Transcript of Astec Industries, Inc.
Fourth Quarter 2017 Earnings Call
February 20, 2018

Participants
Benjamin G. Brock – President and Chief Executive Officer
Richard J. Dorris – Executive Vice President, Chief Operating Officer
David C. Silvious – Chief Financial Officer
Stephen C. Anderson – Vice President of Administration, Director of Investor Relations

Analysts
Michael Shlisky – Seaport Global Securities
Mig Dobre – Robert W. Baird & Co.
Stanley Elliot – Stifel Nicolaous
Jon Fisher – Dougherty and Company
Brian Rafn – Morgan Dempsey

Presentation

Operator
Greetings, and welcome to the Fourth Quarter 2017 Earnings call. At this time, all participants are in a listen-only mode. A 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 your host, Steve Anderson.

Stephen C. Anderson – Vice President of Administration and Director of Investor Relations
Thank you, Dana. Good morning and welcome to the Astec Industries conference call for the fourth quarter in fiscal year that ended December 31st 2017. As Dana mentioned, my name is Steve Anderson and I'm the Vice President of Administration and Director of Investor Relations for the company. 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 fourth quarter. Before we begin, I'll remind you that our discussions 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 fourth quarter and the full year of 2017. David?

David Silvious – Chief Financial Officer
Thanks Steve. Good morning everyone. Thanks for dialing in.

Net sales for the quarter were $312.4 million compared to $326.6 million in Q4 2016, a decrease of 4.3% or $14.2 million decrease in net sales. International sales were $67 million in the quarter compared to $61.6 million in Q4 of 2016, an increase of 8.7% or $5.4 million increase in international sales and those increases were primarily in the geographic regions of Canada, Australasia, Africa and Brazil and those increases in those areas were offset by decreases in Mexico, Japan and South America excluding Brazil, Europe and Central America. For the quarter, international sales increased in the Energy Group and the infrastructure group and decreased in the aggregate and mining group. International sales represented 21.4% of Q4's net sales compared to 18.9% of Q4 2016 net sales.

Domestic sales were $245.4 million in Q4 of 2017 compared to $265 million in the same quarter last year, a decrease of 7.4% or $19.6 million decrease in domestic sales. Domestic sales represented 78.6% of Q4 2017 sales compared to 81.1% of Q4 2016 net sales. For the quarter, domestic sales increased in the aggregate and mining group and the Energy Group and decreased in the infrastructure group.

Part sales were $69.3 million in the quarter compared to $62.5 million in Q4 of 2016, a $6.8 million increase or a 10.9% increase. Part sales were 22.2% of quarterly net sales this year compared to 19.1% of Q4 2016 net sales. For the quarter, part sales increased in the aggregate and mining group and in the Energy Group and remained flat in the infrastructure group.

Foreign exchange translation had a positive impact on sales for the quarter-over-quarter of about a million-and-a-half dollars, that is, if rates were the same in Q4 as in Q4 last year, sales would have been $1.5 million lower. For the quarter, pellet plant revenues were $5.6 million compared to $70.6 million in Q4 of 2016. Recall that these sales are classified as domestic sales and also they're classified in the infrastructure group.

Net sales on a year-to-date basis, were $1,184.7 million compared to $1,147.4 million in 2016, an increase of 3.3% year-over-year or $37.3 million increase year-over-year. For the year, international sales were $252.4 million compared to $206.2 million for the year last year, an increase of 22.5% or $46.2 million increase in international sales. Those increases occurred primarily in Canada, Russia, Australasia and in Brazil and those increases were offset by decreases in South America excluding Brazil, Japan, Mexico, and Central America. International sales represented 21.3% of year-to-date net sales compared to 18% of year-to-date 2016 net sales. For the year, international sales increased in all of our reporting groups.

Domestic sales for the year were $932.3 million compared to $941.3 million in 2016, a decrease of 9.5% or $9 million decrease. Year-to-date 2017 domestic sales were 78.7% of total sales compared to 82% of total sales for the 2016 year.

Part sales for 2017 were $283.4 million compared to $263.5 million in 2016, a 7.6% increase or $19.9 million increase in part sales. Part sales for the year of 2017 were 23.9% of total sales compared to 23.0% of total sales in 2016.

Foreign exchange translation had a positive impact on sales for the full year of 2017 of $2.9 million and that is, if rates were the same this year as last year, sales would have been $2.9 million lower. For the year, pellet plant revenues were $8 million compared to $135.2 million in 2016 and again, these sales were classified as domestic sales and also in the infrastructure group.

Consolidated gross profit for the quarter was $62.8 million compared to $64.5 million in Q4 of 2016, a decrease of 2.6% or $1.7 million decrease in gross profit in dollar terms. The gross profit percentage then, was 20.1% for the quarter compared to 19.7% for Q4 of 2016. The absorption variance for the fourth quarter of 2017 was $3.8 million under-absorbed overhead compared to $9 million under-absorbed overhead in Q4 of 2016—a positive change in that absorption variance of $5.2 million.

Consolidated gross profit for the year was $243.1 million compared to $265.3 million for the year of 2016, a decrease of 8.4% or $22.2 million decrease. That yielded a gross profit percentage for the year of 2017 of 20.5% compared to gross profit percentage of 23.1% for the full year of 2016.

The year-to-date 2017 absorption variance was $1.3 million under-absorbed compared to $16.5 million of under-absorbed overhead in 2016 a $15.2 million positive change in absorption for the year-over-year. SGA&E for the quarter was $44.8 million or 14.3% of sales compared to $45.4 million or 13.9% of sales for the fourth quarter of 2016, a decrease of $600,000 in dollar terms and an increase of 40 basis points as a percentage of sales. The primary driver there was reduced research and development cost and offset slightly by increase in payroll and benefits related expenses.

For the year, SGA&E was $187.6 million or 15.8% of sales compared to $178.1 million or $15.5% of sales for the full year of 2016—an increase of $9.5 million or an increase of 30 basis points as a percent of sales. Primary drivers there were, recall that we had CONEXPO earlier in 2017 for $4.4 million and that was also added to by payroll and benefit-related costs that were up year-over-year. Operating income was $18 million for the quarter compared to $19.1 million for the fourth quarter of 2016, a decrease of 5.8% or $1.1 million decrease. For the year, operating income was $55.5 million compared to $87.2 million in 2016, a decrease of 36.4% or $31.7 million decrease in operating income.

Other income was $700,000 for the quarter compared to $63,000 in Q4 of 2016 and $2.7 million in the full year of 2017 compared to $1.5 million in 2016 and recall that the primary source of that other income is license fee income and also investment income at our captive insurance company. The effective tax rate for the quarter was 41.1% compared to 34.2% for the same quarter last year. While our tax rate for the quarter did include a benefit of approximately $1.1 million from the tax reform legislation, it's obviously higher than our historical average and significantly higher than last year's Q4 rate. Items that caused our rate to be elevated compared to last year include a smaller research and development tax credit in the current year, higher state tax expenses in the current year, and we had increased tax expense on intercompany sales that were deferred in prior years that were recaptured in the current year in consolidation.

For the year, our tax rate was 34.3% compared to 36.9% for the full year of 2016. The tax rate for the year is lower than the prior year due primarily to the impact of the domestic production activity deduction or DPAD and the research and development tax credits. Those were similar amounts in 2017 compared to 2016, but they did have a higher percentage impact due to lower taxable income in the current year as well as the aforementioned benefit from tax reform. On a go forward basis, we believe our annual effective tax rate will be in the 25% to 26% range and we will update this forecast for you on our Q1 call as we get through our first quarter tax provision process.

Mid-income attributable to controlling interest was $10.9 million for the quarter compared to $12.4 million for Q4 2016, a 12.1% decrease or $1.5 million decrease. Diluted earnings for the quarter then, were 47 cents compared to 53 cents in Q4 of 2016, an 11.3% decrease or 6 cent per share decrease. On a year-to-date basis, net income was $37.8 million compared to $55.2 million for the full year of 2016, a decrease of 31.5% or $17.4 million decrease. Therefore, for the year, earnings per share were $1.63 per diluted share compared to $2.38 per diluted share in 2016, a decrease of 31.5% or 75 cents per diluted share.

As we previously announced, the company initiated significant design upgrades to its customers Georgia and Arkansas wood pellet plants to meet full production rates and that obviously negatively impacted our earnings per share in the third quarter and for the year by approximately 59 cents per share.

EBITDA for the quarter was $25 million compared to $25.6 million for the fourth quarter last year, a decrease of 2.3% or $600,000 and for the year, EBITDA was $82.7 million compared to $112.7 million for the full year of 2016, a decrease of 26.6% or $30 million decrease in EBITDA year-over-year.

Our backlog was down $411.5 million at December 31 of 2017 compared to $361.8 million at December 31 of 2016 and prior year adjusted for RexCon—recall we acquired RexCon in October of 2017, so we've adjusted all the prior year numbers in the backlog to reflect that. The increase in our backlog, December versus December is $49.7 million or 13.7%. Our international backlog is up to $75.6 million compared to $62.7 million at December of last year, an increase of $12.9 million or 20.6%.

Our domestic backlog is $335.9 million and last year it was $299.1 million at December. That's an increase of $36.8 million or 12.3% increase. Excluding pellet plant backlogs, our 12/31/17 backlog was $341.4 million, an increase of $57.3 million or 20.2% compared to 12/31 of 2016 and I know that our press release calls out an increase of 22.9%; however, that was an incorrect percentage. That actual percentage is 20.2% on that calculation. So, I apologize for that number.

Sequentially, the December 31 backlog is $411.5 million compared to our September 30 of 2017 backlog of $386.5 million—a $25 million increase in backlogs sequentially, or 6.5% increase sequentially. At year end, we typically announce our January backlog and that is $448 million at January of 2018 compared to $395.2 million at January of 2017, a 13.6% increase in the January backlog.

The foreign currency translation impact on the backlog year-over-year is $2.3 million increase. That is, the backlog would have been $2.3 million lower at prior year rates. On the balance sheet, it still remains very strong. Our receivables are at $120 million compared to $110.7 million in the prior year, an increase of $9.3 million. Our days outstanding then, are 34.3 days compared to 30.5 days at 12/31 of 2016. Our inventory is at $391.4 million at 12/31 of 2017 and that compares to $360.4 million at December of 2016, a $31 million increase in inventory and that yielded 2.4 inventory turns in 2017 compared to 2.3 turns in 2016.

We have nothing on our $100 million domestic credit facility and we have $62.3 million in cash and cash equivalents on the balance sheet. Our letters of credit are at $9.8 million outstanding at the end of December yielding a borrowing availability of $90.2 million. We do have $4 million of debt currently in Brazil and that is used to finance the company's building fixture and inventory.

Capital expenditures for the quarter were $5.6 million and capital expenditures for the year were $20 million. For 2018, we're forecasting around $35 million of capex. Depreciation for the quarter was $5.4 million and $21.3 million for the full year 2017. For 2018, we're forecasting somewhere in the range of $23.5 million of depreciation.

That concludes my prepared remarks on the financial details and I will turn it back over to Steve Anderson.

Stephen C. Anderson – Vice President of Administration and Director of Investor Relations
Thank you, David. Ben's now going to provide comments regarding the fourth quarter of this year's operation, and will offer some thoughts going forward. Ben?

Benjamin G. Brock – President and Chief Executive Officer
Thank you, Steve and thank you to everyone for joining us on our call today. Before going into my comments on our earnings release, I do want to take a minute to say thank you to our entire team at Astec for their efforts in 2017. We did end the year with a record $1.185 billion in sales. Although sales were only up slightly, that did get us another record and an EBITDA of $82.7 million with strong backlogs at the end of December and January as David mentioned. It did take a total team effort in 2017.

In my opinion, 2017 became a year of transition for us as we released an extraordinary amount of new products at the CONEXPO show in March of 2017 and worked through installation and startup issues for our customers at our two large pellet plants that we deliver. Innovation and customer service are important values to us as a company and the two transitional issues just referenced are normal for us historically, albeit at a much lower level historically as well. New products normally carry lower margins as we build them the first few times and a large number of them in the first half of 2017, was a challenge to our gross margin. These margins have recovered and will be in line with our normal margins in 2018. Our investments related to the installation and startup of the wood pellet plants were front and center for us during the year as well, and we're making good progress on these plants.

Moving back to our earnings release, as we commented in the release this morning, we were pleased that our fourth quarter result was in line with our anticipated result that we mentioned on our last call. As for the year as a whole, our transitional issues held our EBITDA to $82.7 million or 6.98% of sales, which in my opinion was a fairly good result given all the new products introduced and wood pellet plant charges during the year.

For reference, our ex-pellet charges EBITDA in 2017 would have been $103.7 million or 8.75% of sales. In addition, if we added back our previously stated new product margin effect in the first half of last year, which was a stated effect of approximately 100 basis points, we would have had a total EBITDA in 2017 at approximately $110 million or approximately 9.3% of sales. This indicates we performed close to our 2016 results in our core business areas, and 2016 was one of our stronger years. That being said, our actual 2017 results include our transitional issues and with those essentially behind us, we are focused on opportunity to have a very good 2018.

As David mentioned, our backlog at December 31st was $411.5 million and our backlog at January 31st was $448 million. Our infrastructure group continued good order intake during the quarter, mainly as a result of good economic conditions and the Federal Highway Bill in the United States. Our aggregate mining group also saw increased backlog for the same reasons. Our Energy Group backlog was up as we experienced good order intake in the group for products targeted at the construction and industrial customers and their groups. We also experience increased quoting activity for our oil and gas drilling products.

Our domestic and international backlogs were both up year-over-year. Our increase in domestic backlog overall was primarily due to the current longterm federal highway bill, new state and local government infrastructure funding mechanisms and good private sector work levels for our infrastructure customers.

Our international backlog increase was a result of improved economic conditions and some larger scale infrastructure projects in Europe, Russia, Canada and Australasia. We've also seen increased quoting activity in Africa.

Our Astec do Brasil facility continued to experience a slight increase in quoting activity in Brazil. As you may recall, we made the decision to maintain our international sales and service organization despite the significant challenge presented to us in the last few years by the strong US dollar with regards to exporting our equipment from the United States. The decision to do so has started to prove to be the right one and it's paid off in increased international orders and backlog at the end of 2017.

We see a longterm opportunity to grow our equipment parts and service sales in international markets. To that end, we have hired Michael Norris as our new Managing Director of International Region Offices. Michael comes to us with a successful track record of increasing international construction equipment sales. He will drive our efforts to increase sales of our equipment parts and service internationally through our global regional office network. Having offices in the regions we are serving worldwide will get us even closer to our customers and help us as we work with them in an even better way in their time zones and in their languages as much as possible. Our region office strategy is reflective of successful international sales models in our industry although tailored to meet our operational model of decentralization. We are excited to have Michael on board and for our future growth in this area.

We do not expect the expense to execute this strategy to be extreme as we will roll our existing international sales and service personnel into our new region office vision as we create each office over time. We expect to open one to two offices in 2018 and these regions are to be determined.

Changing subjects to wood pellet plants, 2017 was an extremely challenging year to us with regards to these plants as we took significant charges related to getting the two plants we have delivered installed and up to speed on production for our customers. As an update on our progress on the wood pellet plants, we are making good progress and believe that our announced charges during 2017 are adequate to cover our commitments to our customers.

Updating our current pellet plant quote activity, we do have ongoing quote activity for new projects; however, as previously announced, we are not going to sign a new pellet plant order until we have finished it, both at the sites that the charges were announced for during last year. Given our progress at the two pellet plant sites, we still believe we'll be in position to add an order in time to deliver a complete wood pellet plant in 2019. As a reminder, if we do get an order for another wood pellet plant, we'll only do so as a supplier of equipment in accordance with our traditional equipment parts and service offerings.

Changing subjects to the Energy Group, we experienced good sales activity during the fourth quarter for products targeted at the infrastructure oil, chemical and food industries, which contributed to the 35.2% increase in backlog in the group. Sales of wood chippers and grinders also remain consistent during the quarter. Our concrete plants are built in Energy Group and quoting activity is good for these for these plants. The World of Concrete show was held in January and our RexCon and CEI subsidiaries enjoyed great customer traffic through their displays. Both have secured orders as a result of being at the show.

Our RexCon and CEI teams are working together on our strategy to meet our goal to become the largest supplier of concrete plants in the United States. We are currently number two. As you can tell by these developments, we're optimistic on our outlook in the Energy Group. Our new product development does continue in all groups; however, at a more typical rate versus the high rates of R&D in 2016 and 2017. Innovation is one of our core values and, in addition to our industry-leading service, our brand promise to our customers.

Looking ahead to the first quarter of 2018, we believe our first quarter 2018 revenue will be slightly higher than Q4 2017 and with regards to earnings in the first quarter of 2018, we expect our earnings per share to be slightly better than our first quarter 2016 earnings per share. Our current outlook for the full year of 2018 is core revenues up 7% to 12% versus last year, with a much improved net income for the year. We expect to be paid on the pellet plant in Georgia in December, which would add $60 million to the sales number, but as a reminder, the sale will be at breakeven margin.

Despite the gains we believe we will show in 2018, we still have opportunities to be an even better company for our customers, our focus is producing even higher quality products than we already do for our customers while focusing on operational excellence internally. To that end, we have hired Jim Joyner as our new Vice President of Global Operational Excellence. Jim has a proven track record of working with global manufacturing companies to increase quality and productivity. He has been working with us as a part-time consultant at two of our subsidiaries since the end of last summer and we are excited to have him join our team. He will work with all of our subsidiaries to maximize quality and productivity in a systematic manner.

We have seen our vendor partners, especially those with products that contain steel, working to increase prices. We have also seen our steel supply vendors pushing for the same. We will work to offset these pressures in many ways including our operational efforts with the addition of Jim to our team. From our last earnings release to now, orders have been steady in the infrastructure group, improving in Aggregate Mining Group and improving in Energy Group. Orders have been up internationally. Bright spots for activity are hot mix asphalt equipment sales, asphalt plants and mobile-type equipment for asphalt, concrete plant quote activity, solar mediation, plant quoting activity, wood chippers and grinders, aggregate crushing and screening equipment quoting activity and international quote activity.

Year-to-date part sales were up 7% versus last year and was 23.9% of total sales versus 23% in 2016. For the whole of 2018, we are optimistic on our outlook. We believe all of our reporting groups have the opportunity to be up on sales and net income for the year. Acquisitions remain a key piece of our growth strategy along with organic growth. To that end, we continue to work on potential additions to the Astec family of companies. Given our current financial position overall, we do have the ability to execute a larger than historically normal acquisition; however, we'll only do so if the acquisition is strategically aligned with the industries we serve.

That ends my comments on the quarter and what we see 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 Steve Anderson.

Stephen C. Anderson – Vice President of Administration and Director of Investor Relations
Thank you Ben. Dana, we can open up the lines for questions now and I'll be glad to entertain those.

Operator
Thank you. At this time, we will be conducting a question-and-answer session.
Our first question comes from the line Mike Shlisky from Seaport Global Securities. Please proceed with your question.

Q: I just wanted to follow up with a gross margin question—I guess, are you still okay with your 25% gross margin target for the year, and is that more of an end-of-the-year goal than it is during the start of the year? Is that goal an area you think you can reach on a full-year basis in 2019 and beyond?

Benjamin G. Brock – President and Chief Executive Officer
We stated our goal to be at 25% exiting 2018. There'll be a little pressure on that with the pricing pressure we're seeing mainly as a result of steel pricing, but we still have the opportunity to do that. That's one of the reasons that we added Jim Joyner to the team. We've done a nice job, to this point, on our lean effort, and I think it's helped us a little bit on maintaining some market shares but we want to take it to the next level and Jim has a great history of doing that at many places around the world and we're excited to have him on the team, but still a definite target for us coming out of 2018 and then, really too early to call on 2019, but certainly that would be our goal.

Q: Okay, got it. I also want to ask about some of the FAST act impacts you've seen so far. At this point of the year, we'll be entering that halfway point of that act, I guess, sort of midpoint through 2018 here. So, there's only two years left after this year. At some point, do you think the order activity, that might slow it down or is that not going to happen for some quite some time in your opinion?

Benjamin G. Brock – President and Chief Executive Officer
Well, in my opinion, I guess, that's maybe a two-part answer. The first part is, you know, we just had the National Asphalt Paving Association Annual Meeting a few weeks ago, and extremely well attended. One of their highest attended in many years, which is an indicator of how good things are for our customers. I personally visited with 31 different companies worth of contractors over that time and, well at the meeting and everyone feels very good about 2018, didn't talk to anybody that they didn't feel good about '18; and okay about 2019, but anytime we see at the end of a highway bill, it could be a slowdown in infrastructure equipment purchasing.

The second part of that answer is who knows what the Trump plan ends up being. If you've read it, or if you've seen any of the analysis on it, it's probably on the one hand, the most creative effort in the last couple of decades to fund infrastructure at a high level, but on the backside, there's really no great way to pay for it. I know they came out with a proposal of a gas tax at 25 cents, which would be 5 cents a year for five years, which we absolutely think is the best way to do it, until you can get to a vehicle miles travelled way of paying for it. I think there's a big jury out on that, but anything it gets would help us.

I think, certainly everybody wants to do something. How they get there is different, but that's probably a little longer answer than you wanted, but I guess, timing-wise, there's probably another couple of years left on the equipment side. A lot of this money is hit, it's flowing, but also, in addition to that you have the state and local initiatives that have happened over the last few years and that's really provided funding out there and private side is still staying strong according to everybody we talk to out there or I talk to, so I would say, probably a couple of years on the equipment side.

Q: That's great color. Kind of a quick followup on that then, if you have this big bill that's in everyone's sights in Washington, D.C., are your most recent quotes of some of your more recent talks with customers, are the quotes done? Is the pen in hand? Are they kind of waiting to sign as soon as that bill gets signed by the President or are your current quotes more sort of the longterm view about their ability to buy equipment from the FAST Act or their current business situation regardless of what President Trump wants to do?

Benjamin G. Brock – President and Chief Executive Officer
I didn't get the feel that anybody was banking on the Trump bill, and most of our orders have been steady, good activity, particularly the mobile side is the Roadtec division, and Carlson's very strong. So, I don't think that they're working with Trump in mind as they're executing right now.

Q: Got it. Excellent. I will pass that along. I appreciate it.

Operator
Our next question comes from the line of Mig Dobre from Robert W. Baird & Co. Please, proceed with your question.

Q: So, you're not providing a revenue outlook for 2018 and I can appreciate why, but when I'm looking at your orders, you're exiting the year with pretty nice order growth, call it 15% or thereabouts. You've got your backlog, if I exclude wood pellet plants, is up about 20. So, orders are pretty decent, backlog is pretty decent, as we look into 2018, is there any reason to think that we would see a slowdown from the current levels? Is there anything that you're either seeing in the market or you're hearing from customers, any color?

Benjamin G. Brock – President and Chief Executive Officer
I don't see it. I think we do have opportunities, like I said in the comments, to be up 7% to 12% over this year's number, based on—

Q: I must have missed that. I'm sorry about that.

Benjamin G. Brock – President and Chief Executive Officer
Yes, and on top of that, with no margin is the wood pellet plant, the 60 million out of Hazlehurst that on the core side 7% to 12% on top of this year's number I think is very possible.

Q: Alright, okay. That makes sense. I've struggled with this throughout 2017 trying to get a good grip on what your gross margins were excluding the noise that you called out. You basically had issues with the wood pellet plants, but then you also had all these new product investments that you don't necessarily expect to repeat. So, if we look on an apples-to-apples basis, what would the gross margins have been for the full year 2017 excluding these items?

David Silvious – Chief Financial Officer
Good morning Mig. This is David. The impact of the pellet charge on the gross margins was about $21 million. That's that 59 cents per share that we discussed and so ex that, it would be about 22% and probably more in the range of about 22.5% when you exclude the impact of the first half of new products running through the shops.

Q: Great. That's really helpful. So, the baseline here is call it 22.5% as we start modeling 2018. You're expecting growth, core growth in 2018 on top of that. I guess, the question would be, you backed away from the 25% gross margin target. I understand that, but given what's happening with your input cost, and your utilization, what's kind of a normal incremental gross margin pull-through that we should be thinking for these revenues for the full year?

Benjamin G. Brock – President and Chief Executive Officer
That's a good question, Mig. This is Ben. I guess, maybe to answer that, maybe not directly answering the question and maybe what the target for us would be even with what's coming at us on the increases that you referenced, I do think we're getting just a little bit more on the pricing side as well. We don't have total pricing power, but we are doing a little bit better and I think we're going to have to offset the steel with some operational improvements that, you know, having Jim part-time, we've started to see that a little bit in the two divisions that he helped us with just part-time. Those were pretty quick gaines where they were made. So, we still think coming through to the end of the year, our target would be to exit the year in the 25% range.

Now, we'll still affect this and going to keep this slightly below that. It could, although we are generally protected through the first half on steel. So, through our buying agreements, we do about 75% of our steel would be in buying agreements and 25% would be kind of left for opportunity purchases. I think it's a little longer answer than you probably wanted, but if you look at our inventory being up a little bit, we did some opportunity purchases in raw, so that was up a little bit.

Then, behind the scenes on the finished goods piece was our Roadtec division went live on our new ERP system in the first of January and we built up a little ahead for Roadtec on inventory just in case—a little bit of a security blanket on that and they're working their way through that pretty rapidly, but probably more answer than you wanted, I guess. I'm sorry to ramble.

Q: No, no. It's great. It's actually a little less than what I wanted, because I've got another question. If I'm thinking about gross margin then, you're saying that I have materials locked in through the first half of the year, but I expect margin to ramp as the year progresses. It would imply to me that your steel costs are actually going to be up in the back half of the year even more than you're experiencing in the front half. So, how do you do that?

Benjamin G. Brock – President and Chief Executive Officer
I think if you believe the numbers that they're throwing at us, it would be hard to argue against you. I know the tariff thing is kind of the question mark that is the cloud on the horizon, but I guess personally in our history, I don't want to say there's no way that steel is going to be that everything we point to in the second half, but I don't think it's going to be as big as everybody thinks personally. Our experience is it's always a huge number that everybody talks about. That being said, there is some allocation work going on in the background with the steel mills. They're anticipating higher price coming, but we're going to work like mad to offset it and I think between the things that we're going to try to do to offset it, and it not being as big as they think. You know, they always think it's going to be a whole lot more than it actually ends up being. I think we still have a pretty decent shot at being where we think we could be by the end of the year.

Q: Got it and then last question for me. Just making sure we have our expectations straight for 1Q 2018, I'm trying to make sure that I understand your earnings guidance, you're saying you're going to be up versus 1Q 2016. Obviously, your tax rate is going to be down a lot and where do we start on gross margins for the year? Is it 23%? Is it more than 23%?

David Silvious – Chief Financial Officer
Yes, we're exiting the year at core gross margin around that 22.5%. We're going to have to make incrementally slight improvements each quarter if we're going to exit this year at 25%, so I think you can look for something in that range.

Q: And, your comment was against 1Q 2016, not 1Q 2017 for earnings?

Benjamin G. Brock – President and Chief Executive Officer
That's correct, yes.

Q: Great. Thank you guys. I'll get back in the queue.

Operator
Our next question comes from the line of Stanley Elliot from Stifel. Please proceed with your question.

Q: On the 7% to 12%, does that include the $60 million from the wood pellets or not just to make sure I'm crystal clear.

Benjamin G. Brock – President and Chief Executive Officer
It does not, Stanley. In my mind, I just still got that, there's no margin in it, so I threw it in on top at the end, but that would be on top of the 7% to 12%.

Q: Are you guys seeing anything else? You've mentioned steel cost. Anything else from the supply chain about their ability to ramp with you guys and get you the products you want and need in a timely fashion?

Benjamin G. Brock – President and Chief Executive Officer
This is Ben. Good question. We talked about that through our first quarter reviews in the first couple of weeks of the year, with all of our companies and so far we feel like we're okay. Not 100%, but high percentages of everybody being able to keep up and stay with what we're needing anyway.

Q: The shift to more of a regional platform for the international sales, was that—did you guys feel like you were missing out on sales or maybe the coverage wasn't quite what you were hoping for? Is it cost savings—help us if you could and maybe with a little more color there please.

Benjamin G. Brock – President and Chief Executive Officer
As we've kept our coverage in place and as things have come back, our market intelligence is a little bit better. We do think we've got an opportunity to add sales that maybe we're missing with more service support, closer to people and in their language and in their time zone. We do a pretty good job of supporting that globally and we do have service representatives all over the world, but we do see the opportunity to grow sales through that and not huge R&D increase. Though we can do this within our typical R&D spend, slight adjustments to the equipment we have for the markets that they're in will help us sell more as well. So, it's kind of a two-pronged effort having the regional offices more knowledge on exactly what we need to be selling in, because we've been almost trying to force our product built for the US into some of these markets. Slight adjustments can get us more volume and having more of that intelligence in with customers will help us grow sales.

Cost-wise again, it'll be a little bit more expensive, but not extreme, because we do have people on the ground already, but we see a few key positions in each region to help us with the products and some of the marketing and then, as we grow sales, we add on the service side and more regional sales guys as the need comes up. The other thing it'll help us to do is target better on our dealers, have almost all of our divisions going through the stores, if not all of them. Some are a little unique and may not overlap, but that gives us better sales coverage globally and likely more dealers in more regions.

Q: Perfect guys. Thank you and best of luck.

Operator:
Our next question comes from the line of Jon Fisher from Dougherty and Company. Please proceed with your question.

Q: Very good Q4. Just a question on SG&A trends. The last three quarters, you've been right around that mid-40s number. As you're expecting sales growth, core business, 7% to 12% in 2018. From an SG&A standpoint, is kind of that mid-40s rate about the right rate with R&D probably being a little step-down year-over-year, or should we expect—what kind of increase year-over-year should we expect from an SG&A standpoint?

David Silvious – Chief Financial Officer
Good morning, this is David. I believe you're going to see SG&A grow slightly. We try to target that 15% to 16% range for SGA&E and with R&D down, we're going to see some increases in other selling costs as activity picks up, so I think you can target that 15% to 16% range, but we are trying, as you can see, we're trying to hold SG&A pretty steady, but it does tend to increase with sales.

Q: Okay, thank you, and then the capex increase year-over-year, if you could just highlight what that's being targeted since that's from a math standpoint, a pretty meaningful year-over-year increase?

Benjamin G. Brock – President and Chief Executive Officer
Sure. Hello, Jon. This is Ben. A good piece of that is that is, at our Carlson division, we are growing our capacity there. We considered the options of moving some of the product from there, but these screeds that go behind the paver are really as much an art as a science and we didn't want to leave the expertise that we have from there. And also, we had a pretty nice environment with the government there to be able to add on there relatively easy. I mean, I don't think it's ever easy, but we made the decision to invest in Tacoma. We also, on the other rest of the capex is generally equipment for the shops and what I would say is we do have a return on investment calculations that we require for all of these capex's, so getting multiple prices from each vendor and then, what's the return over time for them on an excel spreadsheet. That's where the main pieces are coming in.

Although we have a full number in there, some of that could change with Jim Joyner coming on board. We may redirect some of it, but the number itself would not change. We also have a history of not spending everything within our budget on capex, but this year, we have a better chance of getting to that number with the addition at Carlson.

Q: Okay, thank you. Then, on RexCon, you know, great acquisition. I was just wondering if you could break out what the contribution was during Q4 and just how strong that business is from an 2018 outlook standpoint with Astec kind of behind the business and being able to open up some opportunities for them that maybe they weren't able to access before?

Benjamin G. Brock – President and Chief Executive Officer
I'll speak a little, Jon, and then David will come in and tell me if I'm wrong, but they did a great job of selling everything they could right before we bought them. So, their typical month, we would see in the range of $8 million to $10 million, or a typical quarter. They were more in the range of $3 million to $4 million, so they struggled through the last part of the year.

World of Concrete was a good show for them. Their sales picked up and so we're really excited about that. One story I would tell you about the opportunity for cross-over and selling is, at the World of Concrete, we probably over-descended on them. I was there. Norm Smith, who's been with us forever, was there and Rick Dorris, our COO was there and all at different times, but it was interesting how many of our existing Astec customers we met at the RexCon booth and even to the point of one contractor out of the Midwest said to Norm, you guys couldn't have bought a better company. There's only two companies we only get one price from—RexCon and Astec. I thought that was interesting that first of all, somebody would admit that, which is great, because we usually have more competitors on every deal than none. So, I think 60% to 70% of our customers in asphalt plants have some type of concrete operation and we're starting to see that come through.

The other thing we've seen is we do have a vendor finance program with DLL or De Lage Landon. I'm probably saying that—

David Silvious – Chief Financial Officer
De Lage Landon.

Benjamin G. Brock – President and Chief Executive Officer
Yes, and we've already seen them grab a couple of concrete plant deals as a result of having that vendor finance option that they might not have gotten in the past. So, we're excited about it and also excited about using their facility, which we think we have capacity in and CEI's facility that we think a little capacity in to design some new products or even pull some of the products that RexCon has. It'll compete with other manufacturers. It'll give us a chance to grow our market share. Our goal is to be number one there and I think we can get there. They're working on the plan to get there, but we definitely have the capacity to get there.

Q: Okay, thank you and just one last question. You cited Europe as a weak spot in Q4 from an international standpoint. I was just wondering if that had anything to do with Deere acquiring Wirtgen Group and any change in behavior there or if there was something completely unrelated to that.

David Silvious – Chief Financial Officer
It primarily was a strong comp in the prior year and it was just a quarter-over-quarter change that we called out and I think Ben had some commentary on European orders.

Benjamin G. Brock – President and Chief Executive Officer
Well, it's just our quote activity is pretty nice and we actually got our first—actually, I think it might be our second asphalt plant sale into Italy of all places, which is a tough place for anybody outside of Italy getting an order in with manufacturers in country, so we're cautiously optimistic. Our Telestack Group is getting good volume out of the UK and a good number of those orders are going into Europe, so I think to David's point, we're okay there.

Q: Okay, and then just one last—just no competitive dynamic, your position on Deere's acquisition on Wirtgen Group hasn't really changed your neutral to positive from a business competition standpoint?

Benjamin G. Brock – President and Chief Executive Officer
That's correct.

Q: Okay, thank you very much.

Operator
Our next question comes from the line of Brian Rafn from Morgan Dempsey. Please proceed with your question.

Q: Let me ask Ben, you always give a really nice kind of strategic overview on the infrastructure site. If we get some of this rhetoric relative to an infrastructure plan from Trump or if we get a longterm infrastructure bank, does that layer order in over the top of the current run rate or do you think it adds to the runway beyond 2019?

Benjamin G. Brock – President and Chief Executive Officer
I personally believe it adds to the runway. I think it'll take people time to figure out exactly whatever that bill means and I think it'll add to the runway although the runway may be—there may be a little bit of overlap and where that could come in is part of that proposal is speeding up the approval process and one of the things that they do is they take the EPA out of the waterway piece and the US corps of engineers takes over. That's a little bit bigger deal than most people think, because the corps will move it quicker, and that could be a pretty good thing to get the bigger projects going. So, the maintenance will go quickly, the mill and inlay work, but again, there could be a little bit of overlap, but it just extends the runway two to three years.

Q: Yes, two to three years, awesome.

Benjamin G. Brock – President and Chief Executive Officer
It depends on the number, too. It's not going to be $1.5 trillion. I mean, the government spend in his proposal was only $200 billion and then there was a lot of crazy ways to encourage states to do things, so where this ends up to what he proposed could be very, very different, but anything would be great.

Q: Yes, let me ask you again, another strategic question. If you have the same administration in there, do you think the next big secure act beyond the FAST Act, you know, we had, I think, a 10-year spread between them to get the FAST Act. I mean, there was something like 36 to 37 extensions. You see this administration maybe getting the next Highway Act into 2020, you know, done a little quicker than the last?

Benjamin G. Brock – President and Chief Executive Officer
I would. If they can maintain control of all three, you know, the House, the Senate, and the White House, you know, if they can maintain control, I do think they will get it done, but boy that's a—I don't know if I have dice that can roll that many numbers.

Q: Yes. I got you. I bet you.

Benjamin G. Brock – President and Chief Executive Officer
I do think they would, if they have control.

Q: Yes, okay. You talked a little bit about RexCon and CEI on the concrete side going from number two to number one. What size magnitude of sales jump would that be to get that number one position?

Benjamin G. Brock – President and Chief Executive Officer
Encouragingly, we think it's only about $5 million to $10 million. That's how close it is.

Q: Okay, alright, and would you be more capacity constrained at CEI versus RexCon or the opposite?

Benjamin G. Brock – President and Chief Executive Officer
Probably, more at CEI at this stage. RexCon does do a little more outsourcing and an opportunity to bring some of that in, but there's room with some organization, maybe some flow work at RexCon to get more volume through.

Q: Okay. You talked a little bit about the parts initiative on the international side. I didn't get the breakout. What is the mix between domestic and international parts?

David Silvious – Chief Financial Officer
We don't break that out. We have not broken that out in the past.

Q: Okay. Let me ask you, Ben, from the standpoint of the parts, given the fact that you're selling a lot more new infield pavers and screeds and some of the equipment, are you on plan or are you satisfied with the level of parts you're seeing because, obviously, when the infield fleets are newer, you're not going to have as much repair, what's kind of your sense in what you saw on part sales in 2017?

Benjamin G. Brock – President and Chief Executive Officer
Brian, I guess, at up 7%, which is double our growth rate on the overall sales, I thought that was pretty good, but that being said, some of our positions still have a good opportunity to put feet on the ground in some of our parts and personally, I think, concrete's one of those areas, so I think we still have opportunity to grow part sales even with what should come with the new equipment that's out there today. So, it's hard not to be happy with 7% up, but I think we can do better.

Q: Okay, alright. With everybody handing out 401K bonuses and stock, there's been a lot of talk, you guys, what is your sense in your SG&A payroll healthcare cost? For 2018, is that a low to mid-single digit growth or is there anything special in there?

David Silvious – Chief Financial Officer
No, there won't be anything special in there. Our compensation plans are tied to performance and so, as performance increases, that'll be a part of the increase in SG&A as that ramps up, but obviously, that's one of the reasons that payroll and benefit-related costs are down this year compared to the prior year as the incentive plans. We don't see anything extraordinary in SG&A, so I would expect as you've said there, some mid-single digit growth in those costs.

Q: Okay, thanks, Dave. From the standpoint if you look across the 20 companies, where might you guys be going into 2018 capacity utilization? Where might you have some bottlenecks? What kind of shifts are you running? Where's overtime and are you running two or three shifts in one area and one in another area? Just kind of overall across the company.

Benjamin G. Brock – President and Chief Executive Officer
Brian, this is Ben. We're not very much different than last quarter on that. About 80% in the infrastructure group, on utilization 70% to 75% aggregate mining and really, the lower run rates there would be in South Africa and Brazil, although they're getting better. Mining is getting better for us.

Then, energy 65% to 70% with GEFCO and like we mentioned CEI there, but GEFCO there with oil and gas is getting busier, had a good fourth quarter, coming along quite well, but still average all together is 70%, 75%. Pressure points would be on asphalt plants and our paving equipment despite the inventory they have. Every now and then, somebody will come in and want something specific. Those would be the two. If we have pressure points there, and then also on our track-mounted crushing and screening equipment, there's pressure there.

Q: Oh, okay, okay. You guys talk a little bit about more opportunistic or maybe a more positive bid-quote activity in order rates and oil and gas. Are there any specific products that are leading that?

Benjamin G. Brock – President and Chief Executive Officer
Yes, the pumper trailers are pushing that and those are the units that clean out the wells every day during the drilling. Those typically retail or sell for anywhere from $1.2 million to $1.8 million.

Q: Okay, alright. Then, I didn't hear the $35 million capex that you guys talked about, where was that going? How was that—

Benjamin G. Brock – President and Chief Executive Officer
The biggest portion of that would be Carlson in Tacoma, Washington. Two things: We've done very well in our screed market share that goes behind, not just Roadtec pavers, but all different brands of pavers; and then their small paver line has really taken off. It's a pleasure to see that and they haven't even really attacked any international with that. This growth of their facility will allow them to release an international-targeted paver to help grow market share, just even outside the US, but it's been very good for them in the last couple of years.

Q: Okay, I'll just ask one more. When you look at the sales cycle between your initial big quote and then actually getting a sales conversion—has that speed at all changed, or is it about the same as it's always been?

Benjamin G. Brock – President and Chief Executive Officer
Quote to order is still pretty close to the same time. The asterisk on that would be somebody picks up a quick job and then they're in a panic. Almost said the wrong thing—I was going to tell you something else, but they get in a panic and then, hopefully at that point, you're hoping you got something in stock. Generally other than that, it's about the same timeframe.

Q: Alright, guys. Good luck in 2018. Thanks.

Operator:
Ladies and gentlemen, we have reached the end of the question and answer session. I would now like to turn the call back over to Steve Anderson for closing remarks.

Stephen C. Anderson – Vice President of Administration and Director of Investor Relations
Thank you, Dana. We appreciate your participation on this fourth quarter conference call and 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 March 6th 2018 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 7 days. All of that information is contained in the news release that was sent out earlier today. Again, this concludes our call. Thank you all. Have a good week.