Transcript of Astec Industries, Inc.
Second Quarter 2017 Earnings Call
July 25, 2017

Participants

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David Silvious - Chief Financial Officer
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Steve Anderson - Vice President of Administration and Director of Investor Relations

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Jon Fisher - Dougherty & Company
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Presentation

Operator
Greetings, and welcome to Astec Industries' Second Quarter 2017 Earnings Call. At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. As a reminder, this conference is being recorded.

I would now like to turn the conference over to Steve Anderson, Vice President of Administration and Director of Investor Relations. Thank you. Please go ahead.

Steve Anderson - Vice President of Administration and Director of Investor Relations
Thank you, Brenda. Good morning and welcome to the Astec Industries' conference call for the second quarter that ended June 30, 2017. As Brenda mentioned, my name is Steve Anderson. Also on today's call are Ben Brock, our President and Chief Executive Officer; Rick Dorris, Executive Vice President and Chief Operating Officer; and David Silvious, our Chief Financial Officer. In just a moment, I'll turn the call over to David to summarize our financial results and then to Ben to review our business activity during the second quarter.

Before we begin, I'll remind you that our discussion this morning may contain forward-looking statements that relate to the future performance of the company, and these statements are intended to qualify for the Safe Harbor liability established by the Private Securities Litigation Reform Act. Any such statements are not guarantees of future performance and are subject to certain risks, uncertainties and assumptions.

At this point, I'll turn the call over to David to summarize our financial results for the second quarter.

David Silvious - Chief Financial Officer

Thanks, Steve, and I thank each of you for joining us this morning. Net sales for the quarter were $301.9 million compared to $294.4 million in same quarter last year. That's a 2.6% increase or $7.5 million increase.

International sales were $65 million in the second quarter compared to $52.2 million for the same period last year, an increase of 24.6% or $12.8 million. International sales were 21.5% of total net sales for the quarter compared to 17.7% in Q2 of 2016. That increase in international sales quarter-over-quarter occurred primarily in Russia, Europe and Canada. Those increases were offset by decreases in South America and in Africa. For the quarter, international sales increased in the Infrastructure Group and the Aggregate and Mining Group and decreased in the Energy Group.

Domestic sales were $236.9 million in the second quarter compared to $242.2 million in the second quarter of 2016, a 2.2% decrease or $5.3 million decrease. Domestic sales were 78.5% of Q2 2017 sales compared to 82.3% of Q2 2016 sales. And for the quarter, those domestic sales increased in the Agg and Mining Group and the Energy Group and decreased in the Infrastructure Group.

Part sales were $68.8 million in second quarter compared to $63.8 million in Q2 of 2016. Part sales were 22.8% of net sales for the second quarter of 2017 and 21.7% of net sales in the second quarter of 2016. For the quarter, part sales increased in each of our groups.

Foreign exchange translation had a small but negative impact on sales for the quarter of $200,000. That is if rates this year were the same as last year’s rates, sales would have been $200,000 higher. On a year-to-date basis, sales were $620.3 million compared to $573.1 million for the first half of 2016. That’s an 8.2% increase or $47.2 million increase.

International sales for the first half were $129.9 million compared to $96.7 million for first half of 2016. That’s a 34.4% increase or $33.2 million increase. For the first half, the increase in international sales occurred primarily in Canada, Russia, Australia and Mexico and those increases were offset by decreases in South America and Southeast Asia. International sales were 20.9% of the year-to-date net sales in 2017 compared to 16.9% of the year-to-date sales in 2016. For the year, our international sales increased in each of our groups.

Domestic sales for the first half were $490.4 million compared to $476.5 million in the first half of 2016, a $13.9 million increase or 2.9% increase. For the first half, domestic sales were 79.1% of total sales for 2017 compared to 83.1% for the first half of 2016.

Part sales for the first half were $149.8 million compared to $137.9 million for the first half of 2016, an 8.6% increase or $11.9 million increase in part sales. That represents 24.1% of total sales for the first half of 2017 compared to 24.1% for the first half of 2016.

Foreign exchange translation had a positive impact on sales for the first half of $400,000. That is if rates this year were equal to rates last year, sales would have been $400,000 lower.

Gross profit for the quarter was $65.5 million compared to $73.5 million in Q2 of 2016, a decrease of 10.8% or $8 million. The gross profit percentage then was 21.7% in Q2 of 2017 compared to 25% in Q2 of 2016. As we noted in our press release, our gross margins were impacted by two primary items. The first was lower than expected margins on the installation of pellet plant equipment. And the second was that we had several new products moving through our shops during the quarter and remember that new equipment traditionally carries a lower margin through the early part of its lifecycle due to the refining of the manufacturing process.

The absorption variance for the second quarter was $2.1 million over absorbed compared to the second quarter of 2016 absorption variance of about $100,000 over absorbed. So we had a positive change in the absorption variance of $2 million.

Gross profit for the first half was $141.3 million compared to $145.4 million, a decrease of $4.1 million or 2.8% over the first half of 2016. The gross profit percentage then was 22.8% for the first half of 2017 compared to 25.4% for the first half of 2016. The absorption variance for the first half was $2.8 million over absorbed compared to $1.4 million under absorbed for the first half of 2016. That was a $4.2 million positive change in our absorption variance year-over-year. Again, as we noted in our press release, gross margins were impacted by lower than expected margins on installation of pellet plants and the new products moving through the shop.

Foreign exchange transaction gain or loss, which is reflected in the gross margin line in cost of goods sold, is $254,000 loss for the first half of 2017 compared to $331,000 gain in 2016.

SGA&E for the quarter was $44.2 million or 14.6% of sales compared to $45 million or 15.3% of sales for the second quarter of 2016, a decrease of about $700,000 in dollar terms and a decrease of 70 basis points as a percentage of sales. A couple of those drivers were recall that last year we had Bauma in our exhibit expense and so that was a decrease of about $1.3 million. And then our employee benefit and related expenses increased about $1.5 million quarter-over-quarter.

For the year, SGA&E was $97.3 million, or 15.7% of sales, compared to $88.8 million, or 15.5% of sales, an increase of $8.5 million first half versus first half or a 20 basis point increase as a percent of sales first half versus first half. The drivers there were recall we had ConExpo this year, so that was about $4.6 million for the first half and that we had employee benefit and payroll and related expenses of about $3 million that were also an increase first half versus first half.

Operating income was $21.3 million for Q2 of 2017 compared to $28.5 million for Q2 of 2016, a $7.2 million decrease or 25.3% decrease. And for the first half, it was $44 million compared to $56.6 million for the first half of 2016, a decrease of 12.6 million or 22.3% decrease.

The effective tax rate for the quarter was 32.8% compared to 36.2% for the second quarter of 2016. For the year-to-date period through June 30 it was 33.5% compared to 36.8% for the first half of 2016. That effective tax rate was favorably impacted by the increase in our domestic production activity deduction, and an increase in Tennessee jobs credits that we took advantage of and there was a change in Tennessee's enforcement rule which significantly reduced state taxes for some of our larger operating business units.

Net income attributable to controlling interest was $14.4 million in the second quarter compared to $18.2 million in the second quarter of 2016, a $3.8 million decrease or 20.9% decrease. And that resulted in diluted earnings per share for the quarter of $0.62 compared to $0.79 in the second quarter of 2016, a $0.17 or 21.5% decrease for the quarter.

For the first half, net income attributable to controlling interest was $29.5 million compared to $35.9 million in the first half of 2016, a $6.4 million or 17.8% decrease resulting in diluted earnings per share of $1.27 for the first half compared to $1.55 for the first half of 2016, a $0.28 or 18.1% decrease.

EBITDA for the second quarter was $27.8 million compared to $34.6 million in the second quarter of 2016, a decrease of $6.8 million or 19.7% decrease quarter-over-quarter. And for the year, EBITDA was $57.3 million compared to the year-to-date period in 2016 of $68.9 million, a decrease of $11.6 million or 16.8% decrease.

Our backlog is $352.4 million at June 30 of 2017 compared to $371.3 million at June 30 of 2016. Remember that we adjusted the prior year numbers in the backlog for the acquisition of Power Flame, which occurred on August 1 of 2016. The backlog then decreased $18.9 million year-over-year or 5.1% decrease year-over-year. International backlog at June 30 was $76.2 million compared to $54.9 million at June 30 of 2016, an increase of $21.3 million or 38.7% increase in international backlog. Our domestic backlog at June 30 was $276.2 million compared to $316.4 million at June 30 of 2016, a decrease of $40.2 million or 12.7% decrease in domestic backlog.

Excluding the pellet plant backlogs, the June 30, 2017 backlog increased $60.4 million or 27% compared to June 30 of 2016. Sequentially, the June 30 backlog is $352.4 million compared to $361.8 million at March 31 of 2017, a 2.6% decrease or $9.4 million decrease.

Our balance sheet remains very strong. We are at $149.3 million on receivables at June 30 of 2017 compared to $127.5 million at June 30 of 2016. That's a $21.8 million increase in receivables. Days outstanding are then 43.7 this year compared to 38.9 last year.

Our inventory is at $381.3 million this year compared to $379.5 million at June 30 last year, a $1.8 million increase in inventory. And our turns have increased to 2.4 turns this year compared to 2 turns in the prior year.

We owe nothing on our $100 million domestic credit facility, and we have at June 30, 2017 $52.1 million in cash and cash equivalents on the balance sheet. And during the quarter, we made a large estimated tax payment to the IRS of approximately $19 million and we also expect payment soon in this quarter for approximately $12 million related to the Highland Pellet plant.

Letters of credit outstanding at June 30 are $8.4 million and our borrowing availability then is $91.6 million on our domestic credit facility. We have $5.3 million in debt currently in Brazil and that's used to finance that particular company's buildings, furniture, fixtures and inventory.

Capital expenditures for the quarter were $5.4 million and for the year-to-date period are $11.5 million. And we're forecasting for 2017 around $25 million of capital expenditures. Depreciation is at $5.3 million for the quarter and $10.6 million for the first half. For 2017 we're forecasting $23.4 million in depreciation.

That concludes my prepared remarks on the financial details. I'll turn it back over to Steve.

Steve Anderson - Vice President of Administration and Director of Investor Relations
Thank you, David. At this time, Ben Brock will now provide some comments regarding the second quarter of this year's operations. Ben?

Ben Brock - President and Chief Executive Officer
Thank you, Steve, and thanks to everyone for joining us on our call today. As we commented in our earnings release this morning, we were disappointed with our net income for the second quarter. We were pleased that we were able to grow sales and backlog while also shipping new products during the quarter.

Our second quarter sales were $301.9 million versus $294.4 million or an increase of 2.6%. Our earnings per share were $0.62 per share versus $0.79 per share in the same quarter of 2016 for a decrease of 21.5%. Our earnings were mainly impacted by lower gross margin in new products as we expected and significantly lower than expected gross margin on pellet plant installation work.

The significantly lower margin work was the main contributor in consolidated gross margin of 21.7% versus 25% last year. Most of that's found in the Infrastructure Group with gross margins of 18.7% versus 24%. The new product gross margin was just below expectations in the group but very much in line with our projections. The pellet plant installed work was significantly lower than we expected.

In Aggregate and Mining Group, gross margin was 24.1% versus 26.4% last year. New products in that group were just below expectations on gross margins but again very much in range with our projections. In the Energy Group, gross margins were up to 24.9% versus 24.5%; less new products in the Energy Group, more industrial type projects which carry higher gross margins in the group.

Our year-to-date EBITDA was $57.28 million giving us a rolling 12-months EBITDA percentage of 8.5% of sales versus 9.2% this time last year. Our backlog at June 30 was $352.4 million, down 5% versus last year but an improvement versus last quarter's down 18% versus last year.

Excluding pellet plants and including historical Power Flame backlogs, our backlog is up 27% versus last year, an improvement versus last quarter's up 14% versus last year. Our Infrastructure Group backlog was down 20.4%, which was an improvement from being down 32% at the end of the last quarter. Infrastructure backlog was down mainly due to not having a large pellet plant on order.

This group continued good order intake on non-pellet plant products during the quarter, mainly as a result of the Federal Highway Bill in the US, state and local funding mechanisms and the United States improved road and bridge investments and improved international shipments.

Excluding pellet plant backlog, our Infrastructure Group backlog is up 18.6%, which is also an improvement from being up 5% versus last year at the end of the last quarter. Order activity has remained slightly above normal since July 1st in this group.

Our Aggregate and Mining Group backlog increased 55.2% mainly as a result of Federal Highway Bill, state and local funding mechanisms and continued good execution in getting international orders.

Our Energy Group backlog was up 9.5% as we continued to experience good order intake in the group for products targeted at the construction industry, along with slightly increased order activity for our water, oil and gas drilling products.

Domestic backlog was down 13% year-over-year and international backlog was up 39%. Our lower backlog in domestic was primarily due to not having a large pellet plant on order. Domestic backlog, excluding pellet plants, was up 22.7%, an improvement from being up 7% versus last year at the end of the first quarter.

Regarding our increased international backlog, we continue to experience slight improvement in international quoting and our sales groups have done a great job of getting orders on much of what we're quoting. This is despite the strong United States dollar. Our increase in backlog in international is once again a direct result of pent-up demand and our team executing where we could for orders.

We mentioned on our last call that our Astec do Brasil subsidiary experienced a very slight increase in quoting activity in Brazil. We're pleased to report that this subsidiary still has a small backlog. However, we do believe the economic and political environment remains a challenge to us for at least the rest of this year in Brazil. While we're keeping a long view with regards to international, we do see challenging currency conditions remaining in place.

Changing subjects to the Hazelhurst, Georgia pellet plant that we've discussed on several calls, as a reminder it's a new product we chose to finance. As a result, we'll recognize the revenue for this plant as we're paid. This will have an effect on our cash and our inventory until we are paid in full. The order for all three lines is for $60 million. We expect the final payment in December of 2018. And as a reminder, the interest rate on the note is 6%. With regards to the Hazelhurst plant, please keep in mind that we are carrying it on books at breakeven, so its effect to us is in our inventory and cash.

Regarding the Highland Pellet plant in Arkansas, we are down to approximately $4.8 million in revenue that we expect to recognize on the Highland Pellet project during 2017. We have projected gross margin on the amount left to recognize. It's slightly below the normal major equipment margins for the site work, installation, and start-up, etc. The actual margin during the quarter was significantly less than we anticipated and represents the main difference between our estimate at the end of last quarter and our actual result not only in the Infrastructure Group but for the company as a whole.

We're not going to sugarcoat this underestimated cost. It was a big miss on our part and it was a major issue with our net income result for the quarter. We've identified the root cause of our miss on this estimated cost and it won't happen again. As a result, we do not anticipate significant margin effect moving ahead on this project.

With regards to the pellet plant revenues for this year, we had felt we had a good opportunity to add a large pellet plant order during the third quarter, which would have given us a change to deliver a portion of the plant during the fourth quarter this year. That opportunity has passed as we have earned enough infrastructure-related business to make delivery on any new pellet plant order not possible in 2017. As a result, we now project that our pellet plant revenues will be in the range of $20 million to $25 million in 2017.

Updating our current pellet plant quote activity, we still believe a large order will be coming in late 2017. However, the timing of it remains elusive to us. It's too early to project what volume of a large order would be shipped during 2018 should we get one. As we have said many times, wood pellet plant deals are long and complicated to get across the line. While we are optimistic that a new project will happen in the timeframe mentioned, it could always be longer than we anticipate.

Changing subjects to the Energy Group, we were pleased with the slight increase in gross margin in this group and we are encouraged by the second quarter in a row of increased backlog for this group.

Sales of wood chippers and grinders remained consistent during the quarter. Our concrete plants are built in the Energy Group and quoting activity is very good for our plants. However, we're not pleased with our order intake so far this year on concrete plants. We are optimistic on concrete plants for the rest of this year. We remain optimistic on our outlook in the Energy Group for the long term.

Our new product development continues in all groups, however, at a slower pace than we had going into ConExpo. We are focused on selling the new products from the show and increasing gross margin.

Looking ahead to the third quarter of 2017, we are encouraged by our historically good backlog, our domestic infrastructure product sales activity, continued oil, gas and water product sales activity, and our international sales team success given the challenging environment they face with regards to strong US dollar. Given these encouraging signs, we believe that our third quarter 2017 revenue will be ahead of our third quarter 2016 revenue.

With regards to earnings in the third quarter of 2017, we believe that we will improve our gross margins and that our Q3 2017 net income will be ahead of our Q3 2016 net income. Our current outlook for the full year of 2017 is revenues up approximately 5% versus last year with a flat to slightly improved net income for the year, which obviously indicates that we believe we will have an improved second half 2017 versus 2016.

With the exception of the disappointing installation margin on the pellet plant during the quarter, our Infrastructure Group is performing well and has a good backlog. We are also optimistic on our outlook for our Aggregate and Mining Group. Despite the good backlog in our Energy Group, we remain slightly cautious on our outlook for the Energy Group with the main headwinds for this group being persistent.

From our last earnings release until now, orders have been good in the Infrastructure Group and in the Aggregate and Mining Group mainly due to Highway Bill and international sales. Energy Group orders are improved for products targeted at water and oil industries with slightly increased quoting activity. Orders in the Energy Group are good for products targeted at infrastructure customers. Aggregate and Mining Group orders remain soft for products targeted at the mining industry. However, we are seeing slight signs of potential improvements in the mining industry.

Bright spots for activity are hot mix asphalt equipment sales, that’s asphalt plants and mobile equipment, asphalt rubber blending system quoting activity, water well drilling and equipment sales, bulk material and handling systems, aggregate crushing and screening equipment, and international quote activity despite the strong dollar. Again, for competitive reasons, we’ll not be indicating the regions of quote activity; however, we do feel the responsibility to indicate that our quote levels have remained slightly increased.

Year-to-date part sales were up 8.6% versus last year and were 24.1% of total sales again year-to-date. We remain committed to improving our part sales volume in the long term and continue to work to increase our competitive part sales.

As expected and explained earlier in my comments, we had lower gross margins in the second quarter of 2017 on new equipment designs as we built them in nearly all of our subsidiaries. These lower margins were in line with our estimates. The installation gross margins on our pellet plants were significantly lower than we expected. The majority of our customers in the United States are experiencing a stable, private market and we are focused on selling existing and new products.

Looking at 2017 as a whole, we are optimistic with regards to our Infrastructure Group's outlook on infrastructure-related equipment. We remain cautiously optimistic on wood pellet plants in the group. We believe our Aggregate and Mining Group will continue its positive trend. And we believe that our Energy Group will improve on the bottom line in 2017, despite the challenges they faced.

Taking all of that together, we have the opportunity to grow and operationally improve our company for the fourth year in a row in 2017. Acquisitions remain a part of our growth strategy along with organic growth. To that end, we do continue to work on potential additions to the Astec family.

That ends my comments on the quarter and what's in front of us. Thank you again for taking the time to be on our call and for your support as we move ahead.

I'll now turn it back over to Steve Anderson.

Steve Anderson - Vice President of Administration and Director of Investor Relations
Thank you, Ben. Brenda, at this time, we’d like to open the Q&A up and see if we can poll for questions. We’d appreciate it.

Operator
Certainly. Our first question comes from the line of Mike Shlisky with Seaport Global. Please go ahead with your questions.

Q: Good morning, guys. Quickly just turn to the pellet plant issue in the quarter just for a moment, if you would. Could you give us a little more color as to what costs were the issue? Was there a labor issue or perhaps materials? And it's something you said that you're past the issue already here in Q3 but can future pellet plant contracts, if and when you get them, be structured in a way to avoid these cost problems going forward?

Ben Brock - President and Chief Executive Officer
Thanks, Mike. This is Ben. At the end of the day, when we were putting the plant up, we had a late add-on in the process, a change order with the construction firm that was our sub. We had a cost miss estimate really mainly by our guys and what we thought it would cost. It's embarrassing. It's a big mistake but it's a mistake made and it's one that's behind us. And we know how we would handle that going forward. But it is behind us. It's not something that shows back up again.

Q: So it's part of the learning curve, still a pretty new business for you guys, as to how you would characterize it?

Ben Brock - President and Chief Executive Officer
I guess you could characterize that. We don't like that we made the mistake but I guess you could characterize it that way. We know it won't happen going ahead. But it's happened and our guys feel terrible about it and we feel terrible about it. But we know we won't have it going ahead.

Q: Okay, got it. Then just turning to the Energy segment, I saw your gross margins here. They were 24.9%. That was the highest we've seen in over five years in that segment. It sounded like then it might have been just the mix in this quarter. Can you give us your thoughts as to how this might trend in the back half? Often it goes down in the back half versus the first half. Is that a function of how the top line comes in, in the year or is something else at play here that might make these 24% plus margins keep on going into the back half of the year here?

Ben Brock - President and Chief Executive Officer
Part of what else was there, Mike, was our GEFCO unit had a couple of nice orders for pumper trailers that came through at nice margin and then our Heatec group had some industrial orders that came through with nice margins. It was just a good product mix quarter for us. The backlog that we have in that group is a pretty good product mix, too. We just have to execute during the third, but I think to say we're going to push 25% for this quarter in that group might be a little bit of a stretch but we ought to be able to hold it fairly higher than it has been.

Q: Okay, got it. I just want to turn quickly to the pellet plant backlog and the pellet plant order cadence here. It sounds like you got enough other business in infrastructure and elsewhere that's come in perhaps a little bit better than expected to offset what you were hoping for in pellet plants. Is that the way to look at it? It sounds like you were 5% to 10% before growth forecast and now you're at 5%. Is there enough elsewhere to fill in the blanks for the rest of the year if you don't get anything major on pellet plants in the back half?

Ben Brock - President and Chief Executive Officer
Yes, I think so. We have a good backlog and good inquiry level. I've been with a lot of customers during the quarter, activity's good. An example of that is I was talking this morning early with one of our parts fellows and he's already quoting for next year, and we're in July. He's got customers for inquiries for winter delivery now which is about two months earlier than normal. So we feel pretty comfortable about the 5% number.

We really did think we had a shot at maybe getting one line in for the year but our infrastructure order activity has been very strong and there's no way even if we got the order, which we now think will be more towards the very end of the year on the pellet plant, that we could have slid something in. That's where we had the change in the pellet plant estimates, too.

Q: Okay, Ben, thanks. I'll hop back in the queue. I appreciate it.

Operator
Our next question comes from Mig Dobre with Robert W. Baird. Please go ahead with your questions.

Q: Hi. Good morning, guys. This is Joe Grabowski on for Mig this morning. Could you give us a sense as to what the Infrastructure margin would have been ex the issue with the wood pellet plant?

David Silvious - Chief Financial Officer
Yes, I can. This is David. I can tell you that the infrastructure margin would have been about—for the second quarter without the pellet plant issue probably about 22.5% to 22.8% somewhere in that range.

Q: Okay. So I guess it still would have been down maybe 150 basis points year-over-year?

David Silvious - Chief Financial Officer
If you're going to do ex-pellets on Q2 this year, we would do ex-pellets last year where we did have—if you want to compare those particular margins, it would be about flat compared to last year without pellets in last year as well.

Q: Got it, okay. That's very helpful. Looking at the Infrastructure orders each for the last four years the second quarter has had the lowest orders, maybe somewhere in the $80 million to $100 million range. This year the orders were closer to $140 million, obviously very strong. Was there any sort of change in seasonality of orders this year or do you think when we get to the end of the year, we'll look back and see that orders were lowest in the second quarter this year again?

Ben Brock - President and Chief Executive Officer
This is Ben, Joe. It's just the money really started flowing from the federal government and it started to show the job's out and our customer's confidence level was high. I think it's probably—I don't think we're going to see that as the lowest order intake period of the year or the highest. The question was, is this going to look back and say it's the lowest? No, it's not going to be the lowest.

Q: Right, okay, all right. That makes sense.

Ben Brock - President and Chief Executive Officer
I think if I understood your question right.

Q: No, I think you got it exactly right because again it was much stronger than the past four second quarters. Maybe last question for me. So margins ex wood pellet plants were kind of flattish. In Infrastructure, they were down a little bit. In Aggregate, I know you talked about the new products. Any other pressures on margins in the quarter and maybe thinking specifically about steel costs or any other cost of goods sold inflation?

Ben Brock - President and Chief Executive Officer
No, we don't think steel really had an effect on us. We've done a nice job on that. Most of our divisions are covered to the fourth quarter and a handful are already covered into the first of next year. We've also done some price adjustments for what we saw coming. So the combination of those things, I don't think steel has affected us this year.

Q: Got it, okay. Thanks, guys.

Operator
Our next question comes from the line of Stanley Elliott with Stifel. Please go ahead with your questions.

Q: Good morning, guys. Thank you for taking my questions. Can you guys talk about where you could see margins going eventually in the cycle, assuming we get a couple more years of decent growth?

Ben Brock - President and Chief Executive Officer
I think this year getting back to the near 24% range will be where we're working to get to and I think still we're in the cycle, as we've talked in the past. Our high cycle is 25.5% range and trying to get there by the end of next year would be our target.

As I mentioned on the comments, we're slowing down R&D a little bit. Our heritage is R&D but we are slowing that down. We were heavy on that effort going into ConExpo, and we're getting our divisions more focused on executing on the products we've got out and selling new products and getting margin up. So we're in a transition period to really focusing on slowing R&D down and get the margin up.

Q: And that 25.5%, would that be inclusive of Hazelhurst at a breakeven margin?

Ben Brock - President and Chief Executive Officer
Yes.

Q: Go back through the guidance, we're talking about 5% to 10% initially and now we're looking more at 5%-ish but we're not having the wood pellets. But you couldn't have shipped any additional wood pellets it sounds like just because the infrastructure is running so good right now. If you can just help square all that up for me and make sure that I fully understand it?

Ben Brock - President and Chief Executive Officer
Well, it's not that we couldn't, if we got an order to get part of a plant finished right now with our capacity, but to be able to ship and count the whole line for revenue recognition, we physically could not do that now.

Q: Okay. And then lastly for me, with some big acquisitions in this space, have you noticed anything changing on the competitive landscape either in terms of pricing or just anything along those lines would be helpful?

Ben Brock - President and Chief Executive Officer
No change in the competitive pricing that we've seen. Obviously, we noticed that there was a big acquisition announced during the quarter. So we generally think that's probably better for us than not. We think that with that kind of purchase price, they're going to need to show a return so we think that will help the competitive landscape long term.

Q: Great, guys. Thank you very much.

Operator
Thank you. Our next question comes from the line of Mario Gabelli with Gabelli & Company. Please go ahead with your questions.

Q: Hi. Thanks. You anticipated my question about Deere and Wirtgen

Ben Brock - President and Chief Executive Officer
Okay.

Q: So I won't add to that one. But you haven't seen anything yet one way or the other from what they're doing with it, are you?

Ben Brock - President and Chief Executive Officer
No, net yet. We've been told that they already have three people living in Germany, so we'll see how that plays out. And that will be a big difference for them.

Q: Yes, they have a big facility in Mannheim for the last 40 years. Just from my point of view, when you look at 2018, you're looking at the absence of ConExpo, you're looking at the absence of this accounting issue in the pellet plant, you're looking at better results from your new product launches. But is there a way for me to get a handle or my analysts to get a handle on the following: your incoming orders and the non-pellet business what the gross margin is given the mix that's there incrementally?

Ben Brock - President and Chief Executive Officer
I think we'll be in the 24 range by the end of the year on those. And then in the next year, I think we can push them up and approach 25 by the end of next year.

Q: All right, so you got a lot of pluses going into the first half of 2018. I don't want to get into the notion of what is out there on the pellet plant world and what the economics are. So I'm going to pass on this and thank you. Take care.

Operator
Thank you. Our next question comes from the line of Nicholas Coppola with Thompson Research. Please go ahead with your questions.

Q: Hi. Good morning. So on the Infrastructure Group excluding pellets, I'm seeing backlog's up close to 20% year-over-year. Can you talk about growth rates in asphalt plants versus maybe mobile equipment, where are there deltas in this segment and where are you seeing demand be it geographically or however you can characterize it?

Ben Brock - President and Chief Executive Officer
Nick, this is Ben. We've seen it both have been very active at the same time. For us with our new distribution network, with the paving side, that's really spread out the activity for the mobile equipment. So we're seeing it coast-to-coast now which in the past with an up cycle we might see it more concentrated east of the Mississippi. But we've been very pleased with the new dealer network and Roadtec is really having a terrific year and really aligning up for another great year next year we think. So it's really—and for asphalt plants, too, it's coast-to-coast, not as so much for us in the northwest US for asphalt plants but just about everywhere else has been very active.

Q: Okay, that's good to hear. Then maybe just any additional color on your traditional mining markets, what are you seeing there?

Ben Brock - President and Chief Executive Officer
The only thing we referenced in the comments that we've seen a little bit of a heartbeat and that's just a little more conversation. When we see a little bit of backlog in Brazil that means the mining's just trying to turn a little bit, but that's it. We don't see a big trend. We just see maybe a blip on the screen for a heartbeat.

Q: Okay. Thanks for taking my questions.

Operator

Thank you. Our next question comes from the line of Morris Ajzenman with Griffin Securities. Please go ahead with your questions.

Q: Good morning, guys, a follow up. When you gave a snapshot of what Infrastructure gross margins would have been without the wood pellet plant sales this quarter, gross margins would have been approximately 22.8%. So my question is, with such a big improvement that's been going on recently with infrastructure, why is that division ex the wood pellet plant gross margins not much higher closer to 24%, 25%? What am I missing here currently?

Ben Brock - President and Chief Executive Officer
The main piece in that is the new equipment that was flowing through for us and that there was the new transfer vehicle at Roadtec is a good example of that. Astec has a high RAP asphalt plant that was below margin coming out of the plant. Carlson has a couple of a new paver models going through. So that's really where you're seeing that. They were a little bit lower than we thought but still in range with what we thought at the end of last quarter, but that's where you're seeing it.

Q: Will this impact from new equipment sales continue into Q3 or Q4?

Ben Brock - President and Chief Executive Officer
No, I think we'll be increasing gross margin in Q3 and Q4.

Q: All right, so then my question would be, if you were able to extract the impact of new equipment, where do you think adjusted Infrastructure gross margins could have been this past quarter?

Ben Brock - President and Chief Executive Officer
It's hypothetical really but I think we could be in the 24% range. But we have to get through and clean them up and get the margin right.

Q: Got you. And I'm confused, but what was Q3 pellet revenues and Q4 pellet revenues last year?

David Silvious - Chief Financial Officer
I can do that, Morris. I have that information right here, so Q3 last year pellet revenues were $19 million; Q4 was $70.6 million.

Q: Okay. You're expecting for the full year, for the remainder of the year, approximately, am I right, $5 million or is that just one plant?

David Silvious - Chief Financial Officer
Yes, for the remainder of this year there's about another $5 million to be recognized.

Q: Okay. Thank you.

Operator
Thank you. Our next question comes from the line of Jon Fisher with Dougherty & Company. Please go ahead with your questions.

Q: Yes. Good morning. On the capex guidance that you gave, given how tight things are on the Infrastructure side of things, does that anticipate any additional capacity expansions in the Infrastructure Group?

Ben Brock - President and Chief Executive Officer

Hi, Jon, this is Ben. Not for this year but potentially next year we're looking at some additions in the Infrastructure Group.

Q: Okay. And then given OpEx spend was lower year-over-year in this quarter, when you look out going forward the rest of this year, maybe into next year and obviously Q1's got the ConExpo comparison, how tightly can you manage OpEx? Can you keep OpEx spending negative year-over-year or flat year-over-year or was this quarter or Q2 just a one-time anomaly?

David Silvious - Chief Financial Officer
I think Q2 was a pretty good quarter for keeping it down, but I do think we target that 15% range. So as sales go up, obviously it's going to go up. But I think a good run rate for the rest of this year is probably in the 45 range per quarter.

Q: Okay. And then when you talk in terms of 25% and exit rate gross margins for next year potential, does that include contribution from wood pellet plant revenues? Or if you do receive a third order, would that be dilutive to being able to attain that objective?

Ben Brock - President and Chief Executive Officer
If we're fortunate enough to get a pellet plant order and we're fortunate enough to deliver some of it in 2018, it will not be diluted.

Q: Okay. And then just the pricing dynamic other than steel recovering from steel, the demand environment obviously with backlog seems to be really strong. What is your ability to get some additional pricing here either for this year or for orders that you're already booking for next year?

Ben Brock - President and Chief Executive Officer
Jon, a lot of our companies have tried to raise prices a little bit mid-summer because of the backlog frankly and the steel pricing, the warnings, although we've been able to offset that. But we'll be relooking at that. Typically we'll look at pricing in September each year, so we're very close to that. We have a presidents meeting where we'll discuss that with everybody at the end of August. So we will be on top of it. We do face still even though—we still have pretty good competition and they're still pretty aggressive, the Europeans, but we're doing a good job I think of getting a little bit more right now.

Q: Okay. And then last question, it sounds like the new dealers are going well and generating some new business out west. What's the possibility of picking up some Wirtgen group dealers out west to even further your exposure and penetration out west?

Ben Brock - President and Chief Executive Officer
Well, I don't know if I can comment on that. I think they'll probably just maintain the distribution the way it is. But who knows, we'll just wait and see on that. We're very happy with who we have now. We've got almost full coverage out west now, so I don't necessarily see us wanting to change.

Q: Okay. Thank you.

Operator
Thank you. Our next question comes from the line of Mike Shlisky with Seaport Global. Please go ahead with your questions.

Q: Hi, guys. Just a quick few follow-up questions for you while we have you on the phone. I wanted to ask first about the Astec Guardian System. I know that's a relatively new introduction or improvement for you. Can you give us a sense as to how the uptake has been on your new system and whether it's becoming a good opportunity for part sales in the back half of the year?

Ben Brock - President and Chief Executive Officer
The Guardian System is a Roadtec product and that has helped us with part sales. I don't think we have any exact numbers on that, but certainly being closer to how the machines operate and then not just reading engine data but really understand the whole machines, it's helped us. To the point we've had to get a few extra square feet of capacity at the warehouse that we're leasing so it's definitely helping us.

Q: Okay, got it. And then on the concrete plant ramp up, I wasn't sure if you went into too much detail during your prepared comments. Can you just give us an update as to how that's going, when the new products are currently ramped and sort of maybe the back half and maybe an early 2018 outlook for how that business might grow from here?

Ben Brock - President and Chief Executive Officer
Sure. I don't think it will be significant this year. We have three plants in operation right now and I personally went and saw one of them in Kansas during the quarter. The customer is happy with what we're doing. I think with the lease that we have, we're very solid. So I just think we have an opportunity to double that population, if not more, by the end of the year. We have a new sales manager in place for that division and that's why we're optimistic on their opportunities there.

Q: Okay, great. Just one last one for me about finding enough labor out there to build all these products. Obviously with a pretty hot employment market, just curious if you can update us as to are there any issues with trying to find workers for your plants and is there any way you can shift work from one plant to another to resolve those if they were to ever arise from the back half of the year here?

Ben Brock - President and Chief Executive Officer
We have run up on some skilled labor issues during the quarter. As far as shifting work, the opportunities there would be more in the Infrastructure process equipment groups, so Astec with some of the divisions in Infrastructure Group and we are looking at that.

Q: Okay, Ben. Thanks for the follow-ups. I appreciate it.

Operator
Thank you. Our next question comes from the line of Larry De Maria with William Blair. Please go ahead with your questions.

Q: Hi. Thanks. Good morning. First question, and sorry if you said this, but obviously you are chasing a large pellet order for next year. What's the size are we thinking about and what kind of capacity do you have now for 2018?

Ben Brock - President and Chief Executive Officer
We have plenty of capacity for 2018 but the size range of that order is $150 million.

Q: Okay. And you could execute on all of that for next year, if you get it?

Ben Brock - President and Chief Executive Officer
Well, that becomes dependent on permitting and site work that gets done. So it's way too early to call on that. I wish I could tell you.

Ben Brock - President and Chief Executive Officer
We could physically build it. It's could the site—could everything be ready to go?

Q: Got you. And then secondly, obviously this industry is still maturing on the pellet plant side, what kind of annual numbers should we think about in the industry? What's competition like for those now? Not getting the order yet, are there delays or are there competition or is the industry moving slowly? Just any overall color on the industry would be helpful, so we can get more comfort around what an annual number should look like.

Ben Brock - President and Chief Executive Officer
Well, for us, Larry, we've always thought if we can get one to one and half plant a year that would be kind of the business that we could handle, so in the $150 million to $200 million range for us. The market was not good last year for pellets but it's much better right now. The environment's better for the pellets. More capacity coming online in the UK to need pellets. The Japanese market is starting to get better for pellets. So think of it in terms of maybe 2 to 3 plant market up to about 35 to 40 in the US over a 5- to 10-year period and that kind of matches up with what it was a few years ago, but it kind of took a break in demand for a little bit, but it's come back.

Q: Okay. Are we seeing pellet plants go in to supply Japan at this point, or is that just still talk right now?

Ben Brock - President and Chief Executive Officer
To my knowledge, it's still talk but we'll double check and we can get back to you on that. But to my knowledge at this point I don't see that there's been a plant built for Japan demand that I'm aware of, but we'll double check that.

Q: Okay. Thank you. Good luck.

Operator
The next question comes from the line of Jon Fisher with Dougherty & Company. Please go ahead with your questions.

Q: Thank you for the quick follow up, it's on asphalt plants. What would your expectations be for the industry to produce for asphalt plants this year? And if you want to give a number forecast for next year or just directional, can the industry or will the industry produce more in 2018 than they will in 2017?

Ben Brock - President and Chief Executive Officer
Jon, this is Ben. I really would want to revisit with our guys but my gut tells me about 125-plant market next year and we're probably around 100 right now. But I need to go back and double check my gut on that. But I think that would be pretty close.

Q: Okay. And you're still comfortable maintaining your approximate two-thirds market share?

Ben Brock - President and Chief Executive Officer
We feel pretty comfortable. We've been able to hold on to it, but I think we're going to definitely be challenged with our backlog in the mine season this year. We may give up a little market share but we need to do it. We need to get more margin if we're to come back to the pricing question earlier. We're going to be in a little bit of a dogfight on some deals with delivery I think next year.

Q: Okay. Thank you.

Operator

Thank you. This concludes our question-and-answer session. I'd like to turn the floor back to Steve Anderson for closing comments.

Steve Anderson - Vice President of Administration and Director of Investor Relations
All right. Thank you, Brenda. We appreciate your participation on this second quarter conference call and we thank you for your interest in Astec. As our news release indicates, today's conference call has been recorded. A replay of the conference call will be available through August 8, 2017 and an archived webcast will be available for 90 days.

A transcript will be available under the Investor Relations section of the Astec Industries' website within the next seven days. All of that information is contained in the news release that was sent out earlier today.

So as Brenda said, this concludes our call. We thank you all. Have a good week.