Transcript of
Astec Industries Inc
Third Quarter 2018 Earnings Call
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Participants

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Analysts

Stanley Elliott – Stifel
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Presentation

Operator
Greetings, and welcome to Astec Industries' Third Quarter 2018 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 turn the conference over to your host, Mr. Stephen Anderson, Vice President and Director of Investor Relations. Thank you. You may begin.

Steve Anderson – Vice President and Director of Investor Relations
Thank you, Rob. Good morning, and welcome to the Astec Industries conference call for the third quarter that ended September 30, 2018. As Rob said, my name is Steve Anderson. Also on today's call are Ben Brock, our President and Chief Executive Officer; Rick Dorris, Vice President and Chief Operating Officer; and David Silvious, our Chief Financial Officer. In 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 third quarter.

Before we begin, I'll remind you that our discussion this morning may contain forward-looking statements that relate to the future performance of the Company. 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 can influence our results 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 that you familiarize yourself with those factors.

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

David Silvious – Chief Financial Officer
Thanks, Steve. We appreciate each of you joining us this morning. I'm first going to discuss the results for the quarter and year-to-date ended September 30, then I will recap the results without the impact of pellet plant activity toward the end of my comments.

Net sales for the quarter were $256.6 million in Q3 compared to $252.1 million in Q3 of 2017, an increase of 1.8%, or $4.5 million. International sales were $62.4 million this quarter, compared to $55.6 million last quarter Q3 2017, an increase of 12.2%, or $6.8 million. The increase in international sales Q versus Q is primarily in Canada, Australasia, South America and the Middle East. Those increases were offset by decreases in Asia and in the post-Soviet states.

For the quarter, international sales increased in the Aggregate and Mining Group and the Infrastructure Group, and decreased in the Energy Group. International sales were 24.3% of Q3 2018 sales, compared to 22% of Q3 2017 sales.

Domestic sales were $194.2 million in Q3 compared to $196.5 million Q3 last year, a decrease of 1.2% or a $2.3 million decrease. Domestic sales were 75.7% of Q3 sales this year, compared to 78% of Q3 2017 sales. For the quarter, domestic sales decreased in the Infrastructure Group and the Aggregate and Mining Group, and increased in the Energy Group.

Part sales were $69.4 million in Q3, compared to $64.3 million in Q3 last year, an increase of $5.1 million, or 7.9%. Part sales were 27.1% of quarterly sales this year, compared to 25.5% of quarterly sales in Q3 of last year. And for the quarter, part sales increased in each of our groups.

Foreign exchange translation had a negative impact on sales for the quarter of $1.7 million; that is, if rates this year were equal to last year’s rates, sales would have been $1.7 million higher. On a year-to-date basis, sales were $854.6 million compared to $872.4 million for the nine months ended September 30 last year. That’s a decrease of 2%, or $17.8 million.

International sales, year-to-date, were $187 million, compared to $185.5 million at the same time last year. That’s an increase of 0.8%, or $1.5 million. The year-to-date increase in international sales occurred primarily in South America, the Middle East, Canada and Africa, and these increases were offset by decreases in Russia, Asia and the post-Soviet states.

International sales represented 21.9% of year-to-date sales this year, compared to 21.3% of last year’s year-to-date sales. For the year, international sales increased in our Aggregate and Mining and our Energy Group, and decreased in the Infrastructure Group. Domestic sales for the year-to-date period this year were $667.6 million, compared to $686.9 million for the year-to-date last year, a decrease of $19.3 million, or 2.8%.

Year-to-date domestic sales this year were 78.1% of total sales, compared to 78.7% last year at this same time. Part sales year-to-date this year were $236.2 million, compared to $214.1 million for the first nine months last year. That’s a 10.3% increase, or $22.1 million increase in part sales. Part sales represented 27.6% of year-to-date sales this year, compared to 24.5% of year-to-date sales last year.

Foreign exchange translation had a positive impact on sales for the year-to-date period of $1.6 million; that is, if rates this year were equal to last year’s rate sales would have been $1.6 million lower.

Gross profit for the quarter was $58.3 million, compared to $39.1 million in Q3 of 2017, an increase of $19.2 million, or 49.1%. The gross profit percentage this year was 22.7% for the quarter, compared to 15.5% for Q3 of 2017. The absorption variance in the quarter was a $4.1 million under absorbed variance, compared to Q3 2017’s variance of $200,000 under absorbed, so a negative change in the absorption variance of $3.9 million.

For the year-to-date period, gross profit was $137.4 million, compared to $180.4 million for the first nine months last year, a decrease of $43 million, or 23.8%. Gross profit percentage this year year-to-date was 16.1%, compared to 20.7% for the year-to-date period last year. And on a year-to-date basis, the absorption variance

this year is $7.8 million under absorbed, compared to $2.5 million of over absorbed overhead in the first nine months of 2017, a $10.3 million change.

SGA&E for the quarter was $51.1 million, or 19.9% of sales, compared to $45.5 million, or 18% of sales for the third quarter of 2017, an increase of $5.6 million in dollar terms and an increase of 190 basis points as a percentage of sales.

SG&A was impacted by additional payroll and employee benefit-related expenses quarter-over-quarter. Professional fees and consulting fees were up, as well as recall that we added RexCon at the 1st of October last year, so they were included in one quarter last year; that would be the fourth quarter. And they are in the third quarter of this year, so they added about $1 million.

For the year, SGA&E is $154.4 million, or 18.1% of sales, compared to $142.8 million, or 16.4% of sales for the first nine months last year. That's an increase of $11.6 million, or an increase of 170 basis points as a percentage of sales. Recall that we had ConExpo last year early in 2017. It was about $4.4 million. And the SG&A this year is impacted by payroll and related expenses, consulting fees and professional fees are up, RexCon is in the three quarters this year for the year-to-date period and accounting fees are up as well.

Income from operations was $7.2 million in Q3 of 2018, versus a loss of $6.4 million in Q3 of 2017, an increase of $13.6 million. On a year-to-date basis, operating loss this year was $17 million, compared to operating income last year of $37.5 million. That's a decrease year-over-year of $54.5 million.

The effective tax rate for the quarter is 2.5% versus 50.7% in Q3 of last year, and it's 14.4% for the year-to-date period versus 31.1% in the year-to-date 2017. The decrease in the tax rate quarter versus quarter is a mixture of the reduction in the corporate federal income tax rate combined with the pellet plant settlement costs that were incurred in Q2 and their impact on the full year rate. The rate was also impacted by tax planning work that was done in the quarter related to research and development credits.

The year-to-date rate is near where we expected the rate to be, which was in the mid- to lower-teens, and we expect the consolidated tax rate for the full year of 2018 to be in the low- to mid-single digits. And that's a downward adjustment from our previously announced expected effective tax rate for the full year of 2018 due to this tax planning work that had an impact on Q3.

Net income was $7 million in Q3 of 2018 versus a net loss of $2.7 million in Q3 of 2017, an increase of $9.7 million. Income per diluted share for the third quarter was $0.30, compared to a loss per share of $0.12 in Q3 of 2017, an increase of $0.42 per share. On a year-to-date basis, the net loss was $13.4 million this year, compared to $26.9 million of net income last year, a decrease of $40.3 million. And on a year-to-date basis, the loss per share is $0.58, compared to earnings per diluted share of $1.16 for the year-to-date 2017, a decrease of $1.74 per share.

Our EBITDA for the quarter was $13.9 million, or 5.4% of sales, compared to the third quarter of 2017 EBITDA of $400,000 or 0.2% of sales, an increase of $13.5 million. Year-to-date EBITDA was $4.7 million, or 0.6% of sales, compared to last year's year-to-date EBITDA of $57.7 million, or 6.6% of sales. That's a $53 million decrease.

Now I'll note that the following comments are recast for the third quarter of 2017 and the year-to-date periods ended September 30, 2018 and 2017, removing the impact of pellet plant activity for those periods. The third quarter of 2018 was not materially impacted by pellet plant activity, and so it is not recast. Excluding the impact of pellet plant activity during the third quarter of 2017, revenues were $256.6 million in 2018 compared to $265.5 million in 2017, a decrease of $8.9 million, or 3.3%.

Domestic sales decreased 7.5% to $194.2 million in Q3 of this year, compared to $209.9 million for Q3 of 2017. This would also make the infrastructure sales for Q3 of 2018 $87.1 million, compared to $112.1 million for Q3 of 2017, a decrease of $25 million or 22.3% ex-pellets.

During the first nine months of 2018 and 2017, revenues were $929.4 million in 2018, compared to $870 million in 2017, an increase of $59.4 million, or 6.8%. Domestic sales increased 8.5% for the year-to-date basis to $742.4 million this year, compared to $684.5 million for the first nine months of 2017. And therefore, the infrastructure sales for the first nine months of 2018 is $392.1 million, compared to $409.4 million for the first nine months of 2017, a decrease of $17.3 million, or 4.2%.

Again, excluding pellet activity, the consolidated gross margin for the quarter is 22.7%, compared to 23.3% for the quarter last year. The gross margin for the Infrastructure Group, excluding pellets, is 21.4% this year, compared to 21.9% for 2017. And excluding pellets, the consolidated gross margin for the first nine months of this year is 23.9%, compared to the same number, 23.9%, for the first nine months of 2017.

The gross margin for the Infrastructure Group for the year is 22.6% this year, compared to 23.1% for the same period in 2017. The operating income this year was $7.2 million for the quarter, compared to $16.3 million for Q3 of 2017, a $9.1 million, or 55.7% decrease. And year-to-date, operating income was $67.3 million this year, compared to $64.6 million for the year-to-date period last year, an increase of $2.7 million, or 4.2%.

Net income was $7 million this quarter compared and $0.30 per diluted share, compared to net income of $12.1 million, or $0.52 per diluted share in Q3 of 2017, a decrease of $5.1 million, or 42% in net income and $0.22 per share. Excluding pellets again on a year-to-date basis, net income for the first nine months of 2018 is $53.9 million, or $2.33 per diluted share, compared to net income of $44.5 million, or $1.93 per diluted share for the first nine months of 2017, an increase of $9.4 million, or $0.40 per diluted share.

Q3 2018 EBITDA was $13.9 million, or 5.4% of sales, compared to $23.1 million for Q3 of 2017, or 8.7% of sales for that period, a decrease of $9.2 million, or 39.8% decrease. And on a year-to-date basis, EBITDA in 2018 was $89 million, or 9.6% of sales, compared to $84.8 million for the nine months ended this September 30, 2017, or 9.7% of sales for that period. That's an increase of $4.2 million, or 5% increase in EBITDA.

The backlog was $308.6 million at 9/30 of this year, compared to $386.5 million at 9/30 of last year. Recall that we always adjust the prior years for any acquisitions that occur, so the prior year is adjusted for RexCon. That change is a $77.9 million, or 20.2% decrease in the backlog. The international backlog at September 30 was $85.4 million, compared to $76 million at 9/30 of last year. That's an increase of $9.4 million, or 12.4% increase in the international backlog.

The domestic backlog this year is $223.2 million, compared to $310.4 million at 9/30 of last year, a decrease of $87.2 million, or 28.1%. The 9/30/2017 backlog was $310.9 million, excluding pellet plants, making the September 30, 2018 backlog a decrease of only $2.3 million, or 0.7%. Again, excluding pellet plant backlogs, the domestic backlog last year was $234.8 million, making this year's backlog a decrease of $11.6 million, or 4.9% decrease to the domestic backlog ex-pellets.

Infrastructure backlog ex-pellets in 2017 was $173.3 million, and that makes the September 2018 Infrastructure backlog a decrease of $43 million, or 24.8%. Foreign currency translation had an impact on the September 30, 2018 backlog. That is, if rates this year were the same last year, backlog would have been $4 million higher.

On to the balance sheet. Our receivables are at $127.5 million, compared to $109.7 million last year at this time, a $17.8 million increase. Our days outstanding are at 44.2, compared to 38.9 last year at the same time. Our inventory is at $429.2 million, compared to $399.3 million last year at September 30, an increase of $29.9 million.

Our turns are at 2.4 this year, versus 2.5 last year at this same time. We have $25.6 million owed on our $100 million domestic credit facility that we have at 9/30, and at 9/30 we also have $25.7 million in cash and cash equivalents on the balance sheet. We have letters of credit outstanding of $9.5 million. That yields a borrowing availability on our line of credit at $64.9 million. We do have $1.7 million of debt currently in Brazil used to finance that company's billing, fixtures and inventory.

Our capital expenditures for the quarter were $8.7 million, and on a year-to-date basis capex was $17.8 million. And we believe we'll hit about $23 million in capex for the full year of 2018. Depreciation was $5.4 million for the quarter, and $16.5 million for the first nine months of 2018. And we believe, again, that'll be about $23 million forecasted for the full year of 2018 for depreciation.

So that concludes my prepared remarks on the financials. I'll turn it back over to Steve.

Steve Anderson – Vice President and Director of Investor Relations
Thank you, David. At this time, Ben Brock is going to provide some comments regarding the third quarter of this year's operations and some thoughts for the fourth quarter and 2019 as well. Ben?

Ben Brock – President and Chief Executive Officer
Thank you, Steve, and thank you to everyone joining us on our call today. As we commented in our release this morning, we were pleased to report our best third quarter earnings per share number-wise since 2012. And as David noted, our earnings per share were $0.30 per share versus a loss of $0.12 per share last year. While our best EPS since 2012, the EPS was below our expectations, due to factors I'll cover during my comments this morning. Our third quarter EBITDA was $13.9 million, and our year-to-date EBITDA was $4.7 million. As David mentioned, the year-to-date ex-pellets EBITDA was $89.05 million, or about 9.6% of sales.

Gross margin for the quarter was 22.7%, which was impacted mainly by volume and absorption. While we remain focused on our goal of delivering 25% gross margin in the fourth quarter this year, we will be challenged to do so, given some of our product mix and competitive pressures from competitors not facing the same costs associated with higher steel prices. We remain focused on increasing our inventory turns to 4+ by 2020, and I'll discuss our action with regards to this goal later in my comments.

Our ex-pellets backlog at September 30, 2018 was down $2.3 million, or 0.7% versus last year. Our backlog remains historically very good. Our Infrastructure Group backlog was down 47.7%. The group's ex-pellet plant backlog was down 24.8%, or $43 million year-over-year. The group maintained strong quoting activity but lower intake during the quarter, as our customers experienced high work levels and focused on their work. We are pleased to report significant increased order activity in this group. Since October 1, this group has added over $44 million in backlog.

Our Aggregate and Mining Group backlog was up 39.1%, as the group experienced strong order intake, mainly due to good economic activity in the United States. Our Energy Group backlog was up 18.4%, as the group experienced good order intake for products serving customers in the industries of construction, industrial, oil and gas. We also experienced level quoting activity for our oil and gas drilling products during the quarter.

Our domestic backlog was down, and our international backlog was up year-over-year. The main reason for the decrease in domestic backlog was in our Infrastructure Group, as explained earlier. Our domestic quote activity remains very good, primarily due to the current long-term Federal Highway BIll, steady state and local government infrastructure spending and continuing good private sector work levels for the majority of our customers.

Our international backlog increase was due to increased activity, primarily in Latin America and Africa. Our Astec do Brasil subsidiary continued to experience good quoting activity.
Changing subjects to the Energy Group, we experienced good sales activity during the third quarter for products targeted at infrastructure, oil, chemical and food industries, which contributed to increased backlog in the group. Sales of wood chippers and grinders remained consistent for us during the quarter. Our concrete plants are built in the Energy Group. Sales and quoting activity are good for these plants. We're optimistic on our outlook in the Energy Group.

As a reminder, our new product development continues in all groups, however, at a more typical rate versus the high rates of R&D in 2016 and 2017. From our last earnings release to this earnings release, orders were down in the Infrastructure Group, as our customers focused on construction projects, improving in the Aggregate and Mining Group and improving in the Energy Group.

Due to order activity in the Infrastructure Group since October 1, we remain optimistic on Infrastructure. Bright spots for activity are hot mix asphalt equipment quote activity; concrete plant sales; industrial heating system sales, wood chippers and grinders; aggregate crushing and screening equipment, quoting activity; and international quote activity. Year-to-date, part sales were up 10.3% versus last year. Parts do remain a key piece of our business, and we are focused on continuing to improve our part sales.

As we mentioned on our last call, we are working collaboratively with our pellet plant customer in Georgia on the potential sale of the plant. As a reminder, it's our first pellet plant delivered, and the plant has been running for private side pellet customer orders. Our agreements and a $60 million loan, which is due in December, remain in place.

Non-disclosure agreements are in place with multiple prospects for this plant. Based on our discussions with prospective buyers, we believe the plant could be sold this year. We remain confident in the wood pellet industry's potential over the long-term and would sell proven equipment to customers as traditional equipment suppliers only.

Changing subjects to the strategic updates we announced last quarter. As a reminder, we engaged Maine Pointe, a globally recognized consulting firm, to undertake a strategic sourcing review, along with our team, to evaluate opportunities for gains in our procurement operations. Maine Pointe has particular expertise in the industrial equipment supplier industry, and they worked closely with our team to conduct the review. This review started July 9, and we're happy to provide an update on our progress as promised.

The review itself ended the week of August 20, and the results showed we have opportunities for operational and financial gains with regards to our procurement and inventory management. As a result, we moved ahead on an agreement with Maine Pointe to start the implementation of a new strategic sourcing initiative we are calling Astec Strategic Procurement, along with a second initiative related to improved inventory management.

The two projects with Maine Pointe will last approximately through July of 2019. As a result of these engagements, our SG&A will be higher during the period. The fee with Maine Pointe is confidential between the companies, however, the expected return of savings to the fee is in the range of 6 to 1.

Given the anticipated procurement savings and one-time cash release through improved inventory management in 2019, we expect positive gross margin impact of approximately 2% on our gross margin and a one-time cash release of approximately $25 million through better inventory management practices.

Changing subjects to our capital allocation strategy, as we are working to optimize our cost structure we are also working with our board in evaluating the Company's capital allocation strategy to ensure capital is directed to the

areas that will drive the greatest value for shareholders. As we mentioned in our last earnings release, we increased our dividend 10%, indicating we feel the future outlook for our business is positive. We also announced a new share repurchase plan of up to $150 million worth of our shares, reflecting our view that our shares are undervalued against our outlook. As David mentioned during his comments—I'm not sure he did mention this. I'm sorry, he was going to. But we did buy back approximately 297,000 shares for approximately $14 million during the quarter.

The other two areas for capital allocation for us are acquisitions and capital expenditures. We are only spending time on potential strategic acquisitions of companies in the industries we serve today. Otherwise, we are focused on improving internally, which includes strategic investment back into the business through capital expenditures that meet an acceptable return on investment, along with investing in consulting services through SG&A, like Maine Pointe, to improve our internal operations.

Looking ahead to the fourth quarter of 2018, we believe our revenue in the quarter will be in line with our fourth quarter 2017 revenue as reported. With regards to earnings in the fourth quarter, we expect earnings per share to be slightly above our fourth quarter 2017 earnings per shares reported. Given our third quarter result, our current outlook for the full year of 2018 is core revenues up 1% to 3% versus last year, with an improved ex-pellets net income for the year versus 2017.

As a first look toward 2019, we are optimistic on the first half of 2019, given our recent order activity backlog and discussions with our customers. We are cautiously optimistic on the second half of 2019, as more than half the states in the USA have mechanisms in place for stable infrastructure spending and the economic environment for our customers is strong and our international office plan has started with Latin America.

Our focus is on producing even higher-quality products than we already do for our customers while focusing on operational excellence. Specifically, we are focused on executing our Astec Strategic Procurement and inventory management initiatives, combined with our quality and lean initiative led by our VP of Global Operational Excellence, to help drive better financial results as we move into 2019 and beyond.

Targets our teams are focused on for 2019 are earning gross margin gains of approximately 2% through the Astec Strategic Procurement initiative, gaining a one-time cash release of approximately $25 million due to improved inventory management and inventory turns of 4+ by 2020.

In summary, our reported Q3 earnings per share of $0.30 per share was our best reported Q3 earnings per share number since 2012. Our ex-pellet backlog and our Infrastructure Group has recovered to essentially flat this year since October 1. Both are historically high backlogs for the group. We are focused on operational improvement and increasing shareholder value through the initiatives mentioned, working toward the financial goals mentioned today. We believe in our future, and have acted as such through our increased dividend and share repurchase program.

That ends my comments on the quarter and what's in front of us. Thank you again for taking the time to be on our call and for your support as we move ahead. I'll now turn it back over to Steve Anderson.

Steve Anderson – Vice President and Director of Investor Relations
Thank you, Ben. Rob, please open the lines up for questions. We'll be glad to answer any of those we can.

Operator
Thank you. At this time we will be conducting a question and answer session. Our first question comes from the line of Stanley Elliott with Stifel. Please proceed with your question.

Q: Hey, guys, good morning. Thank you for taking the question. Could you help us kind of understand what happened to the business and trends at the end of July really to where we are right now? It did seem like there's barely market deceleration from that time.

Ben Brock – President and Chief Executive Officer
Stanley, this is Ben. I guess, if you're talking about the order activity, or –

Q: Yes, I mean, because we were kind of looking at 7% to 12% sort of an organic number, right? And I believe it was going to be at the lower end, and now we're looking at, I think, you said 1% to 3%. I'm just trying to get a better feel for maybe what was happening with conversations or tone of business or anything along those lines just to help us directionally.

Ben Brock – President and Chief Executive Officer
Right. Okay, thanks. It really goes back to what we said on the call. Last quarter, our customers were just head down working, and it actually opened up a little later than I even thought when we talked on that after that earnings release. And like we said, the $44 million-plus since October 1 is a very strong opening, and that was just a delay that was longer than we anticipated. Now the good news is that it's opened back up. But that delay and the slowness in infrastructure is what got us held back to saying that we feel like it's a 1% to 3% number.

Q: And the comments around the Hazlehurst plant, I mean, at one point, I think we were waiting for them to get a contract, and then there was talk about selling the plant. Could you remind us where we are with all this in terms of closing that out this year?

Ben Brock – President and Chief Executive Officer
Yes, where we are right now is we're investigating the sale of the plant. We have multiple prospects that have signed non-disclosure agreements. We know that the prospects are financially viable. We know with our data room that they're very active. We've met with them. So we feel like there's a pretty good chance the plant could sell this year.

Q: Perfect. And then last for me. Can you talk about some of the puts and takes with the two percentage points of gross margin into next year, especially looking at a higher input cost environment?

Ben Brock – President and Chief Executive Officer
Sure. We have been very decentralized in our history. We're really a collection of many entrepreneurial companies that we purchased from the original founders, with the exception of about three or four of our companies. Actually, we started three and then we joint ventured on Brazil.

Bringing our procurement into a center-led approach where we're truly leveraging our total spend, not just our top 75 items where we have buying agreements, it's a whole different world for us. The ability that Maine Pointe has brought to the table is an overlay software that looks into our system, and we have a full year spend, every single thing in every division, every invoice. And so we're not centralizing the operation, we're center-led. So we have cross-functional teams that are cross-divisional, and people that know what they're looking at, know what they're buying and leveraging that spend in a purposeful way. The opportunity is there for that number.

What I would tell you is when we put a number out there, we want to be sure that we feel like we can hit it. The opportunity potentially could be better, but we feel comfortable with the 2% number. And so it's really the true leveraging of our combined spend across divisions that we have not done in the past.

The one thing I would say is we've done a fairly nice job on our steel. There is opportunity there through the Maine Pointe system. They do this many, many times in the industrial space, and they say we've done a pretty nice job on our steel pricing.

Q: Perfect. And then the uptick on the inventories, was that just higher material costs, or was there anything else within that on a sequential basis?

Ben Brock – President and Chief Executive Officer
Really, the biggest piece of that for us is at Roadtec with the delay. They do have some inventory there. They also, as we've mentioned on previous calls, have built some inventory coming into the year. Because they went live on the new ERP system in January, they had put a little more inventory in place as a just-in-case thing to do, which was the right thing. Unfortunately, what we built was the wrong thing in some cases, but it's sellable inventory.

Q: Perfect, guys. Thanks and best of luck.

Ben Brock – President and Chief Executive Officer
Thank you.

Operator
Our next question is from Mig Dobre with Robert W. Baird. Please proceed with your question.

Q: Good morning, guys. I want to make sure that I understand what the messaging is here on Infrastructure vis-à-vis orders. You said that backlog is up $40 million since October.

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

Q: The part that I'm struggling with whenever we're talking about backlog is that, I mean, the backlog is a function of the revenue that you're recognizing and the orders that you're getting in the quarter. So what I'm curious is, how are the orders themselves trending, or when you're talking about backlog, are you trying to communicate that orders are up $40 million year-over-year in the fourth quarter in Infrastructure? Is that what you're trying to say?

Ben Brock – President and Chief Executive Officer
So, Mig, hi, this is Ben. What we're saying is that we picked up over $44 million worth of orders in the Infrastructure Group since October 1, and that brings the backlog to essentially flat versus last year for the Infrastructure Group.

Q: Excluding with pellet plants?

Ben Brock – President and Chief Executive Officer
Correct.

Q: Okay, okay. I'm sorry that I'm still struggling with this, because theoretically speaking, if I'm looking at your orders in 3Q, you were essentially running right under $40 million, $37 million per month on average. So sequentially we're talking about an acceleration. When you're looking on a year-over-year basis versus what you experienced in 4Q 2017, are you actually seeing the business pick up in Infrastructure?

Ben Brock – President and Chief Executive Officer
Mig, I would probably shy away from saying it's a big pickup. It's very active. But I would say we had a historically higher backlog in Infrastructure last year. I would say that it's as good. I don't know that I would say significantly higher. The activity is very good.

Q: Okay. And then I was, frankly, a little bit confused on the tax rate guidance as well. Are you implying a tax benefit or a negative tax rate in the fourth quarter? Do I understand that correctly?

David Silvious – Chief Financial Officer
That's a good possibility, Mig. With the taxes being a small number relative to a number that could happen in the fourth quarter, whatever the number winds up being for net income or taxable income, that rate could flip. It could become a benefit, a small benefit, but it could be a benefit. It could be a very low tax, depending on income.

Q: I see.

David Silvious – Chief Financial Officer
We're calling for low single digits.

Q: Okay, I see. Because looking at your comments, right, you're saying that the fourth quarter revenue is going to be roughly flat year-over-year but EPS is going to be up only slightly, but taxes are going to be a big tailwind versus 4Q 2017. It would sort of imply to me that your expected gross margin in the fourth quarter is going to be considerably below that 25% target that you have.

And if that's the case, I guess I'm wondering, how should we be thinking about the front half of 2019? I do understand that you're expecting 200 basis points of benefit, but the way that benefit accrues is probably not going to be even through the year, and the starting point seems to be quite a bit below what we were thinking initially on margin.

Ben Brock – President and Chief Executive Officer
Mig, this is Ben. And I'll ask David to chime in if he's got anything I forgot. In the third quarter, our gross margin was 22.7%, which is obviously not where we want it to be. Absorption hurt us, we could have done a better job on that. The goal exiting the year was 25%. We believe 24% to 25% is still achievable. Inflation is real, for us it's starting to show up in the components, but the strategic sourcing is great timing as we leverage our spend. But we've raised prices and we've got the things that you mentioned coming in next year, and we feel good about getting those savings. But to your point, I do think taxes should help us on top of that.

Q: Okay.

David Silvious – Chief Financial Officer
SG&A is going to be up as well. As Ben mentioned, we've got a little higher run rate right now with professional and consulting fees as we go through this project.

Q: Okay, okay, I understand. Then I want to talk a little bit about inventories. As you pointed out on your remarks, your inventories ticked up sequentially, they ticked up year-over-year, and obviously, the business itself softened a bit here. So I'm wondering why we continue to see this continued inventory build. How are you looking at your cash generation at this point, when you're recognizing that you've cut back on your capex guidance, yet at the same time you're accelerating, or you picked up your share repurchase program. So how do we think about these moving pieces, working capital and cash generation?

Ben Brock – President and Chief Executive Officer
Well, on the inventory side we did, during the quarter, slow down a little bit. It was later, in about the middle of the quarter, particularly at Roadtec. We feel like we're in good position for orders that we think are probably going to accelerate in November and December for them as customers get through the work and realize. Most of our private customers are on a September 30 financial year. We think they'll see an uptick. But we have slowed down there, and of course at Astec Inc., there have been orders and we slowed down there as well. But both places are starting to see the order releases we mentioned in the Infrastructure.

We will generate some cash, and still our cash is at about $25 million today, even with the spend and on the share repurchase and on the settlement with the Arkansas pellet plant. And so capital allocation is going to be important. Of course, we increased our dividend as well this year. We still have the stock buyback in place up to $150 million. But as David mentioned, we're going to have a little higher SG&A as we invest in the efforts with the consulting firm and some of our quality lean effort. But the quality lean will probably mostly be in capex. So next year, potentially capex in the $30 million to $35 million range.

We have not done our budget or had it approved by the board, so that's subject to change of course. That's just kind of an early look at it. But we're analyzing all of those options consistently now, as we always do, with our board. But we will have to consider that because we feel like we will generate quite a bit of cash next year.

Q: I see. Last question for me on Hazlehurst. You gave us a few comments on this. You do expect this plant to sell. I guess what I'm curious is, assuming that the sale does not happen in the fourth quarter, what should investors be expecting at that point in time?

Ben Brock – President and Chief Executive Officer
Well, if the plant doesn't sell, in the background, that's what we're working on different scenarios that what if it doesn't sell and what does that mean, and I think that would be too early to call. As people have asked in the background, what do you think, what's the absolute worst case scenario? As we said years ago in our deal was that potentially we're in the pellet plant business, which we don't want to be in. It's not our business. But where the plant is today and how it's operating we feel like it will be a profitable venture. So if it didn't sell today, it would sell down the road. But if it's making money, it will be a business that would be less than 5% of our sales and we'd probably be okay, but it's not our first choice.

Q: Okay. Thank you for taking my questions.

Ben Brock – President and Chief Executive Officer
Okay. Thank you.

Operator
Our next question comes from Larry De Maria with William Blair. Please proceed with your question.

Q: Thanks. Good morning. A couple of things. First, I'm just a little bit of confused, but what's the update on the loan repayment? Color on that, please,

Ben Brock – President and Chief Executive Officer
Larry, it's Ben. Coming back to the previous question, it's due in December, and if it doesn't sell, the question is, what's the worst case scenario? And it goes back to not our first choice but we could be in the pellet business. And if we are, we are. We feel like it could make money. It would be less than, again, less than 5% of our business, probably more like 4% range. It would be an additional company that we might sell later, but if it's making money, we would hold on to. But we have the people that could run it if we wanted to do that or it ended up that way. That's not our first choice.

Q: Okay, I understand. I was confused about that. So the buyback stock with the potential of being in the business and not getting repaid the loan, I guess, is that the right decision at this point? Or do you think you generate enough cash so it doesn't matter?

Ben Brock – President and Chief Executive Officer
We believe we're going to generate enough cash. We really do.

Q: Okay. Secondly, you mentioned the consulting fees, and obviously you get pay back on the material costs, etc., the sourcing. Can you just give us a handle on what's the run rate and timing for those fees so we should put it in our models?

Ben Brock – President and Chief Executive Officer
Through the middle of next year, we – unfortunately, the fee is confidential in our agreement. But return-wise, it's going to be in the range of 6 to 1 savings versus fee.

Q: Six to one savings? And you guys have said – okay, got it. 200 basis points was the savings, correct?

Ben Brock – President and Chief Executive Officer
Yes. And again, like I said earlier, when we put a number out, we want to make sure we're going to hit it. There would be some upside, but that's what we feel comfortable saying we're going to do right now.

Q: Okay. And then with all due respect, Ben, obviously, it's been a challenging time the last few years, and the up cycle that we've seen hasn't really panned out in terms of shareholder value. I'm curious, where does the board head at now? What kind of changes are they thinking about having, or are they actively engaged? I'm just curious about some of the bigger picture, given the really uneven performance the last couple of years, how the board is thinking about the business, management, etc.?

Ben Brock – President and Chief Executive Officer
Well, really the focus is on now that we feel like we're near the—I wouldn't say the end of the pellet business but we are probably near the end of the pellet business as we knew it today. And that's why in our press release we provided not only a table of where we are quarter and year-to-date ex-pellets, but we also provided historical perspective on no pellets at all in our business in the last table with our earnings release today because you hate to say that we're kind of getting back to the old Astec pre-2012, pre-pellets, but just bigger, because we've grown in our core.

And so we feel like now it's execute on the core, internally focused operational excellence and do our best and move into the top quartile performance against our peers. And that's the direction that we've had and that's what we're focused on. And I think the things that we've mentioned on the call and announced last earnings with the initiatives, that reflects our board's desire for us to perform better, and then of course focus on good capital allocation as we move ahead.

Q: Okay. So the board, more or less, wants you to continue the things you talked about. And I believe there's some activists involved as well. Are there any kind of big changes we should think about or that are being agitated for?

Ben Brock – President and Chief Executive Officer
We listen to all investors and we take everything into consideration. I think the things that we're working on now will bring very good results for us, and I think we will be very pleased with where we are by the middle of next year.

Q: Okay. Thank you.

Operator
Our next question comes from Brian Sponheimer with Gabelli & Company. Please proceed with your question.

Q: Hi, good morning.

Ben Brock – President and Chief Executive Officer
Good morning.

Q: As you explained the competitive pressures that you saw in the Infrastructure Group in the quarter, you mentioned competitors that don't have to deal with the steel issues. Talk about that.

Ben Brock – President and Chief Executive Officer
Sure. Many of our competitors coming from other parts of the world don't have steel tariffs and so there is some pricing pressure. The good news is we don't feel like it's affecting our market share. We feel like we're holding our own in a very good way there. But it is putting pressure on us on some of our deals.

Q: Okay. So you're still weighing the deals, just at a lower price point?

Ben Brock – President and Chief Executive Officer
Yes. And I wouldn't say all of them, because we do have excellent technology so we're able to sell the value long-term. But certainly, we need to do a good job of doing that to get the price that we feel like will work.

Q: All right. If I'm looking at the numbers you provided, excluding the wood pellets, obviously on the gross side, it's not quite as good as it was, and on the SGA&E side, similar. You're a decentralized business, how do you enforce a sense of urgency to help improve this business in a timeframe that is appropriate?

Ben Brock – President and Chief Executive Officer
Great question. We have been rolling out these initiatives, me personally in the last two and a half weeks in company-wide meetings and third quarter reviews in front of all of our employees and our presidents and department heads in each subsidiary, driving the message in that, hey, this has changed. This is going to happen. We are committing to doing this. And to be honest, I've been refreshed by the response. A lot of our people love the idea.

Being as decentralized as we were, I'm not sure that I would have expected such an overwhelming, "That just sounds great. Let's go." It is a center-led approach. It's not completely centralized. But what's been great is through the Maine Pointe piece, where they've dealt with both heavily centralized and decentralized companies, the feedback from them is their amazement that actually a lot of what they're doing has been a little bit easier from the people side. People are just absolutely willing to get on board and move.

Now on the flip side, we are on schedule with their plan, but there's been some superhuman effort in that because we have ten different ERP systems. And so looking into those systems and making sure that we're categorizing everything in the same way has been a challenge. We're there, but it's just taken superhuman to get there to be able to use their overlay software to look into the system. So I'm actually encouraged that we can do that, but it's a great question from where we've been.

Q: Okay. And I guess the last one for this call from me. Is the buyback program that you have an open market purchase program or a 10b5-1 plan?

David Silvious – Chief Financial Officer
Yes, it's the 10b5-1.

Q: All right, okay. All right, thank you very much.

Ben Brock – President and Chief Executive Officer
Thank you.

Operator
Our next question is from Brian Rafn with Morgan Dempsey Capital Management. Please proceed with your question.

Q: Good morning, guys.

Ben Brock – President and Chief Executive Officer
Good morning, Brian.

Q: Let me ask you, Ben. If you would go back, say, to last year or early this year, has your longer term, three- to five-year macro vision for Infrastructure changed at all if you go out? We haven't had really a Trump administration shovel-ready stimulus for the business. We have had some talk about the infrastructure bank. It seems like with the FAST Act, the Infrastructure business is pretty solid, like you've said. Has your longer term view beyond 2019 changed at all?

Ben Brock – President and Chief Executive Officer
I would say I think our industry needs a Highway Bill in the first half of next year. We're pretty good – 2019 looks good, and 2020, it's a little bit far out but it looks okay. But in the last year of the highway bill, which 2020 is, that sometimes can be a challenge for us. So some of the things we're doing in the background to offset that are international work and some of the things we're doing with inventory management and that type of thing.

But we're hearing that there's a plan that's coming together that could be released post-election. It's kind of a wildcard for us. Trump has been great on regulations and taxes with our customers and taxes for us, for sure, but the tariffs have been painful and something we've had to work through. But I think right now it looks good for 2019, okay for 2020. But 2020 is far enough out now that I think from a confidence standpoint, our industry, particularly in the United States, really needs I think, at least to think a highway bill, or feel like it's coming. And not a smoke and mirrors type bill. There has to be some real money in it.

Q: Yes, let me ask you. The last highway bill, I think, was a 10-year, 36, 38 extensions? Do you see more of that polarization, or are you getting any sense that the next bill beyond the FAST Act will be a little easier?

Ben Brock – President and Chief Executive Officer
Sitting here today, personally, I think that there will be a bill. I do think that the President, just based on what I'm hearing from some of our customers that are maybe closer to it than I am right now with him, that he does want to do something. But I'm repeating a third-party thing. I have nothing behind that. So I just get the sense that they would like to get something done. In fact, my personal opinion is that might be the last thing that they can all get done together before the next big presidential election, as far as a big thing.

Q: Right. No, I think that that's good. I appreciate the color on that. You had a small comment about Roadtec and maybe orders in November and December. Given how active your national and some of your regional road builders have been, do you get a sense that you might have more off-season orders as winter comes in north of

the Mason-Dixon Line, things slow down a little bit? Is your sense that off-season procurement might be fairly strong following the $44 million you picked up since October?

Ben Brock – President and Chief Executive Officer
I think there's potential there, and I think time will tell. But I think there is potential, particularly before the end of the year, as everybody's looking at taxes and where they are. Time will tell if that's the right call. But after the first of the year, I think it goes into like the normal very good cycle we're in. But I think there's some potential here in the next eight to ten weeks.

Q: Okay, all right. And then maybe I missed it, have you highlighted any new product launches for 2018?

Ben Brock – President and Chief Executive Officer
We have not necessarily. We've had some new products, but we haven't on the call. And we'll do maybe another update on that on the next call. We are working on some things for the Bauma show in April. We are not going to have 33 new products at that show, but we will have a few new products that could raise some eyebrows. So stay tuned for that.

Q: Okay. And then what's been the sense of competitive bidding, pricing, how competitive has it been, say, the last couple of quarters?

Ben Brock – President and Chief Executive Officer
Our customers are shrewd buyers. They have multiple competitors on deals. And even though maybe it's a smaller pool of competitors, particularly maybe on the asphalt plant side, we're rarely alone, and so being competitive, particularly with some of our competitors that don't have the same steel tariffs that we have. Some of those may be U.S. competitors bringing in products from other parts of the world on top of that. But thankfully, we have a good value proposition. And like I said, we've got to do our job and sell our value.

So a little bit of pressure. But all in all, I think we've held our own okay, and to the point that we still feel like we can be in the 24%, 25% gross margin range in the fourth quarter.

Q: Okay. On your supply chain procurement project, does that at all affect how you guys are going to look at forward buying, or are you going to put more if you're kind of in an inventory de-stock, and is it different between finished goods and raw materials? Would you be more reliant in a de-stock on maybe spot prices in procuring raw materials versus forward buying?

Ben Brock – President and Chief Executive Officer
Maybe answering it in a couple of ways. One is with the software system now looking at all of our inventory, when you think about the one-time cash release, one of the things that we can do now is look at where, let's say there's, and I'm picking probably a bad example because motors move pretty quick for us, but if we have a 15-horse motor that's moving slow in one place, now we can get it to another place and get it out, get it sold, get it moving, or even sell it out of that inventory in parts to a customer nearby. That's a capability that's coming that will help that.

On the raw material side, it's interesting but we're just trying to leverage our spend. And when you look at it, some of our companies, we may have an opportunity to be closer to the mills in our purchases, particularly as we leverage the spend. And then as far as also on the minimum and maximum levels, it's a complete overhaul of what those are, but we still have to be able to service our customers. That's extremely important to us. But certainly, there are opportunities on the max-min levels in our inventory to get better too, and that's a piece of that cash release.

Q: Okay. And then you talked a little bit, and maybe you said, I think the word you used was maybe kind of an inflation creep. What are you seeing in inflation maybe across the board in steel and healthcare costs, payroll, a couple of percent? Do you see it accelerating? Give me a sense of where you are.

Ben Brock – President and Chief Executive Officer
It depends on when everybody can get to stick. But I think it's around 2% to 3%. I don't have anything right in front of me to prove that. That's a gut number.

Q: Okay, okay. And then you've talked a lot about Infrastructure, certainly you're steady-state, solid. What's your sense of mining and the energy side? How do you see that, the delta change maybe in 2019?

Ben Brock – President and Chief Executive Officer
Kind of in the range of the 4% to 6% for the year next year. Mining for us, again is mainly at Osborn and BTI and how they feed their underground mining equipment into the mining industry out of BTI. But Aggregate side, the Aggregate piece of the Aggregate and Mining Group looks pretty strong. I went to our dealer conference with our KPI-JCI-AMS group and met with some dealers, and they're pretty optimistic about next year.

Q: And then anything on the Energy?

Ben Brock – President and Chief Executive Officer
Yes, sorry. In energy, we're optimistic, like we said in the comments, a lot of good things going. The oil and gas side seems to be pretty stable. Of course, oil is up, so that's helpful. GEFCO is doing well, got good backlog there. The double pumpers are selling very well for them. The Peterson group is doing very well on wood chippers and grinders, having a good year. RexCon, the concrete side has picked up orders. We're pretty optimistic on energy.

Q: Okay. And then, Dave, on the 297,000 share repurchase, do you have a per share dollar amount, what you bought the shares, average weighted per share cost?

Steve Anderson – Vice President and Director of Investor Relations
Yes. Brian, it's Steve. You can average out the dollars versus the shares, but about $14 million approximately over 297,000 shares.

Q: Okay, all right. Thanks, guys.

Steve Anderson – Vice President and Director of Investor Relations
You bet.

Ben Brock – President and Chief Executive Officer
Thank you.

Operator
There are no further questions. At this time, I'd like to turn the call back to Steve Anderson for closing comments.

Steve Anderson – Vice President and Director of Investor Relations
Thank you, Rob. We appreciate everyone's participation on this third 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 November 6, 2018, and an archived webcast will be available for 90 days. The 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 sent out earlier.

As Rob mentioned, this concludes our call. Thank you, everyone, and have a good week.