14-Feb-2018

Terex Corp. (TEX)

Q4 2017 Earnings Call

Copyright © 2001-2018 FactSet CallStreet, LLC

CORPORATE PARTICIPANTS

Brian Jerome Henry
Senior Vice President, Business Development & Investor Relations, Terex Corp.

John L. Garrison, Jr.
President, Chief Executive Officer & Director, Terex Corp.

John D. Sheehan
Chief Financial Officer & Senior Vice President, Terex Corp.

OTHER PARTICIPANTS

Jamie L. Cook
Analyst, Credit Suisse Securities (USA) LLC

Abdul Tambal
Analyst, JPMorgan Securities LLC

Andrew M. Casey
Analyst, Wells Fargo Securities LLC

Steven Michael Fisher
Analyst, UBS Securities LLC

David Raso
Analyst, Evercore ISI Group

Mig Dobre
Analyst, Robert W. Baird & Co., Inc.

Nicole Deblase
Analyst, Deutsche Bank Securities, Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Kim, and I will be your conference operator today. At this time, I would like to welcome everyone to the Terex Corporation's Fourth Quarter and Year-End Financial Results Conference Call. All lines have been placed on mute to prevent any background noise. After the speaker's remarks, there will be a question-and-answer session. [Operator Instructions] Thank you. Brian Henry, Senior Vice President, Business Development and Investor Relations, you may begin your conference.

Brian Jerome Henry
Senior Vice President, Business Development & Investor Relations, Terex Corp.

Good morning, everyone, and thank you for joining us for today's fourth quarter 2017 financial results conference call. Participating on today's call are John Garrison, President and Chief Executive Officer; and John Sheehan, Senior Vice President and Chief Financial Officer. Following the prepared remarks, we will conduct a question-and-answer session.

Last evening, we released our fourth quarter and full-year 2017 results, a copy of which is available on terex.com. Today's call is being webcast and is accompanied by a slide presentation, which includes a reconciliation of GAAP to non-GAAP financial measures that we will use during this call and is also available on our website. All per share amounts in the presentation are on a fully diluted basis. We will post a replay of this call on the Terex website under Events & Presentations in the Investor Relations section.

Copyright © 2001-2018 FactSet CallStreet, LLC

Let me direct your attention to slide 2, which is our forward looking statement and description of non-GAAP financial measures. We encourage you to read this as well as other items in our disclosures because the information we will be discussing today does include forward-looking material.

With that, please turn to slide 3 and I'll turn it over to John.

John L. Garrison, Jr.

President, Chief Executive Officer & Director, Terex Corp.

Good morning, everyone, and thank you for joining us and for your interest in Terex. As a result of the team's dedication and hard work, Terex delivered on its fourth quarter financial commitments. This performance capped an important transformational year for Terex: doubled the operating profit and margins, driven by better incremental margins in AWP; significantly improved Cranes performance and continued strength in Materials Processing.

We delivered earnings per share of $0.33 in the quarter and we generated free cash flow of $154 million. We significantly improved backlog in every segment heading into 2018 with 56% higher backlog. We also delivered on our full-year financial commitment. For the full year 2017, we increased operating profit by 5% on lower sales. All three segments contributed to our success. Cranes and Materials Processing improved significantly, and AWP's performance gained momentum over the year, culminating in a stronger fourth quarter.

Earnings per share rose to $1.35, a 53% increase from 2016 and a 93% improvement compared to the midpoint of our original 2017 guidance. Our strong earnings per share result was driven by improved operating performance and the fundamental improvements we made to our capital structure. We reduced debt by about $600 million, refinanced at the lowest interest rates in the company's history and returned capital to shareholders by repurchasing $924 million of Terex stock.

Turning to slide 5, we also delivered on our transformational commitments in 2017. By completing the sale of MHPS and the remaining Construction businesses, we concluded the Focus element of our strategy, creating substantial value for our shareholders. We continued to simplify Terex. We implemented our footprint rationalization plan, exiting 12 manufacturing facilities, totaling 2.6 million square feet, reducing our global footprint by 27%. The Cranes team led the majority of the restructuring actions, resulting in significantly improved operating performance.

Across Terex, we reduced administrative expenses, while increasing investment in innovation, strategic sourcing and commercial excellence. With the sale of MHPS, we removed 27% of our legal entities. Since then, our legal and finance teams have eliminated an additional 20%. We now have the fewest legal entities to administer since 1999, another great example of simplification.

And we made progress deploying our Execute to Win business system. We launched innovative new products in each segment, including additions to the Demag line of all terrain crane and the extra-capacity line of Genie booms and new scissor.

Materials Processing stayed at the forefront of crushing and screening technology, with additions to their Powerscreen, Finlay, and EvoQuip lines. We're extending process discipline throughout the sales process as part of our commercial excellence initiative, completing the first phase in 2017. We strengthened our commercial team, adding experienced leadership and expanding our reach with additional representation on the ground.

Copyright © 2001-2018 FactSet CallStreet, LLC

On strategic sourcing, we established the global organization and launched the first of successive wave to leverage our global scale. Overall, we made significant progress executing our strategic plans, but the team clearly understands we have more work ahead of us.

Turning to slide 6, in 2018, we'll continue to simplify the company and continue to implement our Execute to Win business system. The major structural changes in Cranes were largely completed in 2017. Our focus within Cranes will be simplifying operations, improving productivity, and launching new products to drive the required improvement in operating margins.

The finance and IT teams will be leading our administrative simplification efforts. There are several major projects underway to simplify our account structure, improve processes, and enhance performance management systems across Terex. We will continue to shift the balance of our SG&A, investing in customer-focused initiative, including additional engineering, and sales and marketing in every segment.

Our Execute to Win deployment will remain focused on three priority areas: commercial excellence, lifecycle solutions, and strategic sourcing. Commercial excellence begins and ends with the customer. We are initiating the second phase of pipeline management, which includes deploying salesforce.com on a global basis.

This will solidify the gains we made in 2017 and drive increased process discipline throughout the entire sales pipeline. On lifecycle solutions, we'll continue building our global parts organization and developing a longer-term telematics strategy. We will continue to improve our performance and enhance our customer's experience throughout the equipment ownership lifecycle.

Finally, our Wave 1 strategic sourcing teams continue to make progress. We will be making supplier decisions over the course of the year. Based on the initial quotes received from approximately 850 suppliers on over 14,000 SKUs, we are confident that we will achieve our savings objectives.

We expect to see the gross savings start in the second half of 2018. These initial savings will be generated by the less complex components within our Wave 1 categories. The more complex components, which require more extensive supplier development and testing, will be implemented in late 2018 and into 2019. In addition, we plan to launch the Wave 2 categories midyear 2018.

Turning to our 2018 guidance, we expect the global market environment to continue to improve in 2018 and are planning for growth in every segment. Overall, we expect to increase net sales by approximately 10% to roughly $4.8 billion.

Operational improvement initiatives and productivity increases are expected to improve margins in every segment. Overall, we are planning to achieve an operating margin of approximately 7%. On the strength of our operating performance, we expect earnings per share to increase and nearly double our 2017 results.

Our 2018 EPS guidance is $2.35 to $2.65 per share before any share repurchases. We will continue to enhance shareholder value by executing our disciplined capital allocation strategy. We have received authorization from our board to repurchase up to an additional $325 million of Terex stock. We are also increasing our quarterly dividend by 25% to $0.10 per share. Overall, we're excited about 2018 and are planning to capitalize on what we expect to be a strong operational and financial year for each of our businesses.

With that, let me turn it over to, John.

Copyright © 2001-2018 FactSet CallStreet, LLC

John D. Sheehan

Chief Financial Officer & Senior Vice President, Terex Corp.

Thanks, John. I will spend a few minutes reviewing our Q4 and full year 2017 financial results before providing the details of our 2018 guidance. Q4 was an excellent quarter for Terex. AWP grew sharply, up $70 million or 19%. Importantly, AWP's operating profit improved by approximately $12 million or about 65%, driven largely by improved productivity, partially offset by higher material costs. AWP's incremental margin in Q4 was 17%. Over the course of 2017, AWP improved its incremental margin. AWP enters 2018 with considerably more backlog than the prior year, up 51%.

Cranes made a small profit on essentially flat sales. On adjusted basis, this was a $7 million improvement over last year. This marked the third consecutive quarter of positive operating profit for Cranes. Good work by the Cranes' team.

Materials Processing had another had another strong quarter. Sales of $283 million were 20% higher than last year, driven by global demand for crushing and screening products. Operating profit was up approximately 50% on an adjusted basis, representing margin expansion of 240 basis points, terrific execution by our Materials Processing team in Q4 and throughout 2017.

Turning to slide 9. Overall, Q4 sales were up 9% or up approximately 5% on a constant currency basis. Adjusted operating profit doubled compared to last year, improving significantly in every segment. Lower interest and other expense reflects the recapitalization of our balance sheet at the beginning of the year, including improved interest rates. Earnings per share of $0.33 was 3 times the 2016 results. About $0.06 of that increase was associated with share repurchases. It's important to note that the prior year's EPS was earned almost entirely on the release of a tax accrual, so this quarter's result represent a significant year-over-year improvement.

Please note that our as-reported results include provisional balance sheet impact of the new U.S. tax law. Specifically, we adjusted the deferred tax balances of our U.S. operations to the new 21% U.S. Federal statutory tax rate, resulting in a charge for U.S. GAAP of almost $21 million. Additionally, we recorded a net charge of approximately $29 million associated with accumulated earnings and profit of our non-U.S. operations. In total, these charges resulted in an effective tax rate of over 200%.

Excluding the impact of the new U.S. tax law, our full year 2017 adjusted effective tax rate was 26.9%; and in Q4, was 18.2%. I would also note that the new U.S. tax law has removed the U.S. tax inefficiencies associated with repatriating overseas cash. However, approximately $100 million of non-U.S. cash at year-end is subject to local regulations where repatriation is restricted.

Turning to slide 10, I'll spend a minute to review our full year results. During 2017, we executed on our plans and consistently delivered on the commitments we made. Global markets were also stronger than we expected in some cases. It was this favorable combination – stronger global markets and operational execution – that allowed us to increase earnings per share guidance every quarter during 2017, and ultimately deliver a final EPS result above the high end of the range we provided in October.

Importantly, operational execution was the biggest contributor to the $0.47 or 53% improvement in earnings per share compared to the prior year. The benefits of executing the Focus element of our strategy and following our disciplined capital allocation strategy contributed the balance of the improvement. From an operational as well as a financial standpoint, Terex is very well positioned going into 2018.

Copyright © 2001-2018 FactSet CallStreet, LLC

Turning to slide 11. In 2018, we expect to improve our operating margin by about 200 basis points to roughly 7% on approximately 10% higher sales. Increased operating leverage on growing volumes, combined with ongoing improvement efforts, form the basis for our planned margin expansion. We expect this strong operational performance to result in 2018 EBITDA between $385 million to $415 million, approximately 40% to 50% higher than 2017.

We expect 2018 earnings per share between $2.35 and $2.65 per share. This excludes any benefit associated with our recently announced additional share repurchase authorization. From a quarterly perspective, we expect a normal historical sales pattern and we expect our EPS to be generated roughly 15% in Q1, 35% in Q2, 30% in Q3, and 20% in Q4.

Our 2018 guidance includes an effective tax rate of approximately 23%, an improvement of about 400 basis points, of which 300 basis points relates to the new U.S. tax code. As you know, Terex is a global company that earns income in many jurisdictions around the world. The most significant benefit of the U.S. tax changes is lowering the U.S. statutory rate to 21%, partially offset by higher taxes on non-U.S. income and loss U.S. deduction. Overall, Terex will benefit from the new U.S. tax law. The balance of the improvement in our expected effective tax rate comes from the anticipated geographic mix of earnings and improved tax efficiency.

Looking at our business segments, we expect to increase sales and improve operating performance across the board. In AWP, we expect to increase sales by approximately 10% and improve operating margins to between 9.5% and 10.5%. We expect Cranes to continue to make significant year-over-year improvement and earn an operating profit of about 2% on approximately 12% higher sales. Consistent with historical patterns, we anticipate an operating loss in the first quarter, although substantially improved compared to Q1 2017.

Materials Processing is a consistently strong performer. We expect to grow sales again in 2018, anticipating an increase of about 8%, and to further expand operating margins to between 11.5% and 12.5%.

Turning to slide 12. In 2017, we delivered on our commitment to follow our disciplined capital allocation strategy. And in doing so, we dramatically improved our balance sheet, reduced our interest expense and rate, and returned $924 million to shareholders through share repurchases.

We are committed to following the same disciplined capital allocation strategy in 2018. We expect to nearly double our free cash flow to approximately $100 million. Importantly, this free cash flow guidance includes spending roughly $46 million on transformation and previously announced restructuring, which will strengthen Terex in 2018 and over the long term.

Furthermore, subject to market conditions, we are planning to build an additional $40 million of AWP inventories in the second half of 2018 to prepare for what we expect to be continued strong demand for AWP products in 2019. Adding back these expenditures would approximate a normalized free cash flow of $186 million, representing nearly 100% of our net income.

Our cash flow guidance includes $60 million of capital expenditures. Not included in our free cash flow guidance is a $20 million reinvestment in our UK operations. Specifically, we were presented with an attractive opportunity to acquire our principal Northern Ireland-based crushing and screening manufacturing facilities. This will lower operating costs, generating a considerable return on investment. As a result of these actions, we anticipate the company's gross financial leverage will decline to approximately 2.5 times at year-end.

Copyright © 2001-2018 FactSet CallStreet, LLC

Based on market conditions, we will continue to buy back shares. Our board of directors recently authorized the repurchase of up to an additional $325 million of Terex stock. The capital we intend to use for our share repurchases includes cash we generated, but did not spend in 2017, cash we will generate this year, plus overseas cash repatriated to the United States as a result of the new U.S. tax law. We also plan to raise our quarterly dividend by 25% to $0.10 per share. One of the most important commitments we made at our Investor Day in December 2016 was to achieve a 20% or greater ROIC by 2020. In 2017, we improved to 8% and we expect to improve to 15% in 2018.

ROIC expansion is a good measure of our progress because it values both operational improvement and the significant improvements we made to our capital structure. We remain confident in our ability to exceed 20% ROIC by 2020. The Terex team has and will continue to generate shareholder value through the execution of our disciplined capital allocation strategy.

With that, I will turn it back to John.

John L. Garrison, Jr.

President, Chief Executive Officer & Director, Terex Corp.

Thanks, John. I'll spend a few minutes to review the dynamics we expect to see in our segments, starting with AWP. Based on feedback from our customers, we are seeing clear indications that the replacement cycle trough is coming to an end. Based on historical equipment replacement cycles and improvements in our customers' rental and utilization rates, we believe we are entering a period of growth. Our bookings grew 36% in the fourth quarter, leading to a 51% increase in backlog. Backlog increased in the United States, Europe and Asia.

Our recent Genie product introductions are gaining traction, and we will be launching a number of innovative new products in 2018. We're also increasing our service and support capabilities to continue to improve customer satisfaction. Commercial excellence is driving discipline in the AWP sales process, allowing the team to systematically identify, quantify and convert opportunities into deliveries. We expect AWP margins to improve, driven by a modest increase in pricing through the team's better management of the pricing waterfall, and continued improvement in our manufacturing productivity. We expect the pricing environment to remain competitive, but improved compared to last year. However, a potential headwind is the price of steel.

Overall, the AWP team enters 2018 with clear signs that the markets are improving for the first time in several years, and are well-positioned to take advantage of the improvement.

Turning to Cranes, Cranes team made significant progress in 2017, but they clearly understand there is much more to do, and we expect to take another major step forward in 2018. We have an exciting new product development pipeline, building on the success of the new Demag all terrain line. We'll be launching innovative new products throughout the year. Many of these products, like the new Demag City crane, enable us to re-enter important segments of the crane market, where we had a strong presence in the past. Working with our customers, we are identifying and responding to their evolving needs.

The global crane markets have stabilized and we see pockets of growth. Order rates and backlog improved in the fourth quarter. We plan to improve productivity on higher volumes and better operational execution, adding to the benefit from the restructuring actions we took last year. Our utilities team is executing a multiyear growth plan, and we expect volume and profitability improvement.

Copyright © 2001-2018 FactSet CallStreet, LLC

I'm encouraged by the progress that we've made in Cranes. Steve and the team will continue to execute. And with the stabilization we're seeing in the global markets, we are well-positioned to improve our operating margins in 2018.

Turning to MP, Materials Processing is a consistent performer with a proven ability to execute its plans. We entered 2018 with considerably higher backlog and strength in many of the markets we serve. We expect global demand for crushing and screening equipment to continue to grow, driven by aggregate consumption. The strengthening of the British pound is a headwind as our primary crushing and screening factories are in the UK. Demand for our concrete products is expected to be similar to last year.

We also expect stronger demand for our Fuchs material handlers and our broad line of environmental products. Materials Processing is investing in innovation and will continue to launch new products and services that improve its customers return on investment over the course of the year.

The Terex team delivered on our commitments in 2017. We are positioned to increase sales and improve margins again in 2018. Our backlog is up significantly in every segment and our global markets are improving.

We will continue to execute our transformation program, simplifying the company, and building capabilities in our Execute to Win priority areas. Finally, we will continue to execute our disciplined capital allocation strategy and create shareholder value.

With that, let me turn it back over to Brian.

Brian Jerome Henry

Senior Vice President, Business Development & Investor Relations, Terex Corp.

Thanks, John. As a reminder, during the question-and-answer session, we ask you to limit your questions to one and a follow-up to ensure we have time to get to everyone. With that, I'd like to open it up for questions. Operator?

Copyright © 2001-2018 FactSet CallStreet, LLC

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from the line of Jamie Cook from Credit Suisse. Your line is open.

Jamie L. Cook
Analyst, Credit Suisse Securities (USA) LLC

Q

Hi. Good morning. I guess, two questions centered around the Aerial Work Platform business. The implied incrementals for 2018, I think, are about 28%, which is much higher versus where we ended up in 2017. So, can you just talk about the drivers behind that, specifically? I know you're assuming price is improving, or you'll get more price. But what are you assuming on price cost and are there any benefits from mix either by product or by customer?

And then my second question, you talked about building inventory in that business in the second half of the year, I think, by $40 million or so. What are you hearing from customers that provides – that gives you enough confidence that we should be building inventory in 2019 given we're only sitting here in February? Thanks.

John L. Garrison, Jr.
President, Chief Executive Officer & Director, Terex Corp.

A

Thanks, Jamie. Again, overall, as we look at the AWP business, we believe they built momentum over the year, culminating with a stronger Q4. And what we're seeing is stronger underlying market. Our customers are really seeing improvement in their utilization and in their rental rates. We also believe that – Matt's talked about the replacement cycle now for many years, that replacement cycle profit is waning and we're entering a period of growth.

And really as we see it, looking at the backlog, that's really a broad based growth across the North America, Europe and Asia is driving that. And so, as we look to the margin side, the markets still remain competitive, but clearly there's a more favorable pricing environment, especially compared to recent years. We're able to get a modest price improvement in 2018, especially on our national account agreements as compared to negative pricing that we saw in 2017. So, the margin improvement's going to come from some modest price increases, improved productivity on the higher volume is what's going to drive the incremental margin improvement.

And last, I'd say that the team's been working hard – Matt and the team on a commercial excellence side, really trying to have the process discipline, managing the pricing waterfall to ensure that we're not having any leakage on the pricing, given the dynamics in the marketplace is challenged. So, we're getting a modest price increase to cover some higher input costs. And Matt and the team are focused on meeting the needs of the customer, while expanding margins.

And then, Jamie, I think on the last question, clearly, we're just trying to give 2018 guidance and not trying to give 2019 guidance. But in the AWP aerial space, this replacement cycle, we've talked about it now for years. And as you look into 2019, if this replacement cycle is waning, and that's our current look, it would require that we'd build a little bit ahead, if you will, of inventory in the fourth quarter. And so, we're trying to provide full year cash guidance. And so, we thought that we'd call out that we needed to produce a little bit higher. Again, that's based on our current view of the world and the replacement cycle coming to an end.

Copyright © 2001-2018 FactSet CallStreet, LLC

Jamie L. Cook
Analyst, Credit Suisse Securities (USA) LLC

Q

Thank you for that. And just, again – but there's nothing within your backlog or in your order trends that when you're talking to your customers that points to favorable mix, either the larger booms or the independents are coming in now, just to be clear. So, it's really just price productivity.

John L. Garrison, Jr.
President, Chief Executive Officer & Director, Terex Corp.

A

Yeah. That's correct, Jamie. So if we look at our backlog, I would say, it's consistent. We did see slightly higher on the national accounts in our backlog this year, but again, not extraordinarily different. Our product mix and regional mix are relatively consistent with past historical patterns.

Jamie L. Cook
Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. Great. Thank you so much. I'll get back in queue.

John L. Garrison, Jr.
President, Chief Executive Officer & Director, Terex Corp.

A

Thank you, Jamie.

Operator: Your next question comes from Ann Duignan from JPMorgan. Your line is open.

Abdul Tambal
Analyst, JPMorgan Securities LLC

Q

Hi. Good morning. This is Abdul Tambal on behalf of Ann.

John L. Garrison, Jr.
President, Chief Executive Officer & Director, Terex Corp.

A

Hey, Abdul.

Abdul Tambal
Analyst, JPMorgan Securities LLC

Q

Just to follow up on the question. Can you just talk a bit about pricing versus cost across the regions and the end markets broadly?

John L. Garrison, Jr.
President, Chief Executive Officer & Director, Terex Corp.

A

Sure. If we look at kind of global pricing, overall, on a global basis, the pricing environment still remains quite competitive. But again, especially in AWP, in MP, it's improved compared to last year. On the AWP side, 60% of our volumes is under annual agreements. And as I just said, we did see some modest price increases on that. It's really designed to cover the higher material costs that we've seen.

On the Cranes side, the pricing remains competitive, really coming off a bottom in the marketplace. It's not a robust market by any stretch, but we do believe it's bottoming, and the markets are stabilizing. In that space, our

Copyright © 2001-2018 FactSet CallStreet, LLC

new product introductions are clearly helping. The price/value relationship with our new products are helping us on the Cranes side from a pricing standpoint. And I would say, that's also globally.

And then in our MP business, they implemented a price increase across most of the business lines, again, trying to drive some coverage of the material price increases that we're seeing. They do have a headwind in that, on our core crushing and screening business. They manufacture in Northern Ireland, so there's a bit of a headwind with the British pound. But again, the pricing environment there is reasonable given the underlying strength from the customers.

So, that's how I would view it. Still highly competitive on a global basis, but with a stronger underlying fundamentals demand environment, it's improving.

Abdul Tambal
Analyst, JPMorgan Securities LLC

Q

Okay. Great. Thank you.

Operator: Your next question comes from the line of Andy Casey from Wells Fargo Securities. Your line is open.

Andrew M. Casey
Analyst, Wells Fargo Securities LLC

Q

Thanks. Good morning.

John L. Garrison, Jr.
President, Chief Executive Officer & Director, Terex Corp.

A

Good morning, Andy.

Andrew M. Casey
Analyst, Wells Fargo Securities LLC

Q

I guess a high-level question, John. On the overall 10% revenue guidance, what currency contribution are you including? It sounds like you have modest price. I'm just trying to understand the different contributions to that.

John D. Sheehan
Chief Financial Officer & Senior Vice President, Terex Corp.

A

This is John Sheehan. I'll take that, Andy. And quite honestly, when you look at currency in 2018, it really has a mixed impact on us. A stronger euro is, in general, better for us, especially within our AWP business. And on the other hand, a strong pound is not necessarily a good thing for us. As I indicated in my comments earlier, a strong pound with our principal crushing and screening manufacturing facilities in the UK makes our exports more expensive. So when you go across the various business segments, I would start with AWP and that a stronger euro benefits our AWP segment, we do have a lot of volume that we manufacture in the U.S. and export into European countries. So, a strong euro is a benefit to AWP.

I would say that Cranes being – is relatively balanced in terms of manufacturing in the region in which they sell, so FX is a less of an issue for our Cranes segment. And then MP, as I said a moment ago, a strong pound with the manufacturing we have in the UK makes exports more expensive and, therefore, a strong pound is negative to them.

Copyright © 2001-2018 FactSet CallStreet, LLC

Overall, the exchange rates that we've assumed in our guidance are reflective of those that are in the markets today. So that I would conclude that it's a mixed picture. We can't control exchange rates, obviously, so we're focused on our own execution. But the stronger pound headwind is offset with a stronger euro benefit.

Andrew M. Casey
Analyst, Wells Fargo Securities LLC

Q

Okay. Thanks. And then, on the margin, if I look at the puts and takes of some stuff that happened last year, some production inefficiencies and warranty and so forth, are you looking for those to be absent this year in the 7% guidance? And if so, given your commentary about gaining savings from the strategic sourcing in the second half, should we expect kind of margins to gain momentum through the year? I'm just trying to understand. I know you gave the earnings and revenue breakout.

John D. Sheehan
Chief Financial Officer & Senior Vice President, Terex Corp.

A

Yeah. So, I would say that we see ourselves as very well-positioned financially and operationally, heading into 2018. The backlog being up 56% for the company as a whole is certainly a benefit. We expect we're – our guidance is to increase sales and margins in every segment, Andy.

And so, while I certainly would say that we see a very good strong 2018 and we are – we have a balanced guidance from my perspective. And therefore, we have taken into consideration – one of the things I say is that, not all good things happen, not all bad things happen. We have a balanced guidance from my perspective.

I would say that we – I did point out in my comments that we do expect an operating loss for Cranes in Q1. That's consistent with historical patterns for the Cranes business, and that loss will be substantially lower than it was in 2018 – 2017. And finally, in terms of the development of operating profit, you're right I did provide the quarterly expectation for EPS. I think it's reasonable to assume that operating profit follows the EPS development.

Andrew M. Casey
Analyst, Wells Fargo Securities LLC

Q

Okay. Thank you.

Operator: Your next question comes from the line of Steven Fisher from UBS. Your line is open.

Steven Michael Fisher
Analyst, UBS Securities LLC

Q

Thanks. Good morning.

John L. Garrison, Jr.
President, Chief Executive Officer & Director, Terex Corp.

A

Good morning, Steven.

Steven Michael Fisher
Analyst, UBS Securities LLC

Q

Good morning. If you could just talk a little bit about cash flow and what caused the cash flow to be so much better than expectations in the fourth quarter. Was that just a pull forward or timing of working capital?

Copyright © 2001-2018 FactSet CallStreet, LLC

John D. Sheehan
Chief Financial Officer & Senior Vice President, Terex Corp.
A

So, I'm going to say to you – somewhat open to say that John Sheehan's first year at Terex provided a bit of my being conservative in Q3, having watched the development of the cash flow. The rest of the team here would say that the development of cash flow was absolutely consistent with previous years. And we had very strong working capital management in the fourth quarter of the year and that led to the free cash flow for the year of slightly over $50 million. And I wouldn't call it a pull ahead from 2018. It was managing the collection of receivables in the fourth quarter and managing of inventories to the right level. So, no, it's not a pull ahead from my perspective from 2018.

I would also just say that we are doubling our free cash flow guidance from 2017 to 2018 to $100 million and that $100 million takes into consideration investing $46 million in transformation and restructuring activities. It also includes the $40 million investment in additional AWP inventory for 2019 that John referenced and we talked to Jamie about a few moments ago. If you add those figures back, Steven, you get to $186 million of what I'll call normalized free cash flow, which is very close to the 100% of net income commitment that we made at our Investor Day in 2016. So we're generating cash, but at the same time, we're also investing in our strategic priorities and for the future growth of this company.

Steven Michael Fisher
Analyst, UBS Securities LLC
Q

Great. That's helpful. And related to materials cost, you've talked a little bit about that on this call, but just want to gauge kind of exactly what you're baking in because steel prices, from what I see, are already up double digits since December. So, wondering how and when that will flow through to cost of goods sold and should we expect some margin compression when that does happen or you're going to be able to kind of reopen pricing? How should we think about that?

John D. Sheehan
Chief Financial Officer & Senior Vice President, Terex Corp.
A

So, Steven, on steel prices, our guidance does include what I would say is a reasonable forecast for steel prices over the balance of 2018. As you point out, steel is at the upper end of its historic range. We're also very cognizant of and keeping an eye on the Commerce Department's decision on 232.

The way, I guess, I would characterize it, Steven, is that if steel prices continue to rise from here, all other things being equal, that would push us towards the lower end of our guidance range. And if it moderated, we would be at the upper end of our guidance range. Steel is a input cost that we're proactively managing. But overall, we do have a reasonable forecast for steel prices built into our 2018 guidance.

Steven Michael Fisher
Analyst, UBS Securities LLC
Q

Perfect. Thanks very much.

Operator: Your next question comes from the line of David Raso from Evercore ISI. Your line is open.

David Raso
Analyst, Evercore ISI Group
Q

Hi. Thank you.

Copyright © 2001-2018 FactSet CallStreet, LLC

John L. Garrison, Jr.
President, Chief Executive Officer & Director, Terex Corp.
A

Good morning, David.

David Raso
Analyst, Evercore ISI Group
Q

Given the large backlog you have in AWP, you have greater than normal visibility on the year, it would appear. Can you give us a little help on how you see the sales growth cadence in AWP for the year? And then, I have a follow-up off of your answer.

John L. Garrison, Jr.
President, Chief Executive Officer & Director, Terex Corp.
A

David, overall, I think just it's really historical norms. We don't see anything – we're not forecasting or seeing anything off historical norms in terms of the revenue flow through the year. It can ebb and flow, as you know, the middle months – late Q1, Q2 are months. So, things can flow from – into the beginning of Q1 from Q2 over a quarter-end. But we're not forecasting or seeing anything that's fundamentally different than the historical patterns that we've had.

David Raso
Analyst, Evercore ISI Group
Q

Yeah. And the reason I asked is, obviously, the comps are easier in the first half of the year. So, relative to your full year AWP sales guide of 10%, you would think the first half is above 10% and you're implying the back half is below 10%. But when I think that through for the second quarter, which is the big AWP quarter, right, it appears where you're EPS guidance implies for 2Q, it does seem like you're implying an AWP second quarter, where you're incrementals are already north of 30%. Now, the whole year guide is 27%, 28%, so there's got to be something above 30% maybe for a quarter. I just want to make sure we're clear that you're expecting, it appears, your incrementals as soon as 2Q are running that hard. And then, my follow-up on that is how do you think about – structurally, though, not to give 2019 guidance, but the way you're insinuating, hey, 2019 could be another up year for Aerials, how do you think about the business, just so we're the same page, for the out-years for incremental margins in AWP? So, again, if you can clarify that second quarter, sounds like we're north of 30%, and how should we think about beyond 2018? How you think about the business?

John L. Garrison, Jr.
President, Chief Executive Officer & Director, Terex Corp.
A

Well, I'll take the second part of the question, David. Again, we're providing guidance on 2018 with the greatest clarity that we have. And again, not being facetious, 2019 is out there. But again, the reason we thought it was worth commenting now on the Aerial [ph] prices (46:07), the dramatic impact that the replacement cycle has had on demand. And even back at our Investor Day, we thought that the replacement cycle would wane beginning in late 2018 and into 2019. So, I think that forecast appears to be holding. You could argue maybe even it's ending a little sooner than we had originally forecasted.

So, that's why we say, in their business, as you think about it, to meet the demand in Q1 and Q2, you've got to produce some in late Q4. That impacts our cash, as you heard the earlier questions. So, that's really the reason that we felt to comment on AWP business in 2019. It was really about our 2018 cash forecast. But this replacement cycle is real. Time will tell. But right now the indications are its waning and that's why we thought it was worth commenting on AWP.

Copyright © 2001-2018 FactSet CallStreet, LLC

John, did you want to – and second quarter margins are – go ahead.

John D. Sheehan
Chief Financial Officer & Senior Vice President, Terex Corp.

A

Yeah. No, I would say, look, we don't provide quarterly segment guidance. But AWP, the second quarter is, obviously, their strongest of the year. We would expect that to be the same this year and to be a very good quarter for them. So, I'd just sort of leave it there, I think.

David Raso
Analyst, Evercore ISI Group

Q

Well, John, I appreciate the comments about sales beyond 2018, the replacement story. But I mean, long story short, right, the Street [ph] said (47:35) $3 next year and you're saying $2.50 this year. If you grow AWP 10% in 2019 and put a 25% incremental, you've got the $0.50 right there, right, the year-over-year growth regardless of Cranes and MP can get any better at 2019 versus 2018. So, I'm just making sure I understand [ph] the run through (47:55) these models. Do you think of this business beyond 2018 as, yeah, this should be a 25%-plus business for – anybody can forecast what they want for revenue growth the next two years, just so we're on the same page?

John L. Garrison, Jr.
President, Chief Executive Officer & Director, Terex Corp.

A

Yeah. I think, overall, our expectations and, I think, the AWP team's expectation is this should be a 25% incremental margin business. We provide tremendous value to our customers, long-term value – long-term lifecycle value. And the return that our customers enjoy is a reasonable turn as with us. So, I think that's a moniker of the 25% that we need to continue to drive for. Part of our innovation in new products is ensuring we're bringing products to the marketplace that meet the needs of the customers. So, a point or two of price is not a major issue for the customer based on the value that the products perform. So, overall, that's our target for that business, so 25% incremental is something we should be shooting for. Yea.

John D. Sheehan
Chief Financial Officer & Senior Vice President, Terex Corp.

A

And for the company as a whole, and if you just look at the growth in our EPS from 2017 to 2018, right, we're doubling our EPS from $1.35 to – midpoint of our guidance range, to $2.50. $0.91 of that growth or 80% of it is coming from operations on the back of the 10% revenue growth that we're experiencing. And the other $0.24 or 20-ish percent is coming from share count and tax rate. So, we're focused on driving growth of our top line and driving that to the bottom line.

John L. Garrison, Jr.
President, Chief Executive Officer & Director, Terex Corp.

A

And the only other thing I'd add to that, David, is obviously we don't want to give guidance on 2019, but we are making investments in the business for the long-term health of the business as part of our Execute to Win strategic worry. So, as I've said, we're not going to cut engineering spend in a quarter to make a quarterly number that's – to the detriment of the long term of the business. So, again, we're trying to invest near term and long term, and 25% for the company and definitely 25% incremental margins for AWP is something that we ought to put up on the wall and go after.

Copyright © 2001-2018 FactSet CallStreet, LLC

David Raso
Analyst, Evercore ISI Group

Q

Great. I appreciate that. Obviously, people are trying to figure out what's the bigger picture EPS [ph] power (50:15), and Aerials margins last decade were extremely high. I'm not sure if we'll get back to those, but people are just trying to figure out could this be a business getting back to 12%, 13%, 14%. So, we're just trying to get a feel for that, because the share count reduction, obviously, is a nice part of the EPS growth story.

And in that vein, I'll get off after this question. The share repo is not in the guide. Can you at least give us your thoughts on how we should think about that and also the cadence on that? I know the cash flow seasonality, but still just how to think about what are the levers that you're thinking about to say, hey, let's get active on the repo versus hold off as we think through the quarters this year.

John D. Sheehan
Chief Financial Officer & Senior Vice President, Terex Corp.

A

Yeah. So, I absolutely confirm the share repurchases are not built into the $2.35 to $2.65 guidance that we've provided. David, we did, in 2017, follow our disciplined capital allocation strategy. We're going to absolutely follow that in 2018. And the timing of share repurchases is going to depend on market conditions.

John L. Garrison, Jr.
President, Chief Executive Officer & Director, Terex Corp.

A

But I think the key issue there, David, is no change in our capital allocation strategy.

David Raso
Analyst, Evercore ISI Group

Q

All right. Thank you. Sorry for the raspy voice this morning. Thanks.

John D. Sheehan
Chief Financial Officer & Senior Vice President, Terex Corp.

A

No problem.

John L. Garrison, Jr.
President, Chief Executive Officer & Director, Terex Corp.

A

Thank you, David.

Operator: Your next question comes from Mig Dobre from Baird. Your line is open.

Mig Dobre
Analyst, Robert W. Baird & Co., Inc.

Q

Good morning, gentlemen.

John L. Garrison, Jr.
President, Chief Executive Officer & Director, Terex Corp.

A

Hi, Mig.

Copyright © 2001-2018 FactSet CallStreet, LLC

Mig Dobre
Analyst, Robert W. Baird & Co., Inc.

Q

Just want to talk a little bit about Cranes. So, you built up nice backlog in 2017. Obviously, your orders have been running ahead of revenues. But if I look at your guidance for 2018, seems to me that your revenue is still guided below where your orders were running in 2017. So, I'm trying to understand your perspective here given that the end markets seem to be doing a little bit better. Is it that you're expecting orders to moderate or you're simply thinking about building backlog? Are you able to convert on that backlog at this point in time?

John L. Garrison, Jr.
President, Chief Executive Officer & Director, Terex Corp.

A

So, in terms of – and I'll just start kind of high level. Obviously, it was a lot of work in 2017 for the Cranes team on the restructuring. Again, global markets are stabilizing, but they're not robust. There's just pockets of growth. Order intake rates are improving with bookings being up 15% and the backlog up at 70%. So going into the year, we're in a better backlog position than we were a year ago and that gives us some confidence for the – or confidence for the revenue guide of up 12%.

John D. Sheehan
Chief Financial Officer & Senior Vice President, Terex Corp.

A

Yeah. I think, Mig, that as John said a moment ago, our backlog at the end of 2017 represents about 40% of our expected revenue for 2018. That is favorable to 2017. But we still have almost $800 million over and above our backlog that we need to build and take orders for, build, ship.

So, Steve and the team and the entire Cranes team are working every day on booking orders and building and shipping product, and we have a significant confidence in their execution of the plan. And I would just – since we're on Cranes, we're looking at a 330 basis point improvement in their margins this year from 2017. Certainly, 2% isn't our – more operating margins isn't our end goal. But Steve and the team are really making a big step forward with that business in 2018.

John L. Garrison, Jr.
President, Chief Executive Officer & Director, Terex Corp.

A

Yeah. So, Mig, I'd just add that that last year's focus was on a lot of the restructuring activities. And this year, it really is around execution, driving productivity in the plant. We have several new product launches across the plant as well. So, the team needs to execute on that to drive the top line, as well on the margins. So, a shift of focus for the Cranes team, if you will, and it's a big year for us. So, we've made great strides, but we know we've – 2% operating margins is not our long-term objective.

Mig Dobre
Analyst, Robert W. Baird & Co., Inc.

Q

Right. But from the perspective of ramping up production, you are where you need to be at this point, there are no other issues there?

John L. Garrison, Jr.
President, Chief Executive Officer & Director, Terex Corp.

A

In terms of ramping production, there's new product launches that the team have to execute and go through as we go through the year. Overall, one of the questions out there that we've seen is around supplier and supplier lead times. Right now, the good news is, is manufacturing is improving and increasing for the first time in a

Copyright © 2001-2018 FactSet CallStreet, LLC

number of years. Our supply base is seeing that. We do see day-to-day delivery issues that the team has to manage, if you will, across various commodities. So, they're managing that day to day. So, it really comes down to the day-to-day execution on the shop floor, new product development to meet the needs of our customers in a timely manner.

Mig Dobre
Analyst, Robert W. Baird & Co., Inc.

Q

All right. Then, my follow-up, you mentioned margin already, but maybe get an updated view as to how you're thinking longer term from a margin perspective, how much do you think it's still within your sort of self-help that's left in this business beyond 2018 and how much are you relying on either better mix or meaningfully higher volume in Cranes, specifically?

John L. Garrison, Jr.
President, Chief Executive Officer & Director, Terex Corp.

A

Yeah. Thanks. In terms of – we're maintaining our commitment to earn greater than our cost of capital in this segment, which means we've got to get to 6% to 8% type operating margin. Mix does matter. One of the headwinds this year in Cranes is that our crawler mix is off a little bit. But at the end of the day, we've got to have the products and services and the capabilities to drive this business to 6% to 8%, and that's what the team's focused on.

Mig Dobre
Analyst, Robert W. Baird & Co., Inc.

Q

All right. Thank you.

Operator: Your next question comes from the line of Nicole Deblase from Deutsche Bank. Your line is open.

Nicole Deblase
Analyst, Deutsche Bank Securities, Inc.

Q

Yeah. Thanks. Good morning, guys.

John L. Garrison, Jr.
President, Chief Executive Officer & Director, Terex Corp.

A

Good morning, Nicole.

Nicole Deblase
Analyst, Deutsche Bank Securities, Inc.

Q

So, I guess, starting with kind of where we are in the cycle, I think, you guys mentioned that you think that the replacement cycle within AWP is coming to an end. I just want to confirm that that means that 2019 is likely to be peak revenues or what we should consider to be peak revenues for the segment. And then, kind of in a similar vein, where do we think we are in the cycle for Materials Processing. Is there further upside there or is 2019 looking kind of peak-ish for that business too since it's had such a nice growth?

John L. Garrison, Jr.
President, Chief Executive Officer & Director, Terex Corp.

A

I appreciate. I'm chuckling a little bit, Nicole. I don't want to use the word peak around 2019. Again, we just thought it was appropriate for us on the replacement cycle to say that we believe that the replacement cycle's

Copyright © 2001-2018 FactSet CallStreet, LLC

waning and so we're entering a favorable period of growth for AWP. So, I don't want to put any comment on 2019 revenue forecast there or the like.

In terms of the MP business, the underlying demand of the business is strong. Our core aggregate crushing and screening business on a global basis is looking good. We've seen a recovery in the Fuchs. The positive side of higher steel prices is scrap metal prices are up, and there's a pretty good correlation on our Fuchs business with scrap metal prices. So, that aspect of the business is improving. And then, concrete is a little sideways right now due to some regulatory changes in the U.S. So, overall, I think the MP business is in a good position and the team executes well on the volume that they get. So, that's how I'd comment on the MP side.

Nicole Deblase
Analyst, Deutsche Bank Securities, Inc.

Q

Okay. Thanks, John. That's helpful. And then, I guess, shifting to Cranes, we heard from one of your biggest competitors last week, and one of the big trends that they talked about is that they're starting to see crane dealer inventory restocking, which kind of helped their 4Q orders. I'm curious if you guys are also seeing some restocking activity from your dealers at all and if that kind of played into the order shrink that we saw this quarter?

John L. Garrison, Jr.
President, Chief Executive Officer & Director, Terex Corp.

A

Thanks. Overall, our distribution model is a little different. We really don't have a significant number of stocking dealers, Nicole. Most of our dealers really are rental companies as well. And so, we didn't have a big build up of stocking orders through our distribution channel. Talking to Cranes customers, it's different than AWP. On the Cranes side, right now, they're seeing better utilization, but they're still not yet seeing that rate recovery, especially in RTs, in that area.

So, the market is improving, and that's why we used the word stabilized. But it's not as robust as the Aerial market is right now.

Nicole Deblase
Analyst, Deutsche Bank Securities, Inc.

Q

Okay. Thanks. I'll pass it on.

Operator: I now turn the call back to Mr. Garrison.

John L. Garrison, Jr.
President, Chief Executive Officer & Director, Terex Corp.

Thank you. Again, thank you for your interest in Terex. If you have any additional questions, please don't hesitate to reach out with Brian and follow-up with Brian. Again, thank you and have a great day.

Operator: This concludes today's conference call. You may now disconnect.

Copyright © 2001-2018 FactSet CallStreet, LLC

Disclaimer
The information herein is based on sources we believe to be reliable but is not guaranteed by us and does not purport to be a complete or error-free statement or summary of the available data. As such, we do not warrant, endorse or guarantee the completeness, accuracy, integrity, or timeliness of the information. You must evaluate, and bear all risks associated with, the use of any information provided hereunder, including any reliance on the accuracy, completeness, safety or usefulness of such information. This information is not intended to be used as the primary basis of investment decisions. It should not be construed as advice designed to meet the particular investment needs of any investor. This report is published solely for information purposes, and is not to be construed as financial or other advice or as an offer to sell or the solicitation of an offer to buy any security in any state where such an offer or solicitation would be illegal. Any information expressed herein on this date is subject to change without notice. Any opinions or assertions contained in this information do not represent the opinions or beliefs of FactSet CallStreet, LLC. FactSet CallStreet, LLC, or one or more of its employees, including the writer of this report, may have a position in any of the securities discussed herein.

THE INFORMATION PROVIDED TO YOU HEREUNDER IS PROVIDED "AS IS," AND TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, FactSet CallStreet, LLC AND ITS LICENSORS, BUSINESS ASSOCIATES AND SUPPLIERS DISCLAIM ALL WARRANTIES WITH RESPECT TO THE SAME, EXPRESS, IMPLIED AND STATUTORY, INCLUDING WITHOUT LIMITATION ANY IMPLIED WARRANTIES OF MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE, ACCURACY, COMPLETENESS, AND NON-INFRINGEMENT. TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, NEITHER FACTSET CALLSTREET, LLC NOR ITS OFFICERS, MEMBERS, DIRECTORS, PARTNERS, AFFILIATES, BUSINESS ASSOCIATES, LICENSORS OR SUPPLIERS WILL BE LIABLE FOR ANY INDIRECT, INCIDENTAL, SPECIAL, CONSEQUENTIAL OR PUNITIVE DAMAGES, INCLUDING WITHOUT LIMITATION DAMAGES FOR LOST PROFITS OR REVENUES, GOODWILL, WORK STOPPAGE, SECURITY BREACHES, VIRUSES, COMPUTER FAILURE OR MALFUNCTION, USE, DATA OR OTHER INTANGIBLE LOSSES OR COMMERCIAL DAMAGES, EVEN IF ANY OF SUCH PARTIES IS ADVISED OF THE POSSIBILITY OF SUCH LOSSES, ARISING UNDER OR IN CONNECTION WITH THE INFORMATION PROVIDED HEREIN OR ANY OTHER SUBJECT MATTER HEREOF.

The contents and appearance of this report are Copyrighted FactSet CallStreet, LLC 2018 CallStreet and FactSet CallStreet, LLC are trademarks and service marks of FactSet CallStreet, LLC. All other trademarks mentioned are trademarks of their respective companies. All rights reserved.