



Company Name: Caterpillar Inc. (CAT)
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<<David Raso, Analyst, Evercore ISI>>

Great. Thank you, everybody for joining us. Very excited to have our next presentation from Caterpillar. For the Q&A, please feel free to send your questions into me on the chat room. But send them in as you think of them. I can look at them as the presentation is going on. We don't have to wait until the end for the Q&A.

For those of you who don't know me, I'm David Raso, Head of Industrial Research for Evercore ISI. And from Caterpillar today, we have Andrew Bonfield, unbelievably almost three years now as CFO, it's gotten pretty quickly; and Jennifer Driscoll, Head of Investor Relations.

And with that, I'm going to turn it over to Jen. And again, thank both of you – I want to thank both of you for taking the time today.

<<Jennifer Driscoll, Head of Investor Relations>>

Well, you're welcome, David, and thanks for inviting us to your conference. We're pleased to be here today. So for all of those listening in person or via webcast, take a look at Slide 2. It's the most exciting one in the deck, where we remind you that we may make forward-looking statements today, which are subject to risks and uncertainty.

For a full list of the factors that could cause our actual results to vary materially from our forward-looking comments, please refer to our slides and our most recent SEC filings, including our 10-K that we filed on February 17. We also will refer to some non-GAAP financial information. So for that reconciliation of our GAAP to our non-GAAP, please refer to the appendix in our slides. So that's it for the reminders.

And with that, let me turn it over to Andrew Bonfield, CFO of Caterpillar, on Slide 3.

<<Andrew Bonfield, Chief Financial Officer>>

Okay. Thanks, Jennifer, and let me just quickly thank you, everybody, and great to be here. Let me just remind you the results that we came out with at the end of January. Sales and revenues for the year of \$41.7 billion, down 22% year-on-year. Adjusted operating margins of 11.8%, down 400 basis points, reflecting lower volume and some unfavorable price, offset in part by no

short-term incentive compensation. And both profit per share and adjusted profit per share were down year-on-year. Profit per share was down to \$5.46. Adjusted profit per share, excluding the impact of mark-to-market remeasurements of pension and other post-retirement benefits obligations and also restructuring, was \$6.56.

If we move to the next slide, just a couple of highlights. We returned 110% of ME&T free cash flow to shareholders, bringing in average over the last three years to 106% of free cash flow, retiring just a roundabout 10% of the average number of shares over that period of time. Operating margin was within the Investor Day margin range. We estimate that the margin range at that level will be somewhere between a roundabout 11% and 14%. 11.8% was the actual number based on the levels of revenues. At the beginning of the year, we didn't expect to get there given the impact of the pandemic on our business, and we were very pleased that we actually managed to achieve that.

Services revenues, although they were down year-on-year, did actually represent about 41% total ME&T sales. And actually, we're year-on-year down by less than actually we would expect based on original equipment revenues. All three segments saw sales down in the 20%-plus range. All of them did still manage to achieve double-digit margins, despite the challenges of going through the pandemic and then also volume that impacted each of the segments.

We move to the next chart. We continue, though, to invest in the business as we went through 2020. We did actually launch at the end of 2020, our new GX excavators in China. These are lower – more utility type, low on the life cycle management side of the end of the spectrum, cheaper models, made in China, for China with Chinese components and focused particularly on its Taiban customers. These are the individual contractors who basically sit on the side of the road with their phone number on the boom waiting and actually being paid by job per hour.

So, their focus is on really quick return on investment and payback. That enables us to compete in that segment of the market, which has been growing very fast and also then gives us the full lineup, the productivity models, the GC models and the GX models in China. Overall, we expect to see that help our overall share in what has been a very strong market in 2020 and expectations for a strong market in 2021 as well in China.

Looking at mining technology. Obviously, MineStar, our electronics products within resource industries, are principally focused at the moment around large mining trucks, although they're being considered for other applications. We do believe we are market leaders. And that's – obviously, that is an area of focus for us, particularly where as we come out and we expect mining companies to continue to invest in new technologies to improve their productivity with actually a 30% productivity gain on those products, so that's important.

Overall, we continue to invest in our business. Part of the reason why we gave ourselves a wide range of margin targets, 300 to 600 basis points, to remind you, as when we talked about Investor Day about research and development that we would invest what we needed to invest in R&D to make sure that we have the products that our customers need, to meet their expectations and meet the needs of them doing the work as we go through.

If we move to the next chart, a lot of talk at the moment, obviously, is around ESG topics. A lot of people are concerned about where Cat is in this market area. Just to make clear, we are investing in electrification. We are investing in hydrogen technologies, and we have capability here. Thing about Cat, as you know, is that Cat does tend to wait until it's got a product that's actually ready to launch commercially before we talk about it.

Many of you will recall that many years ago, we were considered to be a laggard in autonomy. We now do believe that we actually have a very competitive, if not the best product in the market. Where we're focusing at the moment is within, for example, large mining trucks. One of the things is called trolley assist. Effectively, it's like a tram line, an electric line, particularly on the up slope, which the mining truck connects onto, which obviously reduces emissions by being driven by electricity on the up slope.

We are pleased that the EPA gave us a Clean Air Excellence Award with our Dynamic Gas Blending engine. We do believe that this is a competitive advantage for us, again, particularly where you think about, on the frac side, where this product can actually displace 85% of the diesel that's normally used with natural gas that would otherwise be flared. So, the double benefit of reduced cost and reduced emissions as well is important.

And also, we were pleased to be awarded two awards from the U.S. Department of Energy on hydrogen research, one, which is around hydrogen fuel cells in data centers. And the second is a mix of hydrogen and natural gas in combined heat and power sites. So again, both of those – funding for those has come through and will continue to be part of our investment thesis as we move forward.

Finally, just talking about operational excellence. One of the things we won't stand still on over time is focusing on investment. We also need to make sure we continue to drive our journey of operational excellence. Three areas, in particular, let's talk about where we focused in 2020, and we'll continue to focus in 2021. We had a number of products, which weren't able to deliver a sufficient level of OPACC to meet our overall goals.

OPACC is our operating profit after capital charge, which is our key measure of profitability, effectively means a capital charge on the assets involved in that business. These businesses weren't achieving that, so we've done – addressed some of those. Sale of our marine propulsion business and also the restructuring of both our longwall mining business and our hydraulic mining shovels business, moving those businesses closer to the customer out of very high cost areas in there.

Also continue to focus on outsourcing. We've done some work around a new HR system implementation, which will improve our efficiency. We've outsourced a significant proportion of our finance cost, again, to drive efficiency and productivity in the back office. And at the same time, we continue to focus our program on reducing our overall procurement costs. Both direct and indirect costs are areas where we still continue to see opportunities to drive continuous improvement and cost out of the business.

So with that, that's a quick overview of where we are in Cat. And now I'll hand over to David for the Q&A session.

Q&A

<Q – David Raso>: Terrific. Thank you. I remember you were kind enough to sit down with me very soon after you started in late 2018, and the three things I had asked you like what was your first view of Cat. And I think one of the things you mentioned was the modest CapEx needs the company would need on the next upcycle. And it was also clear, dividend growth and maybe more share repurchase than we had seen in the past.

At the May meeting in 2019, we got the view on the dividend growth, the use of the share repo for the residual free cash flow after dividend. The CapEx needs on the way up. Do you still stand by that from what your first impression a couple of years ago that on this upcycle, the CapEx needs will be relatively modest? Or is the cycle taking a little different shape than you would have thought?

<A – Andrew Bonfield>: I think, I mean, one of the things, again, just back to one of the three pillars of the overall strategy is around operational excellence and lean still continues to be a key focus on that. We do believe that we have sufficient capacity for the upcycle. Now that doesn't necessarily mean that we won't be spending CapEx on bricks-and-mortar because, obviously, there are times, particular product lines where you have to build capacity out, and we've approved those capacity increases.

For example, for something larger, we approved an increase in expansion within our building construction products division. So, we do those where we need improved manufacturing capacity. But I think the thing is, obviously, we've utilized our footprint much better. We believe we have good access today. And we believe that, in most outlooks, for most end markets, we are very comfortable with the capacity we have.

Coming back to your point, I mean, yes, I mean, one of the things that I remarked on is our cash generating ability. I mean if you look at the free cash flow last year, \$3.1 billion. And we did continue to make sure that we had sufficient inventory – Cat inventory on hand to meet any upturn in markets and still throw off \$3 billion in what was a significantly down year, is a sign of the strength of the model. And I think that's really a bit – as you and I have discussed, David, which I think is a bit – probably will be where investors still underappreciate the ability of this company to throw off a lot of cash.

<Q – David Raso>: Yes. Well, the cash generation and where the balance sheet today leads to an acquisition question, but maybe I'll just step back kind of big picture. Now that you're an old hand, having been there for a few years, I mean the historical framework for Cat in simple terms, and we always think the cycle could be different, and at times, you realize it doesn't change that much from cycle to cycle.

The historical framework is Cat's revenues off the trough will more than double, and the EPS will triple to maybe even a five bagger in some special cycles. When you step back and think of

where you said the capacity is for the company, the cash flow that you have, but at times, people can argue, well, oil and gas CapEx isn't going to be what it's been in the past. Mining, the negative side of coal, but then the positive side of copper and EV, generally speaking.

Your balance sheet is a lot stronger entering this cycle than others. So I'm just curious, just a sort of a step back, big picture question. If the historical framework is at least doubling revenues and tripling earnings, there's a lot of puts and takes, but the one difference is the margins are starting at a lot higher level, where usually coming off of a trough, your margins are mid-single digits. I mean back in the day, obviously, they were even negative 20, 30 years ago. How do you think about that normal framework for investors thinking about Cat coming off of a trough?

<A – Andrew Bonfield>: Yeah. So I mean I think – I mean, one of the things this business does have is obviously the significant level - so there are two factors, which probably should drive margin performance as you think of the upcycle. One obviously is – obviously, the leverage that is created within OE as you expand – as your end markets expand, and that obviously is significant. Obviously from the business perspective, RI is much more sensitive to that than the other businesses. But even the other businesses, it's still a significant factor as you move forward. So always leverage is there.

Now the – because our margins are absolutely higher than they have been historically, that does negate some of the room for expansion, because you've already got some of that efficiency built in. So therefore, there isn't quite as much footprint or fixed cost to spread across, so that model doesn't always work in the same way as it has historically.

Second area from an overall margin perspective, which is an area, which is important, is the drive around services and services growth. So as we talked about our target of doubling services revenue to \$28 billion by 2026, that is another area where, obviously, margins can continue to be driven as well higher given, obviously, again, that you would expect those revenues to be much more stable and can actually help margin expansion.

Again, there's not a lot of fixed costs associated with expanding the services footprint. So again, those are opportunities for us to drive profitable growth, and that's why they're core to, obviously, when we do operational excellence and services and services revenue growth. That's why they are two of the three legs around, obviously, the profitable growth mantra.

Obviously, the other part of it is NPI, and you need to make sure your products are relevant to customers and meeting their needs at that particular point in time, which obviously then drives overall revenue. So yes, all of the – that's why those are the parts of the strategy, David, and that does work, obviously.

I always worry about going back to historic precedents because there's always a slight difference, as you say, between one cycle and, therefore, that can create differences, which can impact how we perform as we go through this cycle versus other cycles. But what we would say is, yes, there is that opportunity as we move forward. And obviously, the good news for us is that we got through this cycle in a much more resilient way than most people probably had expected or anticipated based on the history of Cat.

<Q – David Raso>: Yes. It seems like the operating move off the bottom, the EPS growth off the bottom, the more it's an inflationary cycle, the – usually the bigger – right, the bigger leverage. And the way it's shaping up right now, you'd like to think it has a chance to be more like that than in the '90s, where you guys did a good job, but – right? It was low commodity prices.

In the 2000s, you had a big inflationary cycle. And last decade, you did a nice job on margins, but the revenue growth, I mean, your revenues have been down six out of eight years, and that's pretty unbelievable that do we have a run here, Fed permitting and you can make your own macro views, but do we have a run this decade that's more of the inflationary end markets where your margins are usually pretty healthy?

But then the key difference, I think, right now are also is the free cash flow. I mean, the last 10 years, your free cash flow has averaged something like 12% of revenue. In the prior two decades, it was always – the average was like 7% or 8%. So that extra 400 bps of free cash flow, when you're doing \$50 billion, right, it's a nice extra \$2 billion laying around.

So I think the use of the balance sheet and even the May meeting in '19, you didn't really address it. You just said, shareholder, here's the free cash flow, dividends and repo. The balance sheets, for us, it's our sandbox to play with. So given where we are viewing which markets have headwinds, secular, tailwinds, new technology, the service push, can you take us through how we should think about the acquisitions from here?

<A – Andrew Bonfield>: Yes. So I mean, obviously, from an M&A perspective, I mean, one of the things we've – Weir was an opportunistic focused acquisition, which was based on an expectation of end markets, which was pretty conservative. We used the WTI at the rates it was at the time. Obviously, that's come back up, which obviously gives us expanded opportunity with that.

So opportunistic acquisitions will always be there, David. They will always be something where they can expand. The other advantage of Weir was not just because of the opportunity with – from an oil price perspective, but also focus on services, and that does give us a better position on the overall onshore oil and gas market and accelerate some of the strategy around the frac trade and so forth.

So that was really, really important for us for both reasons. So strategic reason plus and also obviously opportunistic from a value perspective. Obviously, in this market at the moment, obviously, value is much harder to find, so that's going to be a constraint on probably M&A, but that doesn't mean we won't look for them. We will obviously be opportunistic as and where they can.

As far as the other really strategic areas of concern, I think there are a couple of things. One, which is technology and services areas where we can see much more opportunity for us, particularly on the M&A side, because, of the alignment with the strategy that we've got. So be it a simple acquisition last year, we did acquire a company called Marble Robot, which fits in with our overall strategy around autonomy within mining.

It was a small acquisition, but it built capability and accelerated capability that we didn't otherwise have. That's important for us as we move into – out for the next several years, so using technology or acquisitions, as well accelerating capability or if there's just something, which we just can't get access to.

So obviously, in the event that there are major switches to technology, which could impact our business, obviously, then that – we've got that freedom within the balance sheet to at least try and acquire those technologies early on, if we don't see those becoming available more generally.

So for example, today, battery technology, there are so many people in the market. It's unlikely to be something where you would sit there and say, you have to acquire a battery company in order to have an electrification strategy. There's more likely to be many people building into that area that do that. So again, that sort of thing, you probably wouldn't, now other areas of there maybe things that come along, which we'll look at.

Services, again, is definitely back to the point about accelerating our services growth. I believe that's good business for the company. It's less cyclical. It's good margin structure. And it's good for our customers because, ultimately, end of the day, offering them services that they need and need to acquire creates that customer intimacy from a Caterpillar perspective, and that long-term growth, that long-term bond, is another area where we could use the balance sheet as well.

<Q – David Raso>: It feels like you have a pretty solid \$8 billion or \$9 billion to play with, so it's a sizable level of flexibility. When I think about the – I'm just thinking about from a stock perspective, obviously, the financials have to work as well. But even the Weir acquisition, which, the way I think oil and gas CapEx will at least balance at a minimum from here, it will turn out to be a strong deal.

But again, from a stock perspective, people like they're doubling down on fossil fuel, which I don't think was the right way to look at it, especially the size of your company versus what that was. And even when I hear down in the channel, you're going to go direct with that. You're even going to service some of the Cat dealers pump.

So to me, that's reflective of Jim [Umpleby] wants to service revenue. He's going to go direct. And making acquisitions where you can go direct and not feel like it has to go through the dealers opens up what you could buy. But from a stock perspective, are you and Jim thoughtful about the idea of another asset that's even an attractive financial acquisition that doesn't serve the needs of the Venn diagram of you want your services, but maybe something more about new energy than maybe legacy energy that could have a better impact, I'd argue, on the stock, regardless of how good the financial acquisition might be for "older fossil fuel?"

<A – Andrew Bonfield>: Yes. So I mean, first of all, there's – the energy transition is going to happen. We are not burying our heads in the sand. We are not assuming that everything is going to stay as is. It's not, that is very clear. And obviously, we need to – and we continue to make investments in areas like electrification. So we are spending money today. We are not – we are

spending quite significant R&D dollars, and that will continue and probably only accelerate as we go forward.

Obviously, what you need to balance out, and the challenge for us, is around timing of where things fit within the market. So again, we gave a few examples today, which are where customers are looking for options to try and find differences within the new energy market. So again, back to that point about the tram line within the large mining trucks, the Dynamic Gas Blending engine, which is a competitive advantage, we believe, in the fracking side. But things like – we talked last year about the first electric train locomotive we produce for Vale. So again, that is an area where we have some – we have capabilities that we will continue to build.

Again, from an M&A perspective, yes, are we open to those? Again, as I said, if there is technology out there, which advances our capability by a period of time and gives us competitive advantage, yes, we would. That doesn't necessarily mean we're going to go and buy a battery company because, as I say, I think that is going to become a commoditized approach. Well, actually, you need to think about is the packaging of batteries rather than actually the battery yourself because the battery technology is pretty well known.

So it's about finding the right niches and how does it actually drive that growth over the time. So yes, we are open to those things. I wouldn't necessarily just go and do it for the sake of doing it. It's got to have a financial return, and we've got to see it as being something, which fits into the overall opportunity set that we have in front of us.

<Q – David Raso>: The mining market, obviously, picking up. How quickly are we taking quotes to the factory floor and actually getting orders that will ship in the near term, next six to nine months? And also, if you could give us some sense of – some of your competitors, I've been pleasantly surprised of what percent of the order book is autonomy, right? We've clearly gone from, it has to be a greenfield. So no, it doesn't. It definitely can be a brownfield opportunity. What percent of the order book would you argue that's building with Denise's [Johnson] business that's autonomous?

<A – Andrew Bonfield>: Yes. I mean, we don't obviously disclose the percentage. But obviously, it is a growing number of the conversations around – particularly probably with Tier 1 miners because, obviously, the capital cost. So again, remember, obviously, David, not all mining companies are the same. So obviously, the larger companies with the bigger balance sheets and lots are looking at it from a couple of advantages.

One, the productivity gain. So obviously, that's really important for them. Two, from an ESG perspective, because it reduces emissions. And also in a post-COVID world, it improves their resilience because, obviously, you don't have the issues about having to have people on site. So safety, productivity and resilience of their business operation.

As far as retrofit is concerned, there are some, both from a mixed fleet and also, obviously, from a Cat fleet. People are looking at that. I think, obviously, the challenge in an existing mine is, obviously, is it fit for purpose and is there enough productivity left in the mine to make the capital investment worthwhile because, obviously, it's much more than just the actual mining

trucks themselves. You've got to make sure you have the right infrastructure in place around that. So it's going on.

I mean, we are seeing high levels of interest in autonomy. As is always the case, capital discipline is still there within the mining company. I think the Anglo CEO came out last week and made the exact – the comment. Discipline will still be here. We're not just throwing money at commodities. But I think, obviously, we do expect, given where we see the demand for commodities and, again, back to the energy transition driving particularly things like copper and so forth, that we do believe we'll make those end markets even stronger, which obviously will give them the confidence to invest. And obviously, we believe autonomy is a great opportunity from in there.

<Q – David Raso>: Can we announce we move past the quote stage?

<A – Andrew Bonfield>: No. I mean, we've got – obviously, we'll update as we go through the year. But as is always the case, it's an environment, which people have to be confident in, and we're still living with the legacy. There's still a little bit out there, David, of COVID concern, which is still how quickly do things recover back to more stability. Obviously, all the news is very positive. The vaccine news, all of those things add confidence, but I'm not sure yet everybody is yet ready to go and say, absolutely push the button.

<Q – David Raso>: We're going to run out of time.

<A – Jennifer Driscoll>: I think we have time for one more question, yes.

<Q – David Raso>: Yes. Well, we had two minutes, one per minute. The dealer stats were already kind of hooking up. It feels like if any of the markets stayed pretty firm, is there anything out there that worries you about the turn in the retail environment and then your ability to catch that given you are already were under producing last year? So kind of two pieces of that. Do we feel comfortable that retail momentum we spoke of is still there and your ability to match it with the production that's up even more than retail?

<A – Andrew Bonfield>: Yes, yes. And obviously, we did see, obviously, recovery in the fourth quarter, particularly in CI and RI. Obviously, our focus is one of the reasons why we had a little bit of extra Cat inventory, David, was so that we are able to produce the demand or whatever that be in 2021. Obviously, as is always the case, there are products that are – some products are more popular than others at the moment and was – there are individual products where we are on managed distribution. But that's a reflection of just ramping up demand – ramping up supply to meet demand. So we're working on those sorts of bottlenecks where we do have them. But generally, as we said, in the fourth quarter, our expectations are that, obviously, overall, we expect a positive year in 2021.

<<David Raso, Analyst, Evercore ISI>>

All right, Jen. I won't try to squeeze another one. But, seriously, I appreciate...

<<Jennifer Driscoll, Head of Investor Relations>>

Thank you, David. Thanks for hosting us.

<<David Raso, Analyst, Evercore ISI>>

Seriously, I appreciate you taking the time. Hopefully, we can do this again in person.

<<Andrew Bonfield, Chief Financial Officer>>

Okay. Thank you, David.

<<David Raso, Analyst, Evercore ISI>>

Thanks for participating. And thank you again, Jen and Andrew. All right. Have a great rest of the day.

<<Jennifer Driscoll, Head of Investor Relations>>

You're welcome, and we'll put a transcript up on our site as soon as it's available. Thanks.

<<David Raso, Analyst, Evercore ISI>>

Great. Thanks, Jen.