. So, it's things like that. And, obviously, autonomy in mining is obviously a big area of focus as well, which helps the productivity offerings that the customer gets. So, it's all about making sure that you are adding value, which then gives value to the customer, and enables them to be much more successful because ultimately, at the end of the day, it's their value that we create for them. CAT machines are a tool for them to do the job they're doing, and we need to make sure we're giving them the most productive and best tools for the job.

>> MICHAEL FENIGER: Thanks, Andrew. Just a follow up on the pricing conversation. I mean, pricing growth was inevitably going to moderate. What do you see in the relationship of price versus cost, pricing above your cost, I mean, remaining for the rest of the year? Is your cost inflation falling faster than your pricing? Is there a scenario where price versus cost is structurally higher for Caterpillar going forward?

>> ANDREW BONFIELD: I think, again, back to the point, you've got to make sure you're creating value for a customer in a situation where you're pricing. Pricing has obviously moderated. You've seen that. You saw that in the first quarter, and we expect it to moderate as we go through the year. Obviously, what I still focus on is making sure that price exceeds manufacturing costs so that there is no margin degradation as a result of input cost inflation. But input cost inflation has slowed. I mean, we've seen things like freight reduce, which has been a big factor for us in the last couple of quarters as well. So, all of those things are positives, which enable us then to be able to serve customers. We're not putting through big price increases. We're not having to

price for that input cost inflation as well. So, we're able to do that. So, I think that's really important. I think it's also important, as we think through the year that we did say at the start of the year, we would see more price in the first half. And then as we lapped the big price increases from the previous years, that would start to moderate as we go through. And the second-half, we'll see a lot less of that in 2024.

>> MICHAEL FENIGER: Fair enough. And, Andrew, since CAT last reported, the macro environment is becoming more uncertain than ever. We may see higher for longer rates. Are you sensing customers pausing or pushing out orders right now? Or do you sense customers are still willing to really invest through this uncertainty following some years of underinvestment?

>> ANDREW BONFIELD: Yeah. I think it's, obviously, where the economies are in different places around the world, and we've spoken about that before. So, obviously, places like China are in a significant downturn, particularly in the above 10-ton excavator market, which is where we play. The U.S. has remained strong and particularly on the construction side and that is a bright point for us, particularly on the machine side. Obviously, in Resource Industries we're seeing particularly a little bit of drawing back in areas like articulated trucks and off-highway trucks specifically relating to 2023 comparisons relating to the catch up of the backlog. But those are areas where they're softening. But those were expected and built into our guidance. I think, as we look out, interest rates are starting to moderate in Europe. So, it's not just a U.S. phenomenon. We are starting to see interest rate declines in Europe and their economies are on a different place, obviously a little bit softer as we saw in the first quarter. So, again, that's going to be a little bit of a mixed bag.

And then really, I mean, the benefit in the U.S. is really the full value of the money that's flowing through IIJA, IRA, CHIPS Act and a lot of repatriation of manufacturing as well. And then, finally, the bit, which is probably underappreciated, I think, in the portfolio is the strength of Energy & Transportation. And as we look out, the bit that's actually happening there, not just, obviously, data centers are the big story of the day, but generally just across the board, actually much stronger performance in Energy & Transportation as some of those end markets are starting to improve. So, again, that's the benefit of Caterpillar. We are a portfolio of company businesses and businesses are going to be in different places around the world, and that helps us to be able to perform as we have been able to do.

>> MICHAEL FENIGER: And, Andrew, just to follow up with that last train of thought, I mean, speaking of investing maybe through uncertainty, CAT just raised its CapEx for the first time in a while. I mean, spending \$2 to \$2.5 billion of CapEx, I think is your

guide for 2024. That's a big step up since you've joined as CFO. Can you just talk about that level of investment, expanding that engine production capacity? Why are you doing this right now? How much capacity, Andrew, does this bring and provide Caterpillar in 2025, 2026? What markets do these engines really serve?

>> ANDREW BONFIELD: Yeah. So, stepping back, let's look back at what we've done from around the O&E model. The whole point about the O&E model is to always remind people capital has cost, it's associated with it. We have to deliver above the cost of capital in every investment we make. And that has driven a lot more discipline across the business. You know, CAT historically would have chased the cycle, and you would have seen highest investments at actually back to 2012. Peak investment in CapEx was 2012. And then, obviously, everything fell off the cliff face after that. And the company had overbuilt capacity, which then had to be shut down. And that was it, chasing cycles. I think one of the things the whole discipline approach of the O&E model has been that capacity is only built when needed, use Lean, use Operational Excellence as a way of driving your ability to produce more. But there are going to come times when capacity is needed. So, generally we've been making small capacity investments over the last several years. They've been relatively moderate. They've been in areas where, for example, Building Construction Products where we've seen a little bit faster growth, and we needed more capacity. We build capacities to go through. This is probably the biggest large-scale investment we've made for a number of years in large engines. And the aim is to double capacity by the time we bring everything online. It will have some incremental benefits in 2025, 2026, but not hugely. It's much more beyond that.

Why are large engines such an area of focus for us? A couple of reasons. One, obviously, still for mining. These are the large engines, C175s, which go into large mining trucks and then we still believe there is a large long-term play in large mining trucks, particularly around the energy transition as one.

Secondly, which is around energy demand. Energy demand is continuing. We've seen a lot of news recently about where energy demand has been relatively flat for many, many years and now people are expecting increases, obviously driven by artificial intelligence, big driver of that. But also, I mean, just think about it, as you bring people into EVs, that requires more electricity. There is more intermittency with renewables and there aren't good storage factors today. So, energy demand actually is expected to increase.

It was funny yesterday, if anybody's listened to CNBC first thing in the morning, the comment was that we spent \$12 trillion so far on the energy transition and reduced fossil fuel usage by 1%. So, the reality is a lot of that business, obviously from, an Oil

and Gas perspective, LNG; but also backup generation in particular as well is another part of that. And, you know, we are moving to a world with a lot more of distributed generation. So, that distributed generation requires backup intermittency because of renewables and then on top of that data centers as well. So, all of that was part of the reason why we've expanded capacity.

>> MICHAEL FENIGER: And, Andrew, just to follow up with this, as you referenced, I mean, data centers are certainly in the headlines right now. Do you have any sense of the contribution of data centers to your Power Generation business today? Do you expect that vertical to grow in 2024 and 2025 based on the strength of your backlog and the order commitments you're seeing from your customers there?

>> ANDREW BONFIELD: Yeah. I mean, as we've indicated, if you think about it, Electric Power is the fastest growing part of our Energy & Transportation business today. That is not just data centers; data centers is a part of that. There's, obviously, a lot of services in there and there are other areas where generator sets are provided as well. But data centers are a big factor within that growth, and that's the way we probably try to express it rather than quantify, per say, the area. There's a number of factors within what's driving data center growth, as we've talked about. One, which is AI proliferation, that means, obviously, there's a lot more significance relating to that.

Secondly, also the size of a data center is growing much, much larger. So, now I think you have put on a note today referencing 15 to 40, generator sets for a data center, that's for a relatively modest data center today. There are bigger data centers today, and that is probably only going to get bigger as we see AI come on. So that is, again, a large upside; and, again, part of the strength of the backlog. Yes, we always remind everybody the backlog is a dealer order, not necessarily always firm orders. But in Energy & Transportation, there are direct orders in Solar, but there are also other orders coming through from, for example, data centers. And that is part of that and that strength of that backlog as we move through.

>> MICHAEL FENIGER: Andrew, thank you for that. That was helpful. Is there any rule of thumb when we think of how much CAT equipment is on a data center site? I mean, obviously, there is the construction side, which you guys are leading in as a construction manufacturer, to help build these sites. And then there's the backup power side. Do you have any rule of thumb of how much CAT equipment, either backup or construction is on one of these sites, as these sites get bigger and more complex, how much backup power that could require and where we could see that kind of moving towards in the next few years?

>> ANDREW BONFIELD: Yeah. I think from a cost perspective or of value to us, obviously, the generator sets are a bigger value because, it is, you know, equipment that's being used to manufacture a site. A data center is also used in other applications, so it doesn't necessarily require a lot of new equipment, per say. And often maybe equipment has been repurposed from another job site previously. So, probably we don't quantify it in that way as much; but obviously, any time that there is construction activity and dirt needs to be moved, that's always good for CAT. So, we'll never complain about that. But it's not something whether, you know, you can really point. The data centers, the generator sets on data centers are really the main value and driver of value for us and have been for quite a while.

>> MICHAEL FENIGER: Andrew, I don't think investors typically associate Caterpillar with generator sets. I'm curious what the competitive landscape is for backup power. How do you compete with and is CAT's dealer network an advantage when it comes to supplying this backup power for these markets? We're hearing from contractors on the field, Andrew, that there's still a lot of tightness out there in terms of getting their hands on backup power. Does this provide some pricing power for Caterpillar in this high-demand backdrop?

>> ANDREW BONFIELD: Yeah. So, let me try and take this. Obviously, there aren't that many players who are competitors. And I think one of them who recently made a comment on their Investor Day that they thought their direct business was a competitive advantage versus CAT dealers. The reality is a CAT dealer is there on the ground and able to work very closely and deal with any issues. And that's, I think, you know, for many people a major factor. The dealer network, as we always talk about it within Construction Industries, is part of the strength of Caterpillar because it enables that relationship with the customer on the ground to and actually enable service delivered quickly and expeditiously in the event of an issue. So, remember what we do is we sell the engine, the engine is packaged, often maybe at the dealer or close on-site into a generator set to the customer's specification. And the dealer is providing some of those services there, as well as providing this service for the [engine], for the generator set as you move forward (company clarified after the discussion). Yes, as we know today, people would like to have more equipment as is always the case. You know, what that does mean is that's an advantage for us because we don't just provide diesel backup generation, but we also have the capability to provide prime power, for example, through turbines with, through Solar. So, again, that's other options which potentially could be attractive to some customers in the event, particularly if they can't get a good connection, they could look at prime power as an option as well. Obviously, a turbine is not good for backup generation because of the speeds which, is why diesel or gas is the

prime focus of backup generation, because you really want that instant availability which you get from diesel or gas.

So I think, that gives us, a lot of demand. And, again, what you have to think through and in the context of that from a pricing perspective is much more about the long-term relationships. So, you're trying to build as well. Often these are with large companies that you want to build a multi-year relationship. And so, if we just try to take advantage of short-term demand spikes, then, when we do build the capacity, obviously that then does mean that they may not be there at that point in time if they can find alternative supplies. So, it's much more about really building those long-term customer relationships. And I think we do a really good, quite a good job at doing that. And, again, with our dealers on the ground, with the data center itself.

>> MICHAEL FENIGER: Thanks, Andrew. And another portion of your E&T business, I know we spoke a lot about the Power Generation and backup generation side. Another big area of your E&T business is Oil and Gas. And, you know, oil and gas prices have been pretty volatile this year. CAT's portfolio is pretty broad based in terms of how it serves the energy market. Do you still expect Oil and Gas business to be up in 2024? What areas of that portfolio in energy is driving that growth?

>> ANDREW BONFIELD: Yeah. So, if you look at Oil and Gas at the moment, we talked about the fact that well servicing [is showing some short-term moderation] and would still have some impact this year (company corrected after the discussion). We're not seeing that change dramatically at this point in time. Obviously, with oil prices staying where they are, there aren't the number of wells being drilled. We'll see what happens in the second-half as we go through the remainder of the year.

On the Gas Compression side, from a reciprocating Gas Compression, again, that is taking gas away from the well. Obviously, gas prices have been pretty weak recently, natural gas prices. So, that's had some impact in that part of the business. And, you know, obviously, we'll need to watch that as we go through the remainder of the year.

The strength of the business at the moment is Solar, in particular on the Oil and Gas side. Solar has a very good order backlog. A lot of that is for large scale LNG projects, which, obviously, is based on global demand for gas and particularly, obviously Europe trying to wean itself off of Russian gas, even though today it's still buying about 50% of its gas from Russia. So I think, again, that's all part of that export approach and that's all part of where the Oil and Gas has been going. So on top of that, remember the thing about Oil and Gas is it's about services as well. And our services model there is particularly strong and has been doing very well as well.

>> MICHAEL FENIGER: And, Andrew, can you just touch on a little bit, flesh out a little bit more on Solar? I think that's kind of a misunderstood business. What are you seeing in terms of the Solar Turbines backlog when it comes to the Oil and Gas side and the Power Generation side? What typically drives this business? Is it high oil prices, low gas prices, pipeline growth? What do you monitor that you find drives that Solar backlog?

>> ANDREW BONFIELD: Yeah. So, there's two different parts, obviously, to Solar. There's the part that's in electric power and there's part in oil and gas. There's much more oil and gas weighted rather than electric power. Turbines can be used in prime power. And I think that's actually where there's an opportunity for us, particularly when you think about what's happening in the energy market today where people are being told they can't get a great connection because there isn't sufficient capacity in the local network. People are looking at prime power options, and that's an opportunity for us to sell turbines into there. And that's become, something which we're looking at and we're having more dialogue about with customers, not necessarily into firm orders as such today.

As far as the oil and gas part of it, it's really driven by pipelines and LNG projects. And really LNG projects are very strong at the moment, as I said. And, offshore is probably still pretty weak at the moment, although there's signs of activity of offshore starting to pick up, but it's early stages from that perspective. The bigger driver has been LNG.

>> MICHAEL FENIGER: Perfect. Andrew, just moving on maybe to Construction Industries. The construction market has been very strong despite the higher interest rate environment, you know, reshoring mega projects, infrastructure. Do you have a sense of how much your North America construction exposure is tied to those heavy projects versus maybe the lighter projects that are more rate sensitive? Given some of the tailwinds and headwinds in construction, how are you seeing the North America construction market evolving going forward?

>> ANDREW BONFIELD: Yeah. So generally, as we always said, about 75% of our CI business is what we call non-residential, 25% is residential. You know, and we keep talking about the fact that North American residential actually has been relatively strong and stayed at very high levels even though it's come off slightly from where it was. But that is reflecting the fact that, as we've been going through in a high interest rate environment, demand for housing is high, existing homes are not being sold. So, there's been lack of inventory which has pushed people to new build. And that's obviously been

positive particularly from Building and Construction Products perspective in that regard. About 75% as we say is non-residential: commercial real estate, which is the one which obviously people got very excited about; just remind you, it's relatively small proportion of total CAT sales, and, again, has not been a major factor over the last period of time. And part of that infrastructure related spend, it's a big, big driver for us, has been what we're seeing on the infrastructure side, how that's coming through, how that's being managed across mega projects. And reshoring is probably in the short term was actually a bigger factor in that as people were building, you know, battery plants and so forth as part of IRA. But there's still a lot of the IIJA money, still has not been actually put into project yet. They're still going through permitting. So, a lot of activity still to come. And, you know, at some stage, yes, North American construction will moderate. You know, that's the law of the supply and demand. But just remind everybody that, we're still seeing places like China, which was probably our second largest major market after North America, historically being at a very, very low level.

So, there are pros and cons as we move out. And, you know, a lot of governments around the world still think infrastructure is the way to go to try and manage their overall economies and drive performance. And, finally, on top of everything else, just to remind you, the energy transition doesn't happen without a lot of construction. There are a lot of power lines to be built. There are a lot of solar farms to be built. And there are a lot of wind farms to be built. And you need dirt to be moved as part of that. So, again, those are all good, long-term secular trends for construction.

>> MICHAEL FENIGER: Fair enough. In the construction topic, Andrew, inventories are always very topical. At times the market only views inventories as binary. You're either in the restocking phase or destocking. As the CFO, how are you evaluating inventories at Caterpillar today at its dealer network into the second-half? In the fourth quarter last year, dealers took out about \$1.4 billion of machine inventory and you actually expanded margins. That was incredibly impressive. Is that possible to take out a billion dollars of machine inventory out this year without harming profitability again?

>> ANDREW BONFIELD: So, let me step back and say what we're trying to do from an overall management of dealer inventory. I think historically we always talked about the fact that CAT would, as cycle started, as dealers started to order more because they started to see, a ramp up in demand. What that tended to mean was availability went out because we hadn't ramped up production. Dealers ordered more to get slots, and then eventually we started to get availability right. And then what happened was dealer orders tailed off almost instantly as a result of that because availability was coming down and in that stage, we were still moving machines out. We had built production and we overbuilt inventory. That's the reality of the situation. As we've said that, we are very

focused on making sure dealers are independent businesses; they manage their own inventories, but we manage orders much tighter than we have done historically through what we call an Sales & Operations Planning process to avoid some of that peak-to-trough added issue that's made as a result of that whipsaw effect. And part of that is being much more proactive. I think the CAT of old would not have managed inventory down in the fourth quarter in the way it did last year with dealers because we would have still been within the normal range and, therefore, wouldn't have seen it as a priority. What we're trying to do is make sure we remain in that three to four months, particularly on the Construction Industries side as best as we can, as much as possible.

Yes, we did take out a lot of inventory in the fourth quarter. It didn't have a huge impact on volume because it was made up with volumes elsewhere. So, where we did see the volume decline, mostly in Excavation, that was offset by very strong performance in Earthmoving. Also, within BCP, as you remember, we did have some product cutovers, and that had some impact on dealer inventory in the fourth quarter. But that was planned for as part of the year, so it probably didn't have as much margin impact because that was thought through and managed on a much more proactive basis. So, what we always try to balance out is making sure what we're doing is not going to end up, say, where we were maybe back in 2012, where we ended up with a lot of dealer inventory out there, which meant that we had the production cuts on top of the demand that decreased, was much, much more significant and had a much, much, much bigger impact than it needed to have had on the business as we moved through in the following years.

>> MICHAEL FENIGER: Fair enough, Andrew. And just talking about Resource Industries in April, one of your biggest dealers, Finning, publicly talked about booking \$700 million of orders for copper mines and oil sands. Resource Industries is actually the smallest contributor to group profit out of your three segments, but it was the biggest in 2012. Are copper, iron ore and coal prices, are they high enough to drive replacement? Are you seeing customers pause for some of these projects? Any color there?

>> ANDREW BONFIELD: So, again, back to the longer-term secular trend for mining, in particular, is very positive. And that's because if you think through the energy transition, the amount of copper that needs to be mined over the next several years is a multiple of what has been mined historically. You know, coal demand today is relatively low. So, that's a very small proportion of our total revenues. So, it's not a replacement. We're not going to lose coal and gain something else. So, it's not a net, net zero. We think it's a long-term benefit. So, there's a long-term trend with the energy transition and with the other minerals that need to be mined as part of that change. You know, you

need more iron ore, you still need more lithium, you need more nickel, cobalt and so forth.

So, all of that are long-term positives which will help us in that business for the long term. If you think about large mining trucks today, the parked fleet is still low, you know, people tend to focus on CAT on large mining trucks. Let's be honest about it. That's the area which probably gets most attention. If you think about large mining trucks today, parked fleet is, again, very low levels versus history. The fleet is still aging. So, what that says today is we are not at a replacement cycle yet as far as actually replacing existing equipment because the fleet would not be aging. That age would start to come down or be flat. So, first of all, there's that part of it which needs to be thought through.

Second, it is around what a customer is looking at. Customers are taking into account a number of different factors when they're doing it. Obviously, commodity prices are key. Copper prices are pretty strong. so that's not an issue in investing in copper. One of their biggest challenges is around permitting. As you know, that's a big factor for a lot of the mining companies and permitting takes much, much longer today than it has done historically. And that has an impact on their ability to ramp up production as quickly as everyone would expect given the secular trends.

Third thing, which we're not sure whether it's a factor or not is around their ESG commitments and particularly around things like battery technology and large mining trucks. We're doing our early learner programs now. We're starting to see those machines ship out. And, if you're thinking about fleet replacement, you've got to take that into account if you have an ESG goal which some of the large mining companies do have. So, those are all factors which probably go into play.

Finally, I think the other factor has been, you know, they've been able to rebuild trucks in a much better way. Again, this comes back to our grand promise of quality, which they are able to rebuild. And if they're able to rebuild, they extend lives and they've been extending lives over through this cycle. That actually is not necessarily a bad thing for us because, from a profitability perspective, obviously, services are as attracted to us as Original Equipment. So, in this regard, it's all good for the long term. Short term, we've got bumps in the road this year. That was two factors. One which is to say the articulated trucks where we had a large backlog which we've now shipped out and moved on. And then, secondly, off-highway trucks, which is mostly Indonesian coal. With dropping of Indonesian coal prices, that market has closed down. And that we've got to work through in the first half of this year but should improve as it goes through the second half.

>> MICHAEL FENIGER: Perfect. Thank you, Andrew. And, you know, in the beginning of this year, you raised your free cash flow generation target. Maybe if you kind of unpack where it was, and where you're raising it to now and what is really, Andrew, driving that better free cash flow generation? How did you look at CAT's capital allocation approach now with a higher baseline of free cash flow going forward?

>> ANDREW BONFIELD: We were very pleased last week to increase the dividend by another eleven cents a quarter to \$1.41, which is part of our commitment to growing the dividend by high single digits for four years after the 20% increase back in 2019. So, again, we are in good shape. So, overall at capital allocation, as we said, we will continue to return substantially all free cash flow to shareholders over time through dividends and share buybacks.

What has happened? So, what is the driver of our ability to drive more free cash flow? So, if you remember our previous targets were \$4 to \$8 billion, which is based on being between \$1 and \$2 billion higher than they had been historically. Obviously, last year we were able to generate \$10 billion of free cash flow. So, we moved the targets to \$5 to \$10 billion.

Why are we more confident about our free cash flow generation? I think, again, the discipline of the O&E model is the big driver here. We do not build CapEx. We are not spending CapEx to build capacity to chase the cycle. We're trying to find other ways about managing through and avoiding building more factory capacity just for the sake of building, having the last machine at the peak of the cycle being able to be delivered. So, that discipline has definitely been something which is factored.

Secondly, I think improved performance operationally, from a margin perspective, that margin performance improvements come from a number of things. One which is, again, relentless focus on efficiency both from an in-factory perspective and also from a back-office perspective. So, in the factories, obviously, Lean; making sure we're managing out some of our products which were less profitable. We disposed of some of those businesses. We continue to make our manufacturing more efficient, looking at where we're sourcing, how we're sourcing, how our product lines are working. And all of those are factors which go into there. And then back-office, looking around things like making sure, finance, for example, had never been outsourced before 2017. None of it had. We had finance shared services, but we've moved it to a third party who is able to help and drive more efficiency in our back-office processes. And that sticks through all different types of processes as well.

Finally, the services focus. We've invested a lot of money in services. Most of that is going through the P&L. And a lot of that is around driving services and services growth. Again, that drives long-term customer commitment, but it's also about making sure you're creating value for the customer by giving them simple things like an app that's easy for a retail customer to be able to transact with Caterpillar. Doing things like making sure the dealers hold the right level of inventory so that they can actually provide the right part to the right customer at the right time, which is the most important factor in selling parts and services. Making sure that we're working on things like condition monitoring through Prioritized Service Events, like trying to tell the customer, you know, what's the worst enemy of a customer? Downtime when they need a machine to do and make an application. And that part of it, you know, by getting more into Prioritized Service Events, you are able to do much more early-stage servicing to avoid a downtime or an event behind it.

And then the final thing, which is really about our expanded offerings again, which also is part of that. And historically would have been competing with an offering, for example, taking a high-end, medium wheel loader and competing with a lower-end, medium wheel loader from a third party. And because particularly for the application is needed, people don't need bucket sensors, they didn't need all the bells and whistles on it, but we would discount and that would impact margins over time. Well, now we've actually introduced the GC range, and the GC range then gives a competitive offering against that lower-grade, lower offering, and gives the same CAT quality and TCO, but with less of the technology on; and, therefore, it's competitive and avoids margin dilution. So, that margin expansion that we've been able to generate has been, again, part of that focus and ability. So, again, and finally even going through when we went through COVID in 2020 with that significant downturn, still being able to, even with paying STIP still during that year, so a big cash outflow, not cutting back on any investment, still being able to generate over \$3 billion of free cash flow tells us that in most circumstances we are able to continue to deliver that. And, obviously, from a shell perspective, that focus on OPACC, Operating Profit After Capital Charge, we do believe it's the greatest correlation to TSR, Total Shareholder Return, because effectively it focuses us on driving free cash flow.

And so, when I joined, a lot of people said what was the thing you most appreciated by about CAT when you joined? And having been around for quite a few years and different companies, cash generation capability is the one thing that investors have always underestimated at Caterpillar. Now, we haven't been consistent about our deployment of capital back to shareholders. I think we've been doing that since 2019, and that has helped. And if you look at the share count decline since then, that's all part of getting to this virtual circle of driving free cash flow, buying back stock, being able to

fund the dividend increase and doing all of those things together as part of our capital deployment strategy.

>> MICHAEL FENIGER: And, Andrew, just to follow up with this, because this has been a key strategic focus for you, clearly, you're driving a higher baseline of free cash flow, you're repurchasing shares, you announced your dividend increase. Can you see CAT adding another vertical or end market over time? Are there any markets CAT is in today that maybe it wasn't in a few years ago or other markets that you would like to expand into that we should keep our eyes out for?

>> ANDREW BONFIELD: Yeah. I think, as most of us would tell me, that CAT's track record in mergers and acquisitions probably is not the best. We will always be opportunistic; on an M&A perspective, we'll always look out there. The SPM acquisition was a great case in point where we took a business, which we saw opportunity for us particularly on the gas side to own pumps and valves, and that helped us to drive a better offering to customers on the frac trailer. Obviously, that was one where we saw the opportunity and we would do it.

Do we think about additional verticals? One of your competitors last year made a comment about we should go and buy AGCO, CAT should go and look at AGCO. Let me just say, trying to acquire a company with the only discipline which says you have to achieve a return in capital above the cost of capital and go and compete against a major 60% market share company probably would not get a lot of thought. And, in fact, when it did cross my desk, it didn't even get sent to the M&A team to look at. So, it was never even feasible. I mean, never rule out, never. If there are opportunities and adjacencies where we see an opportunity to add value to our customers, obviously we will continue to look at that. But more likely on the M&A side is more add on services. So, things like Tangent. If you think about it back to the point that we've been talking about, not necessarily for data centers, but generator sets, if you are a company manufacturer, you've got your backup generation on site, and you want to use those generator sets and monetize the value. You can sell the electricity back into the grid, and Tangent will help you monetize that. So, it's about having those sorts of services, I think will be much more the way we will go, which would be adding capability, which helps create value for our customers.

>> MICHAEL FENIGER: Fair enough, Andrew. And for years investors kind of look at CAT as a macro play, just follow the backlog. I'm curious, given the dynamics in recent years, is the backlog still the best barometer for us to follow for CAT's earnings profile going forward? Do you find that CAT is maybe more diversified within its segments, you know, Construction Industries, Resource Industries, E&T than it was in, in past cycles?

>> ANDREW BONFIELD: Yeah. I think we have deemphasized the backlog for a number of reasons. Particularly in Construction Industries, the backlog is primarily dealer orders. So, it's not necessarily customer demand. So, I think you have to be very careful about following it in that regard.

And also within RI, there's an element of that with dealer orders particularly on the heavy construction and quarry and aggregates side rather than on the mining side. But within mining and Energy & Transportation, a significant proportion of orders are backed by firm customer orders before they're both put into our backlog. So, particularly for that part of the business, it's really important. It's a better monitor of those businesses, less so on CI as I say for that reason. But actually CI backlog remains relatively consistent. It doesn't actually fluctuate that much. The bigger swings probably will be more in Resource Industries and Energy & Transportation.

So, there are some benefits of following it, but I would be very careful of being a prisoner to the backlog and saying whatever the backlog is doing, that's a sign. I mean, we were pleased that, as we said, backlog is also a function of availability. And when availability is stretched a little bit like say, for example, it is in large engines, the backlog doesn't come down quite as quickly. And also for Solar, because it's a longer lead time project business, sometimes the backlog doesn't come down quite as quickly as we would have expected. Backlog is still relatively elevated compared to historic trends. So, there's some value in it; but it's not the only thing. I think, for me, it's a mixture of backlog, what we're shipping, which is our sales and revenues, and then I also follow what's happening on sales to users because ultimately, at the end of the day, that's real demand, particularly on the CI side. So, trying to keep all of those things in focus are the things to try and actually manage the business in the best way possible, to try and make sure you keep those disciplines to avoid over building inventory, over building capacity, getting set up too quickly and trying to manage that. So, it's a tool. It's one of the tools, but it's not the only one. And, there are a lot of other factors. That's part of it.

Secondly, our businesses, again, just are much more diverse today than where we were historically. Services is a bigger portion of our revenue than it has been historically. That's important because it's less cyclical. You know, if you think about construction, you know, construction is strong in North America, not so strong in Europe, strong in the Middle East, not so strong in China. So, there are parts of it, even within the individual segments, it's not one-size-fits-all. So, I think it's about that, having that balanced, broad portfolio and actually managing the business as best as we can. Yes, we are more economically sensitive than a lot of other companies; but overall we are actually, maybe less economically sensitive than people think. And that's the

perception we need to continue to change. And part of the reason the consistency of our cash flow, for example, whilst earnings and sales and revenues may fluctuate a little bit more, cash generation is pretty consistent throughout the business.

>> MICHAEL FENIGER: Fair enough. And, Andrew, with that consistency, there's always an economic sensitivity to some degree. There's always a fear of an industrial downturn in the recession. You know, clearly there was a great financial crisis in 2009, but since then there's also been, you know, a mining equipment downturn, an oil and gas downturn; we saw COVID. So, how could that next industrial downturn impact CAT this cycle? Is there any rule of thumb that we should think of our investors on the line to think of in terms of the earning sensitivity for CAT in that type of background?

>> ANDREW BONFIELD: Yeah. We give the margin targets within different levels of sales and revenues. That's partly to give a guidepost to investors of what we think we should be able to deliver from a performance perspective at different levels of sales and revenues depending where we are in the economic cycle. So, that's a general thing that was to help investors give them a guidepost. You know, I wouldn't necessarily get focused on and I've had the questions before about, well, the bottom end of the range is \$42 billion. So, that must be where you're going to go to in the next downturn. That's not necessarily what that's meant to be. That was meant to be a profile based on historic sales and revenues trends from the 2010 to 2016 timeframe, not based on anything. It's not based on what we expect.

I think generally, we saw, even during COVID, a pretty rapid downturn on the machine side, but actually overall sales and revenues were probably a little bit more robust than people thought through that timeline. So, I think it depends on the nature of what happens. And it's just one of those things which, we'll manage as best as we can through that time frame. But we're happy that the portfolio is in a different place today and so that not everything is going to go down all at the same time. And there will be things that still can have upside, which may be able to more than offset the impact of any economic downturn. Obviously, big geopolitical events like COVID are things that nobody can avoid, and they will have some impact on a company like CAT. But I think we're much more resilient than we were historically and able to move out of that much, much quicker than we have been.

>> MICHAEL FENIGER: Helpful, Andrew. And you referenced this a little earlier, but we're seeing CAT deliver record earnings where China's been kind of in a slump. Can you just talk about, CAT's China portfolio, how that's evolved in recent years, any context of the percent of revenue it is today, how far it is below those peak years? And are you seeing any green shoots at all on the ground over there?

>> ANDREW BONFIELD: Yeah. As we've discussed numerous times in the last couple of years, China has been quite weak and the market, particularly for 10-ton and above excavators, which is the market we're focused on, has dropped quite dramatically. We always talked about China being between 5 and 10% of CAT sales and revenues. It is significantly below the bottom end of that range today, and that's a factor of the end market. We're not expecting an upturn this year. Obviously, if it does happen, that's a positive upside. But, you know, we're just keeping in line on the ground. Obviously, there is the big property overhang that's still there. I think reports yesterday that the property overhang was still having an impact in China, much more than people were expecting. So, I think it's just one of those things. They just have to work it through and, you know, they don't have the capacity to do what they used to do, which is driving the economy just by building more, more things. So, that's been a big factor, which has impacted our business there. But, we're still very much a strong legacy in China. You know, we're still very focused on our China facilities. China manufacturing is still important for us, both for that market and for other markets, particularly in the Asia Pacific region. And so, we still will believe in China and hope that it recovers as soon as possible.

>> MICHAEL FENIGER: Great. Andrew, just the last question as we wrap up. Last quarter, you kind of flagged, it seemed like Middle East was strong, but there was some weakness you flagged in Europe. Just curious if you can kind of unpack that, what are you kind of seeing in Europe? There's obviously geopolitical elections. We also saw the ECB move. I'm just curious with what you saw in the first quarter with Europe, how you're kind of thinking of Europe and the Middle East as we're kind of moving forward? Thank you.

>> ANDREW BONFIELD: In Europe itself, we had quite a strong fourth quarter, which probably was part of the reason maybe we had a little bit weaker first quarter than we were expecting. And it may have been the strength of the fourth quarter. We misread what that impact will be as we moved into Q1. But, obviously, Europe is in, a tough area for the moment, in the current environment economically. Obviously, Germany has been pretty weak. As you know, Germany normally is the driver of Europe. Energy costs have come down, so that's a positive. The cost of living is reducing over time, which is a positive. And hopefully over time we'll start to see Europe recover and the reduction in interest rates in the ECB may start to see a positive impact. So, hopeful that Europe will start to pick up overall; but, that's something which has been relatively negative.

Middle East has been very strong and remains pretty strong. So, we're very happy with the performance in the Middle East, a lot of activities going on particularly in places like Saudi Arabia, and that's a big driver of the performance. So, yeah, that we aren't seeing any change. We haven't seen any change, that remains strong in Q1.

>> MICHAEL FENIGER: Perfect, Andrew. Well, we're up at the end of the hour. I want to thank Andrew for his time today and Ryan for making time available for everyone listening on the call. There will be a replay for anyone that wants to go back and listen to the fireside chat and the conversation. Everyone, thanks for joining us and, Andrew, we really appreciate it.

>> ANDREW BONFIELD: Thank you very much, Mike.