Transcript of Astec Industries
First Quarter 2017 Earnings Call
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Participants

Ben G. Brock - President and CEO
David C. Silvious - VP, CFO and Treasurer
Rick Dorris - EVP and COO
Stephen C. Anderson - VP, Director of IR

Analysts

Mig Dobre - Robert W. Baird
Stanley Elliott - Stifel
Michael Shlisky - Seaport Global
Jon Fisher - Dougherty & Company
Nicholas Coppola - Thompson Research Group
Brian Rafn - Morgan Dempsey

Presentation

Operator
Greetings, and welcome to the Astec Industries' First Quarter 2017 Earnings Conference 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.

It is now my pleasure to introduce your host, Mr. Steve Anderson, VP and Director of Investor Relations. Please go ahead, sir.

Stephen C. Anderson - VP, Director of IR
Thank you, Latania, and good morning and welcome to the Astec Industries' conference call for the first quarter that ended March 31, 2017. As Latania mentioned, my name is Steve Anderson and I'm Vice President of Administration and Director of Investor Relations for the company. Also on today's call are Benjamin G. Brock, our President and Chief Executive Officer; Richard 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 quarter.

Before we begin, I will 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. Factors that could influence our results today are highlighted in today's financial news release and others are contained in our annual report and our filings with the SEC. As usual, we ask you to familiarize yourself with those factors.

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

David C. Silvious - VP, CFO and Treasurer

Thanks, Steve. We appreciate each of you joining us this morning. Net sales for the quarter were $318.4 million compared to $278.7 million in Q1 of 2016. That's a 14.2% increase or $39.7 million increase in sales. Of that, international sales were $64.9 million compared to $44.5 million in Q1 of 2016, an increase of 45.9% or $20.4 million increase in international sales and represented 20.4% of the current quarter's sales versus 16% of Q1 2016 net sales.

An increase in international sales quarter-over-quarter occurred primarily in Canada, Russia, Australia, Mexico and Africa. Those increases were offset by decreases in South America and in Southeast Asia. For the quarter, international sales increased in each of our groups.

Domestic sales were $253.5 million in Q1 of 2017 compared to $234.2 million in Q1 of 2016, an 8.2% increase or $19.3 million increase. That made domestic sales 79.6% of Q1 2017 sales compared to 84% of Q1 2016 sales. For the quarter, domestic sales also increased in each of our groups.

Part sales were $81 million in Q1 of 2017 compared to $74.1 million in Q1 of 2016. Part sales were 25.4% of quarterly sales in Q1 of 2017 compared to 26.6% in Q1 of 2016. For the quarter, part sales also increased in each of our groups.

We always talk about foreign exchange and its impact on sales, and this quarter it was only slight, it was about $600,000. So if rates this year were equal to last year's rates, our net sales would have actually been $600,000 lower.

Gross profit for the quarter was $75.8 million compared to $72 million in Q1 of 2016, an increase of 5.3% or $3.8 million. The gross profit percentage was down to 23.8% compared to 25.8% in Q1 of 2016.

As we noted in our press release, one of the major detractors in our gross margin was the fact that several new products were moving through our shops during the first quarter and new equipment traditionally carries a lower margin through the early part of its lifecycle due to the refining of the manufacturing process for those products.

The absorption variance for the quarter was $700,000 over-absorbed compared to $1.5 million under-absorbed in Q1 of 2016. That's a positive change in the absorption variance of $2.2 million.

The foreign exchange transaction gains or losses that are recognized in our gross profit were $169,000 loss in Q1 of 2017 compared to $115,000 gain in Q1 of 2016. Our manpower increased by 445 people; about 180 of those are at Power Flame which was acquired on August 1, 2016.

SG&A for Q1 of 2017 was $53.1 million or 16.7% of sales compared to $43.8 million or 15.7% of sales in Q1 of 2016. That's a $9.3 million increase in dollar terms and an increase of 100 basis points as a percent of sales. Recall that in Q1 of 2017 we had the ConExpo show on which we spent $4.3 million. So of the 9.3 increase in SG&A, 4.3 was represented by ConExpo. The remainder is payroll and related expenses. Health insurance expense went up and commissions obviously would be with sales being up.

Power Flame added $1.7 million to SG&A for the quarter because they weren't in the first quarter of 2016. Operating income was $22.7 million compared to $28.2 million in Q1 of 2016, a decrease of $5.5 million or 19.5% decrease.

The effective tax rate for the quarter was 34.1% compared to 37.4% in 2016. The effective rate for the first quarter was favorably impacted by certain discrete tax items related to a couple of our foreign subsidiaries and by the new tax accounting rules related to stock-based compensation that are now in effect.

Net income attributable to controlling interest was $15.1 million in the first quarter of 2017 compared to $17.7 million in the first quarter of 2016, a decrease of $2.6 million or 14.7% decrease. Our diluted earnings per share then was $0.65 compared to $0.77 in the first quarter of 2016, a decrease of $0.12 per share or 15.6% decrease in EPS. EBITDA in the first quarter of this year was $29.4 million compared to $34.3 million in the first quarter of last year, a decrease of $4.9 million or 14.3% decrease.

Our backlog at March 31 of 2017 was $361.8 million compared to $438.7 million at March 31 of 2016. That prior year number is adjusted for Power Flame, and all these prior year numbers are also adjusted for Power Flame as we talk about these. That total backlog decrease was $76.9 million or 17.5% decrease.

International backlog at the end of March of 2017 was $71.3 million compared to $50.8 million at the end of March of 2016, an increase of $20.5 million or 40.4% increase in international backlog. Domestic backlog at the end of March of 2017 was $290.4 million compared to $387.9 million at the end of March of 2016, a decrease of $97.5 million or 25.1% decrease in domestic backlog.

Excluding the pellet plant backlogs out of those numbers, our March 2017 backlog is $293.2 million compared to $258 million at the end of March of 2016, an increase of $35.2 million or 13.6% increase in backlogs, excluding pellet plants.

Our balance sheet remains strong. Our receivables are up to $156.2 million at the end of March compared to $119.4 million at the end of March of 2016. That's a $36.8 million increase. Our days outstanding crept up a little bit to 43.2 compared to 38.7 at the end of March of 2016.

Those things are up and inventory's down by $16.9 million March-over-March because the quarter frankly was back-loaded a little bit. March was a very strong month for us, and that caused receivables to be up, payables to be up and inventory to be down as there wasn't time to replenish. So we had a very strong March in the first quarter of 2017 relative to 2016.

We owe nothing on our $100 million domestic credit facility, and we have at the end of March of 2017 $55.4 million in cash and cash equivalents on the balance sheet. Our letters of credit outstanding are $8.5 million, our borrowing availability then is $91.5 million and we have $6.3 million in debt in Brazil used to finance that company's building, machinery, equipment and inventory.

Our CapEx for the first quarter was $6.1 million, and for 2017 we're looking at around $30 million as a forecast for capital expenditures. Our depreciation for the first quarter was $5.3 million and for the full year 2017 we're predicting $23.4 million in depreciation.

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

Stephen C. Anderson - VP, Director of IR
Thank you, David. Ben will now provide some comments regarding the first quarter of this year's operations. Ben?

Ben G. Brock - President and CEO

Thank you, Steve, and thank you to everyone for joining us on our call today. As we commented in our earnings release this morning, we were pleased with our first quarter 2017 results. Our first quarter sales were $318.4 million versus $278.7 million last year for an increase of 14.2%.

Earnings per share were $0.65 per share versus $0.77 per share in the first quarter of 2016. That's a decrease of 16%. Earnings per share were impacted by lower gross margin in new products as we expected, and our Infrastructure Group gross margins were 22.9% versus 26% on mainly new products going through those facilities and lower margin on the install and construction on the Highland Pellets project.

The Aggregate Mining Group gross margin was 24.9% versus 27.2% mainly a reflection of new products going through those facilities. The Energy Group gross margin was up at 24.5% versus 21.4%. They obviously had less new products going through their facilities and more industrial type projects which carried higher gross margins in the quarter.

Our ConExpo expense came in line at what we thought at $4.3 million which after taxes would have been around $0.12 per share. Our earnings for the quarter, as a reminder, were $0.65 per share. So if we added ConExpo back in, our first quarter 2017 without ConExpo expense would have been $0.77.

Our year-to-date EBITDA was $29.45 million which is 9.25% of sales. Our backlog at March 31st was $361.8 million, down 18% versus last year. Excluding pellet plants and including historical Power Flame backlog levels, our backlog was up 14%.

Our Infrastructure Group backlog was down 32% mainly due to not having a large pellet plant on order. This group continued good order intake on non-pellet plant projects during the quarter, mainly a result of the Federal Highway Bill in United States and improved international shipments.

Excluding pellet plant backlog, our Infrastructure Group backlog is up 5%. Order activity has remained very good since April 1st in this group. Our Aggregate and Mining Group backlog increased 26.4% mainly as a result of the Federal Highway Bill and good execution in securing international sales.

Our Energy Group backlog was up 18.9% as we continue 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 25% year-over-year, and international backlog was up 40%. Our lower backlog in domestic was primarily due to not having a large pellet plant on order. Domestic backlog, excluding pellet plants, was up 7%.

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 are 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 really good for orders. Despite our gains internationally, the strong U.S. dollar remains a significant headwind for our export efforts.

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 now has a small backlog; however, we believe that the economic and political environment remains a challenge to us for at least the rest of this year in Brazil.

We are maintaining our international effort despite the challenge presented to us by the strong U.S. dollar and depressed mining industries in some of our key markets. While we're keeping our long view across the international, we do see the challenging currency and mining conditions many in place for the foreseeable future.

Changing subjects to the Hazlehurst, Georgia pellet plant that we have discussed on several calls, as a reminder, it was a new product that 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 inventory until it's paid in full. The order for all three lines of this plant was for $60 million. We expect the final payment in December of 2018. As a reminder, the interest rate on the note is 6%. With regards to Hazlehurst, 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 $8 million in revenue that we expect to recognize on the Highland Pellets project during the rest of 2017. Margin on the amount left to recognize is slightly below normal major equipment margins, as it is site work, installation, and start-up type work.

We want to congratulate Highland Pellets today on being named the Groundbreaker of the Year at the International Biomass Conference in Minneapolis, Minnesota earlier this month. This award recognizes perseverance through multiple challenges to bringing a project to fruition. We're proud to be a pellet plant supplier to Highland Pellets.

Updating our current pellet plant quote activity, we still believe an order will be coming in 2017; however, the timing remains elusive to us. Given what we know, we believe the next sizable order will come in the second half of this year. We are also working on other projects that are in the $75 million range, each that would not happen until late this year at the earliest.

Based on what we know today and because we are now ahead on the Highland Pellets revenue recognition, we continue to project that our pellet plant revenues will be in the range of $40 million to $50 million in 2017. 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 always could be longer than we anticipate.

Changing subjects to the Energy Group, we mentioned on our last call that we had seen a slight increase in quote activity. We were able to close on some of those quotes and ship them during the first quarter. We also were able to secure other orders that are in Energy Group backlog.

Sales of wood chippers and grinders remained consistent during the quarter. Our concrete plants are built in the Energy Group and while the quoting activity remains good for these plants, our sales of concrete plants are still not where we would like them to be at this point.

We remain optimistic on our outlook in the Energy Group in the long term, and we have seen a recent bump in activity on the oil side due the stability on the price of oil of the short term, so we are slightly optimistic with regards to our products targeted at the oil industry.

Our new product development continues in all groups. Regarding new products, the ConExpo Trade Show which is held every three years was the best of the nine shows that I have ever attended. We spent around 4.2 million on the prior ConExpo, and we spent 4.3 million on this year's show. Attendance at the show was as strong as expected with approximately 126,000 attendees in total.

Show data obtained through our RFID technology confirmed to us at over 90% of the attendees either entered our booth or walked by it during the show. I worked the floor with our sales teams and customer visitors to our booth were in terrific moods with regards to outlook for their business in the coming years. The feedback from our

customers on our new products was encouraging as well. It was an unusual show in that we were successful in selling a record amount of equipment during the show. For competitive purposes we will not be confirming an exact amount sold at the show.

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

With regards to earnings in the second quarter of 2017, as we mentioned on our earnings release this morning, we continue to have a larger than normal level of products in our manufacturing plants which will challenge our bottom line results to more in the range of our second quarter 2016 results. This earnings range is a historically good bottom line for us.

These new products are good for our long-term outlook but they are also likely to affect our margins and our warranty costs during the second quarter, which will likely put our net income behind our 2016 performance at the end of the first half this year but well ahead of our first half of 2015 performance.

Our current outlook for the full year of 2017 is revenues up 5% to 10% versus last year with an improved net income for the year, which indicates that we believe that we will have an improved third and fourth quarter this year versus 2016.

Our outlook for 2017 combined with our 2016 performance also indicates we believe that by the end of 2017, we'll have grown our company sales in the range of 22% to 27% over the two-year period along with increased net income. This would represent strong growth and good performance in our industry segment.

Our Infrastructure Group is performing well, and we are optimistic on our outlook for our Aggregate and Mining Group. Despite the good backlog in Energy Group, we remain cautious on our outlook for the Energy Group with the main headwinds for this group being very real.

From our last earnings release to now, orders have been good in the Infrastructure Group and improving in the Aggregate and Mining group mainly due to the Highway Bill and international sales. Orders remain improved internationally; however, not strong internationally mainly due to the strong U.S. dollar and mining conditions.

Energy Group orders are improved for products targeted at the water and oil industry with slightly increased quoting activity. Orders in the Energy Group are good for products targeted at the infrastructure customers. Aggregate and Mining Group orders remain soft for products targeted at the mining industry.

Bright spots for activity are hot mix asphalt equipment sales, which included hot mix asphalt plants and mobile equipment, concrete plant quoting activity, wood pellet plant quoting activity, wood chippers and grinders, aggregate crushing and screening equipment quoting activity, 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 in international.

Our year-to-date part sales were up 8.5% versus the last year and was 25.4% of total sales. We remain committed to improving our part sales volume in the long term along with working to increase competitive part sales.

As expected and explained earlier in my comments, we had lower gross margins in the first quarter of 2017 versus the first quarter of 2016. Our focus will be to continue to increase gross margins during 2017. The

majority of our customers in the United States are experiencing stable private markets, 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 this group. We believe our Aggregate and Mining Group will continue its trend of order intake, and we believe that our Energy Group will improve on the bottom line in 2017 despite the challenges we face.

Taking all of that together, we have the opportunity to successfully grow and operationally improve our company for the fourth year in a row in 2017. 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 will only do so if the acquisition is strategically aligned with the industries we serve.

In closing, we want to take a minute to recognize our co-workers at Roadtec. I want to congratulate them on being named the Company of the Year by the Tennessee Association of Manufacturers.

That ends my comments on the quarter and what's in front of us. I want to 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.

Stephen C. Anderson - VP, Director of IR
All right. Thank you, Ben. Latania, if you would open the call up for the Q&A, we would be glad to entertain questions.

Operator
Thank you. At this time, we will conduct a question-and-answer session. Our first question comes from Mig Dobre with Robert W. Baird. Please proceed with your question.

Q: Good morning, guys.

Ben G. Brock - President and CEO
Good morning.

David C. Silvious - VP, CFO and Treasurer
Good morning, Mig.

Q: My first question, maybe on SG&A a little bit. I'm trying to understand the moving pieces here. I certainly understand the ConExpo expense. Last year if I remember correctly in 1Q 2016, you had $2 million of expense associated with Bauma. So the net increase year-over-year is about $2 million before ConExpo. There was incremental $1.7 million from Power Flame which I believe still creates a year-over-year headwind in 2Q and potentially somewhat in 3Q. I guess what I'm trying to figure out is the remaining increase in SG&A adjusted for all these items, should we consider that as something that will flow through for the remaining three quarters or was there something specific in 1Q?

David C. Silvious - VP, CFO and Treasurer
Hi, Mig. This is David. No, there were a couple of things that were specific to the first quarter. First, you had the increase in the sales obviously drove an increase in commissions. And as sales grow, commissions will grow. We've added a number of people. We've added 445 people, 180 of which are at Power Flame quarter-over-

quarter. So a portion of those are in SG&A, not all of those are in SG&A. The vast majority are in direct labor in the shops, but a portion of those certainly drive some of the payroll and related.

You had health insurance which was up quarter-over-quarter, and you had in that payroll and related was some FICA taxes and things like that that were up related to profit share distribution; 401(k) was also up related to profit share distribution which happens in the first quarter. So you had a number of things that added up to some substantial numbers in the first quarter. I do believe that as we go forward you're going to have a higher run rate on SG&A, and that's simply because we've added Power Flame and also because we've added people that to the tune of, say, 47 million of run rate as opposed to the mid-40s, the 45 or so that we've had in the past year or so.

Q: Okay, that makes sense. That's helpful. Then I want to go maybe at segment level here and start with Infrastructure. Ben, I appreciate all the commentary in terms of end market demand, but I guess the way I'm kind of looking at it is a little bit like this. If I look at 1Q 2016 and I take out your wood pellet plant order that you had back then, which was to my recollection about $123 million, and I compare your implied bookings in the first quarter of 2017 versus 2016, there's really virtually no growth. It's something like 1% year-over-year growth in Infrastructure bookings. And I'm trying to figure out how to equate that versus ConExpo which happens once every three years and you noted it being very strong and strong demand because it doesn't—I don't really see it in orders and I'm wondering if that's something that you expect to show up in the second and third quarter or if there's another way to look at this.

Ben G. Brock - President and CEO
Thanks, Mig. This is Ben. I think a lot of that you're seeing—the Aggregate Group had a very strong ConExpo, so it has shown up a little bit there and a lot of that went to infrastructure-type customers that was driven by some of the Highway Bill activity we got. And there was some international in that as well. The jaw crusher we had on the show floor was a portable jaw crusher and a fellow from out of the country came in. He wasn't even thinking about it, he fell in love with it and wrote his name on it in Sharpie pen, which was kind of interesting. But I think where we'll see the differences in the third and fourth quarter in just the stability and the confidence our customers have.

You're right. You look at quarter-to-quarter, we got the Highway Bill in December of 2015, and it just opened the floodgates, which was great. But it was a good run, and I just think it's going to be more consistent this year; there's no backlogs and talking to customers. So I think that's where our confidence comes in, in saying we have a chance to still be up this year even if we don't get a really big strong pellet plant on top of what we're seeing.

Q: I can appreciate that. I'm sorry to keep pressing you on this issue, but I think the point is that here in infrastructure if we're thinking about asphalt plants, if we're thinking about mobile paving, what we're trying to figure out is exactly where we are in this investment cycle. And theoretically speaking on ConExpo we should have seen some kind of demand bump here based on everything going on with infrastructure and all the talks surrounding the Highway Bill. So I guess from your perspective where are we in this replacement demand cycle and what do you think will need to happen going forward in order to see real acceleration in order growth excluding wood pellet plants in infrastructure?

Ben G. Brock - President and CEO
So I think looking at the timing of the bill, we'll go through 2020 on the bill. We've got probably three-years-ish, two to three more years on the equipment cycle. And I think if you go back in our history you'll see fairly consistently when we actually have highway bills which we went back and looked at, we see about a 10% number there, and that's a growth number. Now some of those years were higher because we've made acquisitions. But on the core business we've seen those numbers be there. So talking about the timing, I would say two to three years more is the window, current Highway Bill, the asterisk being what will Trump do and does that extend that timeframe?

I think it's too early to call. We're going up to the middle of May and I think we'll have more I guess color on that middle of May. But the current bill for roads and bridges is about $205 billion. If you lay $300 billion or $400 billion or $500 billion on top of that over a longer term, that would be very helpful.

Q: Right. I certainly can understand that. I guess what I'm wondering is do we need to see that in order for infrastructure orders to increase after this initial boost that you got last year from the Highway Bill or can something else happen in the meantime to generate that incremental demand. I'm thinking here about the new California bill that was passed recently that did increase funding.

Ben G. Brock - President and CEO
Right. I think it'll stay consistent, and I think it'll be up a little bit. The California bill is a $52 billion bill. As you know it's driven through $0.12 a gallon gas tax and fees on cars and diesel tax increase. Our customers are related with that. We've definitely seen a pickup in activity in California. Tennessee passed a gas tax last night late, $0.06 a gallon over three years, $0.04 for the first year and then $0.01 a year for the next two. That's really big for Tennessee. They've got 962 targeted projects in all the counties in Tennessee which I think there are 95 counties in Tennessee.

The other thing that's in the Tennessee bill in the background is the provision for municipalities to do their own funding mechanisms. I think they're doing gas tax increase or sales taxes or whatever to be able to increase local spending on infrastructure, so that was encouraging too. I guess really what I'd end up basing it on is just staying in touch with customers and the general knowing what's kind of going on. The money is really flowing a little more now from the federal side. It's just an interesting environment right now where deals we haven't even been working on, it's embarrassing, but we're getting phone calls out of the blue, I need to get a plant pretty quick. Unfortunately, we don't have pretty quick delivery on plants, but we're working on that.

Q: That's great. My last question and I'll be back in the queue is maybe, David, a little bit of color on the Energy Group margins. We've seen a lot of volatility over the last few years, certainly nice improvement here in the first quarter. How should we think about the segment margin or gross margin, however you want to put it, for the rest of the year in here?

David C. Silvious - VP, CFO and Treasurer
Mig, this is David. The Energy Group margin has stabilized as you have clearly pointed out, and I think that it's going to remain relatively stable through the rest of the year. You have a couple of growth performers in there. The wood chipping plants at Peterson and Heatec is performing well. GEFCO has stabilized somewhat. And as Ben had mentioned, we've seen some quoting activity in the water well drilling rigs and in the oil and gas that seems to be at least a little more life in that area. So I think those margins have stabilized, and I think you'll see that through the remainder of the year.

Q: Great. Thanks, guys.

Ben G. Brock - President and CEO
Thank you.

Operator
Our next question comes from Stanley Elliott with Stifel. Please proceed with your question.

Q: Hi, guys. Good morning. Thank you for taking my questions. Ben, could you start off and just clarify what you said about the 10% number? Was that you'd expect 10% growth over that two- to three-year period of time, was that 10% per year? Just kind of help us with that answer for that please.

Ben G. Brock - President and CEO
Sure. When we went back and looked at our revenues after highway bills and for the length of the bills that were there, particularly the big bill ten years ago, this was a while back, we saw about 10% a year revenue growth as a company as a whole during the Highway Bill. Where I might have thrown you off is that there were years where we might have been more than that when we purchased a company and that helped our revenues go higher than that, during maybe in the 16% range, I can't remember exactly. But we historically have seen about 10% during the buying cycle through the Highway Bill.

Q: Perfect. Thank you for clarifying that. Kind of talking about the margin piece, you mentioned some work expenses right in Q2. My guess is we're going to be looking at higher steel prices in the back half of the year. Is it fair to assume or how are you all thinking about margins from here? Can they get back up to kind of the mid-20s sort of level in the back part of the year all else being equal?

Ben G. Brock - President and CEO
I do. Our steel prices, about the same time last year, maybe middle of the year we kept getting the same type comments from our suppliers, 10% to 15% increases and they didn't necessarily materialize. The jury is still out on that for this year. We're okay on steel generally in most of our places through Q3. So all of our presidents are on deck and keeping an eye on cost and making sure we're priced correctly. We feel pretty good about where we are in steel.

I guess on the margin side, I think 24.5% by year-end is where we think we could be. If we get lucky, maybe a little better, but we certainly think we can get back there. I think we're holding our warranty in previous position considering the new products, so I think we may have a chance to be a little better. But we're telling it like we see it unless something changed.

I think if you look at the product mix that we have with the new things going through, I think we're okay on gross margin in the first quarter, but we can do better. So the absorption was favorable. That helped us in the quarter. Steel was not a major issue in the first quarter. But we are seeing a lot of pricing pressure from Europeans, international companies, but we're holding our own. And so we feel okay about how we're doing against that.

Q: So how is pricing in the marketplace? Is it still very competitive or is it that kind of the prospects for business improving has rationalized pricing somewhat or kind of what's happening in the marketplace on that, if you could?

Ben G. Brock - President and CEO
Stanley, I guess if I gave you a gut answer, I'd say it's stabilizing. But in the fourth quarter there was some previous fighting over pricing which I'd say is probably stabilizing this year. And I think I've used the term if you held up your hand with your thumb and your index figure out, you just barely separated them, we have a little pricing power. I think we've got a little bit more than we're giving ourselves credit for, so we're working on that internally too.

Q: Perfect. And last for me, could you kind of highlight where you are from a capacity utilization standpoint? I know you guys have expanded the facility to help with some of the throughput. And I guess the other part of that is if you do get a large wood pellet order from whoever might be out there, can you end up delivering that in 2017? And I will hang up. Thanks.

Ben G. Brock - President and CEO
All right, thanks. Our utilization now is in the 75% range. We were probably 70 to 75 last quarter but we're probably firmly in the 75% range now. Infrastructure is running 80% to 85%; Aggregate and Mining is 70% to 75; Energy is where it's really gotten a little bit better at 65 to 70. They've been running 60 to 65. So 75% is a good

number. If we got a pellet plant—and again the timing on those is—I used the word elusive in the comments. I might add frustrating to that, but we still see if we can get one in the third, we could probably get part of it in the fourth quarter. And so we're working toward that. Our guys are at the Industrial Pellet Conference in London as we speak. Sentiment there is very good. The demand is up for pellets. It was a little cooler winter where they used pellets in some of the portions of Europe, and there's new utility and energy production coming online in 2018. So the longer term outlook is we think pretty good for pellets, but it's kind of a breather here in 2017.

Q: Great, guys. Thank you.

Ben G. Brock - President and CEO
Thanks. But to answer specifically the question, if we got one line, we still think we could get one line out this year. But if it came earlier, maybe more. But for sure, if we could get it in the third, we could probably get it out in the fourth. And one line would be 15 million to 20 million.

Stephen C. Anderson - VP, Director of IR
Thanks. Latania, we can go to the next caller.

Operator
Our next question comes from Mike Shlisky with Seaport Global Securities. Please proceed with your question.

Q: Hi, guys. Good morning. I kind of want to first touch on the Q2 outlook versus the back half outlook. I totally get that as you go through time with some of your new products some of the manufacturing variances will get worked out probably in the next couple of months. But I was curious about the warranty expense. Could your accrual for warranty remain elevated in the back half of the year? I can imagine it's hard to get a good sense of that just by two quarters of new product launches. Can you give any sense as to how long some of the elevated warranty might last here?

David C. Silvious - VP, CFO and Treasurer
Hi, Mike. This is David. The warranty accrual that we are currently accruing is adequate and would cover the back half of the year. So depending on the lifetime of the warranty, typically anywhere from 90 days to a year to in some cases two years we would already have that accrual in place. And so it would not necessarily impact the third and fourth quarters of the year.

Q: Okay, got it. And then turning over to ConExpo, Ben I know you wouldn't actually quantify what you might have gotten as far as orders or contracts from the overall event, but can you give us your thoughts as to maybe the two or three most well-received products at the show? Just kind of curious as to what categories you think are kind of doing better right now as far as new products go.

Ben G. Brock - President and CEO
Sure. But again, it was the best ConExpo I've ever attended. I've been to nine of them. But I'm not going to lie to you, the first one I was so young it was just fun to be there. I was just a kid. But it was a really good show.

We did have a lot of new products in the show. Every group had new products. We mentioned on the last call the Silobot, and I'll tell you the activity around that was very strong. In fact, we were right below the mezzanine level at one point early on and they were two and three deep just standing there on the mezzanine watching it run, which was kind of neat. So great activity coming off of that. We decided that we would offer that as a service rather than a product and use it where we have guys go out and measure the silos and offer the parts on the backend of the visit. So that's pretty exciting.

Our MTV-1000 from Roadtec which is a smaller version of a material transfer vehicle got great attraction. That was the first time showing it at a show for it. Carlson CP130 Paver was a really good reception on that product. That's a smaller commercial type eight-foot paver.

We had a global track unit that was a horizontal shaft impacter. It was a hybrid machine, first time ever shown. That got a lot of great attention. A lot of competitors wanted to come take a look at that. So we were fighting that off during the show. Good feedback on the T500 from Telsmith. That was a Cone Crusher. And of course I mentioned the portable jaw that Telsmith had that the guy signed his name in Sharpie on it during the show. So that got good reviews during the show. We got two people that were fighting over it, but he ended up with it.

And then the Energy Group had some good feedback on the concrete plant, the Fusion, 200 ton per hour plant; got good feedback but still frustrating. We've got customers coming to see it over the next few weeks, but we really think we've got something there. So we just have to do a better job of selling it. And new drum chipper from Peterson got a lot of good reviews talking to customers. That was a smaller drum chipper, a 3310. GEFCO had a new StrataStar 5 drill that would do some angle drilling, got good feedback. We put that in the front of the booth trying to get them more promotion.

So overall that's probably more than you wanted, but I thought it was just a good show and our people really performed well. Because there were a lot of people in the booth, and we tried to get to everybody. People may not remember what we told them, but hopefully they remember we treated them well while they were there. And I'm sure they saw a lot of equipment. It was a great show.

Q: Got it. I also want to ask about Agg and Mining. One of your—or a large company in the industry has also put out some pretty good numbers from their mining group today. They haven't had their conference call yet. But they were saying that their mining was up 15% in the quarter, largely on parts, but also they did some whole goods. I guess kind of your commentary on Agg and Mining was probably still more on the Agg side being better. Agg is doing pretty decently. I was kind of wondering, can you isolate how you're doing on Mining? Is there a chance that the outlook there from last quarter has improved there at least a little bit for you or is it still too early to tell for this year?

Ben G. Brock - President and CEO
I would agree a little bit better. Most of our direct mining business would go through our Osborn group in South Africa, and they have noticed a slight increase in quote activity. We've targeted mining from some of the larger crushers, and we just haven't been as successful as we wanted to be. We have a nice product. We're working on a few ways to move that. So I think we agree a little bit of light but not enough that makes us feel great positive yet. And part of that is maybe showing up a little bit in Brazil too because we do have a small backlog there and maybe need to give a little more credit to mining for that. But it just feels like talking to everybody more of it is going to the traditional rock quarries with the exception of Osborn.

Q: Okay, got it. I'll leave it there. Thanks, guys.

Ben G. Brock - President and CEO
Thank you.

Operator
Our next question comes from Jon Fisher with Dougherty & Company. Please proceed with your question.

Q: Yes. Thank you. Good morning. When you talk about new products, are you differentiating between acquired products when we're talking about kind of dilution at the margin line or are acquired products considered new products also?

Ben G. Brock - President and CEO
More the products that we're developing, like the GT440 Hybrid horizontal shaft impacter that we talked about.

Q: Okay. Are acquired products typically dilutive from a margin standpoint or when you're looking at acquisitions, are you typically acquiring accretive businesses?

Ben G. Brock - President and CEO
Accretive. Power Flame is accretive. They've been great. And Telestack too, that was the one before that. They have been tremendous. Both have been very good.

Q: And then from a capacity utilization standpoint, you talked about being up to 75%. With the trajectory of FAST Act and some of the growth rates that you talked about, where do you think capacity utilization should be or kind of what's your comfort level with running utilization of the fiscal plan?

Ben G. Brock - President and CEO
Obviously, we'd like to every group in the 80s, but we get challenged a little bit. Our Roadtec division is doing very well, had a great first quarter. We're very happy with how they're doing, but we're probably getting stretched there. But we have capacity to help them at GEFCO in Oklahoma, although GEFCO really versus where they've been had a pretty good first quarter. So we're looking at those things to balance it out a little bit for Roadtec. I think if we could get everybody in the 80s, we'd feel pretty good.

Q: Okay. And when you made the comment of potentially exiting this year with gross margins in the 24% to 24.5% range, is that stronger revenue run rate utilizing the utilization rates closer to 80 or in the 80s, or are there other things that would drive that gross margin improvement?

Ben G. Brock - President and CEO
That's getting through some of these new products and getting their margins up, that's having better use of the plants through third and fourth quarter. We see the third and fourth being better this year than last year.

Q: Okay. And then is pricing, are you net-net getting pricing positive or is there just less price discounting going on and pricing is net flat to slightly negative?

Ben G. Brock - President and CEO
It's probably flat with an option for up right now, if that makes any sense.

Q: No, it does. Okay. All right, that's all I had. Thank you very much.

Ben G. Brock - President and CEO
Thank you.

Operator
Our next question comes from Nicholas Coppola with Thompson Research Group. Please proceed with your question.

Q: Hi. Good morning.

Ben G. Brock - President and CEO
Good morning.

Q: So I wanted to follow up on those new products that you mentioned that were a drag on margins. Was that in both the Infrastructure segment and the Aggregate & Mining segments? Any kind of direction there?

Ben G. Brock - President and CEO
Yes, everywhere had some new things going through. We just went on our quarterly review trips the first of this month, went to every North American facility we had, and it's a blessing and a curse. It's great because everybody's excited and they're going through, and then the curse part is these couple percent that hurt us. But long range we'll be fine. But I was trying to think if there's one that didn't have something new going through. And Rick Dorris, I don't know if you—just about every place we went?

Rick Dorris - EVP and COO
Yes, I can't think of one that didn't have anything.

Ben G. Brock - President and CEO
So we kind of saw that coming and that's why we mentioned it when we saw that.

Q: Okay. Well, that's certainly a good thing but helpful to understand the results. And then on raw materials again, I heard that you have steel prices locked through Q3. Beyond that where do you see steel inflation, what's your ability to pass that along? Can you speak to that?

Ben G. Brock - President and CEO
So we're protected through Q2. Q3 in some of our places we start seeing projected increases with what we've been told. Again, do they stick is the question. But in the meantime our guys are working on ways to offset that through pricing and other ways, in the lean manufacturing that we're doing. All I can say is personally we've all been in front of and talked with all of our presidents in the last three weeks about this, and they're on point. So we're going to do everything we can to offset anything that does actually come.

Q: Okay. And the last question for me, just wanted to kind of ask about international sales again. So second quarter in a row nice year-over-year growth. Where in the international business are you seeing strength by geography or product category?

Ben G. Brock - President and CEO
Well, it's been a pleasant surprise. It kind of validates us keeping our sales structure in place through the downtime there. But it's still concerning the dollar is still strong and we've done a nice job of filling pent-up demand. Mining, although, like we talked about, there might be a small light, until it's there, we're not believers quite yet, but it's certainly we're quoting a little more. Just a good job by the team.

I think when you look at the countries that David mentioned, Russia has been good for us. We did sell hot-mix asphalt plant into Russia during the quarter. It's almost like when Trump took office, Russian orders started going, but let's not start a political firestorm over it. Africa has been good for us. Australia has been good. Canada has been good. So those regions have been where they—it's almost like everybody got, well, we've waited long enough and the currency's not moving, we're ready to go, and we've thankfully been in the right place. So I guess if we can keep doing that, that's good, but the currency is still a real deal.

Q: Okay. Thanks for taking my questions.

Ben G. Brock - President and CEO
Thank you.

Operator

Our next question comes from Brian Rafn with Morgan Dempsey. Please proceed with your question.

Q: Good morning, guys.

Ben G. Brock - President and CEO
Good morning.

Q: Ben, you talked a little bit about the FAST Act coming through and I think you said demand was kind of like opening a floodgate. So I'm assuming kind of the pent-up demand from some 35 iterations on the Highway Bill over 10 years is over. A more normalized demand pattern, are you seeing any differences between local and regional highway contractors buying versus maybe more larger, design build national contractors?

Ben G. Brock - President and CEO
Yes, I would say that and I don't have any science on this but 90% private contractors, 10% big contractors, probably big like the second group you mentioned.

Q: Okay. And then any, whether it's bid-quote activity, is there any sense of difference between the mobile equipment paver side versus what you're seeing on the aggregate side, the rock crushers and the screeners and stuff, or they weren't moving in tandem?

Ben G. Brock - President and CEO
Well, we started earlier on the asphalt side, but now the aggregate side is picking up and coming with it. That's been historically how that's gone. And so thankfully it's moving in the same direction now, but I still think we got some room on the aggregate side to keep going.

Q: Okay. With things being fairly robust at Roadtec, are you running two shifts, three shifts? How much overtime when you start pushing that 80-plus capacity?

Ben G. Brock - President and CEO
We actually have three shifts going, but two are more—the first shift's a heavy shift and then the rest we still have room to add people. Rick, the third is very small?

Rick Dorris - EVP and COO
Right.

Ben G. Brock - President and CEO
So we still have opportunities; however, we are considering adding capacity at that facility.

Q: Okay. You said you're up 445 in employee payroll, 185 at Power Flame. Where would the other 260 be spread? Is it more direct labor in the shop? Is it sales? Where are they kind of throughout the organization?

Ben G. Brock - President and CEO
It's mainly manufacturing at Astec and Roadtec. And then we're doing some succession planning because—so we're doing a little bit of that more in the engineering side in a few places right now.

Q: Okay. When you talk about some of the detrimental impact on margins with the new products, is the product lifestyle such that you're offering maybe a little more discounting to brand new products, early adopters and how you kind of see that building out over the lifecycle of a new product?

Ben G. Brock - President and CEO

Brian, there may be a little bit but not a lot. We'd probably take more of a hit on it coming through the shop and a little bit more warranty to be able to sell more later. But once they get the product, it's there to help make them successful and help make them money. So we might give a little bit more discount, but by and large we're pretty fortunate that customers work with us on them.

Q: Would you say the class of new products then, Ben, would structurally be lower margins just by design of what you guys kind of launched?

Ben G. Brock - President and CEO
I think they're in line with how our normal new introductions are, so I would say they're in line. There are just more of them than normal.

Q: Okay. And then when you get some of these new product sales at ConExpo and that, is there a decent backlog of that or is it really just one-off here and there or are you talking about dozen of sales?

Ben G. Brock - President and CEO
Unfortunately, we don't usually have dozens of sales on anything, so a lot of them are first-time orders and then we go try to find other contractors or customers to keep building the numbers that we're building.

Q: Yes. And then a question I've asked in the past, as you've seen certainly the road builders' pent-up demand, more normalized buying, and so they're increasing certainly their paving fleets with newer product, you really haven't seen a major falloff in part sales and so repairs and people trying to nurse older equipment. Do you have any reason for that?

Ben G. Brock - President and CEO
Well, I think we have been purposeful in getting sales reps in the field and really pushing to get our parts volumes up and get competitive parts as well. And our competitive parts have done fairly well in the first quarter. So there is a good—it's not a huge increase but a little bit increase in that. So I would attribute it to just our guys being in place and executing, although as a reminder we were off a little bit too late last year. So we've picked up a little bit. We got some more major component part sales in Q1 that helped us as well.

Q: Yes. And then just one more, Ben. You talked about kind of—how do you kind of see the evolution of the pellet plant business say over the next five to ten years? Is there a point where instead of being kind of the slow grinder that there may be faster adoption or you may end up with multiple orders, or is this just something that there just isn't enough size in the world other than being more of a slow kind of a grinding business?

Ben G. Brock - President and CEO
I think the jury is out on the slow grind part. If you were sitting in London and you listen to our guys talking to us that are at the show there, it's like, man, this is the best. We're about to go crazy. But I think the reality is more consistent demand with utilities and know which countries are going to go with it. Japan is talking really big about going into pellets over coal and of course nuclear is out for them. So a lot of our customers that we're talking to are talking to Japan and talking to different places in Europe. So the jury is out on that. I think we're thinking of it as a one to one and a half plant a year business, hopefully into 2018, for the next three to four years. But it's hard to just—the lumpiness of it, it's still so new. Our confidence level on that is not huge. Our confidence level on another plant and a large plant is pretty good, and we feel good about one late this year or sometime in the second half and then delivering the majority of it in 2018. But it's elusive to us, for sure. It's frustrating.

Q: It's very good, and that's excellent commentary. And then with the hires that you guys have had, what do you kind of see adding headcount through the balance of the year? Are you kind of full up or might there be a fairly robust hiring cycle throughout the end of the year?

Ben G. Brock - President and CEO
We asked our presidents through the quarter review cycle and talking with our group presidents about—remember that when you wake up, look in the mirror and say we are in a cyclical business. So we want to add for the business we have, not for what we maybe think might come. So we are analyzing that now. But if the business comes, we'll add people, but our first place is manufacturing. We don't want to get overloaded in office-type positions.

Q: And then one final. You mentioned, Ben, you talked a little bit about strength in the infrastructure side state-by-state. You mentioned California. You talked a little bit about your home state of Tennessee. Are there any other standouts?

Ben G. Brock - President and CEO
Georgia put a really nice bill in not too long ago, and we're seeing pretty good activity in Georgia. And it's unfortunate what happened with the bridge back on 85 coming out of downtown with the pipe that caught on fire. The contractor that's working on that is C.W. Matthews, and they're couldn't be a luckier state with a better contractor. If you ever have something like that unfortunately happen, they are the ones you'd want doing that.

But I think the ones that are out there are pretty well documented. But it's been over about—it seems like we're up to around 20 states in the last few years that have done something. I'd have to go back and look. It's a lot of them.

Q: Great. Thanks much, guys.

Ben G. Brock - President and CEO
Thank you.

Operator
Thank you. At this time, I would like to turn the call back over to Mr. Steve Anderson for closing comments.

Stephen C. Anderson - VP, Director of IR
Thank you, Latania. Again, we appreciate everyone's participation on this first 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 May 9th and an achieved 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, again, this concludes our call. Thank you all, and have a good week.