Titan International, Inc.
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Company Representatives:
Paul Reitz: President and CEO
Jim Froisland: CFO and CIO

Analysts:
Stephen Volkmann; Jefferies
Joe Mondillo; Sidoti & Company
Larry DeMaria; William Blair

Presentation

Operator: Ladies and gentlemen, welcome to the Titan International third quarter 2017 earnings conference call. During this session, all lines will be muted until the question-and-answer portion of the call. (Operator Instructions)

As a reminder, certain statements made in the course of the conference call are considered forward-looking statements for the purpose of the safe harbor provisions under the Private Securities Litigation Reform Act of 1995, and reflect the Company's or Management's intentions, hopes, beliefs, expectations or predictions for the future.

The Company's actual results may differ materially from the intentions, hopes, beliefs, expectations and predictions contemplated in these forward-looking statements as a result of various factors, including those discussed in the Company's latest Form 10-K and Form 10-Q filed with the Securities and Exchange Commission.

In addition, today's remarks may refer to non-GAAP financial measures, which are intended to supplement, but not be a substitute for, the most directly comparable GAAP measures. The earnings release, which accompanies today's call, contains financial and other quantitative information to be discussed today, as well as the reconciliation of the non-GAAP measures to the most comparable GAAP measures, and is available within the Investor Relations section of our website.

Participating from Titan International on today's call will be Mr. Paul Reitz, Titan's President and CEO, Mr. Jim Froisland, Titan's Chief Financial Officer and Chief Information Officer. Please note, today's call is being recorded.

At this time, I would like to turn the call over to Mr. Paul Reitz.

Paul Reitz: Good morning. I appreciate you joining us today. I'll run through some highlights of our business, then turn it over to our CFO, Jim, to go through the financial world, and we'll conclude by taking your questions.

11%, 10% and 21% -- those figures represent our year-over-year revenue growth for the first three quarters of this year. These growth figures clearly illustrate that the decisions and actions that Titan has taken over the past few years are working effectively and have enabled us to jump-start this growth engine.

We started the year on a positive note, with the first two quarters exceeding double-digit growth after 18 periods of revenue decline, but the third quarter for us really kicked it up another gear, breaking through that 20% level. What we're seeing is good diversified growth that reaches across all our geographies, segments, many of our products.

Our undercarriage division, ITM, and our North American tire division continue to benefit in the aftermarket from our strategic business decisions and the investments that we've put into them over the past couple years. We're seeing our North American wheel business kick it up another gear, which is a good indicator for the OEM market conditions.

Look, I think it's clear that the Titan team has done a good job generating sales growth in 2017, but I'd like to take a few moments here and now add some commentary around margins. First, let's step back and look at what's gone on in our industry and the cyclical end markets that we serve. After the super-commodity cycle ended, we've seen our sales growth decrease by over 40% from the peak.

During this downturn period, we've commented and reiterated that Titan is making sound, quick decisions to adapt our operations to these changing market conditions. We've done this while maintaining our per-person efficiency levels at the plant level, our cost of quality, and many other plant performance measures have remained stable or up during this period of revenue decline.

We've also never lost our intense focus on our most valuable assets, which is the Titan and Goodyear Farm brands and our product portfolios and our ITM brand, and those product portfolios that we put into the market that really cover the entire gamut of the needs of our end-customers.

We've consistently made these important and crucial investments in these areas, and we've built a good, strong Company for the future. I believe we're now seeing and we're moving beyond these concerns from the downturn period, and our 2017 sales growth further confirms the good decisions we've made in recent years.

So that's leads to the question why aren't our margins growing at the same level as sales? Let's start with what we highlighted in the first two quarters this year surrounding raw materials. In 2017, Titan, along with nearly all tire companies, have discussed the negative impact of raw materials, namely the sudden spike in natural rubber and the impact that has had on our financial and other companies' financial results.

In fact, just last week, a major tire manufacturer saw a third quarter drop in earnings of 35% that they attributed primarily to raw materials. These issues with raw materials should not be confused as a Titan-related operational issue as some narratives have stated.

I do want to note that since we manufacture off-road tires, our tires and our products require a higher blend of natural versus synthetic rubber, so the negative impact of raw materials in the first half of this year was proportionately larger to us than other companies.

Now, clearly, our revenue is also smaller, but the other big impact is the blend that goes into our tires is more based or heavily based on natural rubber compared to synthetic, and that's where the large spike took place from the end of last year into the first half of this year. As we previously stated, this impact was $10 million and $9 million in each of the first two quarters, respectively.

Look, we will take additional measures in the future and learn from this situation to mitigate the impact of volatility in raw materials in the future, but it's a battle that everyone in our industry will not be able to completely mitigate in these types of volatile situations.

Now, looking at this quarter, we have seen our raw material costs stabilize, and along with that, our results have progressively improved each month during this quarter. This led and this helped us post in the third quarter a 14% gain in gross margin dollars and a 64% increase in adjusted EBITDA.

Another issue impacting our margin is the overall dynamics and conditions in our end-markets. As noted previously, we adjusted quickly to the downturn to reduce our headcount by 2500 people, or 30% of our total workforce if you look at it that way. These are big numbers, and we still effectively managed our output per man-hour and our cost of quality at our plants. So, again, we kept our plants operating very effectively and efficiently while we reduced our workforce by 30%.

While our volumes have increased this year, we still operate at a lower level of capacity utilization that goes against our existing fixed cost base. This clearly results in a higher overall cost per unit compared to prior years. That's the simple math, but we're not accepting that as the simple reality. We've closed two plants in the past couple years, and we will continue to look at opportunities in the future to reduce our fixed cost base.

Another matter that takes place in the ag market is that we've seen small ag perform well the past couple years, and we have a strong customer base in that area that we've been able to grow with. However, large ag, which has higher margins, is still down significantly and operating at lower levels than prior years.

In some of my recent travels, I've heard from many dealers that feel large ag is definitely on firmer ground. In North America, the dealer sentiment has improved, and we've also seen improvement in inventory levels, so I think you're seeing a stronger foundation for large ag. But, again, as you look at our margin performance here in recent times as our sales have grown, it's been coming from the smaller side of the business, which does have lower margins historically for us.

With that being said, we're not sitting around looking at our current margin levels and waiting for tailwinds to come propel us forward. We understand that our margins need to improve, and we believe that our margins can and will grow in the future.

So I'd like to take all that and roll it forward to add some color on where we see our business going in 2018. We believe that the positive sales trends will continue in 2018, with growth in the range of 7% to 12%. Along with the continuing sales growth, we'll drive a gross margin dollar improvement of between 25% and 40%.

Our continuing efforts to manage SG&A costs will drive that down in the range of 10% to 10.5% of sales. The margin and SG&A improvements that I just talked about will then flow through to EBITDA, to move that upwards in the range of 50% to 100% from 2017 levels. Our capital expenditures that past few years have ran well below our G&A, as our investments that we've made in prior years, in earthmoving and construction primarily, haven't continued at near the same levels.

So as we look into 2018, we're forecasting that our CapEx will fall in the $35 million to $45 million range, which will sufficiently cover not only safety, maintenance and our environmental efforts, but also we'll place capital into positive return generating projects that will benefit us into the future.

All right. I'm going to move in a completely different direction from the financial story there and talk about this quarter, where we signed an agreement with Oracle to implement a cloud-based ERP system. Our CFO, Jim Froisland, has extensive experience with system implementations, and as you know, he's also our Chief Information Officer.

So the plan we're outlining with our ERP implementation is going to be a controlled and disciplined approach that's focused on making our back-office, non-plant operations more efficient, meaning we're not going to be risking causing irreparable damage to Titan's overall business. Our current systems are not broke, but we do need to remove the decentralization that is causing this back-office and SG&A inefficiency.

Titan is a much different Company than what it was just a few years ago. As you've seen, we've taken measures in 2017 to adapt our SG&A costs to this reality. However, we've really been doing that with one arm tied behind our backs because of our inherent system limitations. It's time we do something about that, and that's why we've announced the implementation of our new Oracle system, cloud-based Oracle system, to move us down that path.

My last comment today is on Dico. During this quarter, we recorded a $6.5 million accrual for a contingent liability related to the previously announced ruling on the Dico matter. We did put out a press release on that. The accrual obviously was announced in our filings this morning. We will be appealing this ruling, and obviously I'm not able to say much more than that on today's call.

However, the comment I do want to make and make sure everybody is clear on is that this Dico property we're talking about isn't located in some desolate part of Des Moines. This property sits in a growing part of downtown, and if you've been to Des Moines at all in the last five years, you know how much that city is growing. Where our property sits is right next to a recently-announced $250 million development, so this property is on the radar of the politicians in the area as to its value to the city. As such, our property definitely has sizable value that Titan will look to extract in the future.

So through this extended downturn, I really am pleased with how the Titan team has demonstrated consistently that we've made good decisions to manage our operations and our overall business. I believe that is really evidenced in the growth that we've seen in the first three quarters of 2017 and, again, capped off this quarter with doubling of our revenue, increased over 20%. And also, I believe that the thoughts I've shared on 2018 and where that's going are, again, further evidence of how Titan has positioned itself well for the future.

So with that, I'd now like to turn the call over to our CFO, Jim Froisland.

Jim Froisland: Thanks, Paul. I will begin with a reminder that the results we're about to review were presented in a news release issued this morning and will be discussed in more detail in our Form 10-Q, which was filed this morning.

Let's start with the income statement. Net sales for the third quarter of 2017 came in at just under $371 million. This was up more than 21%, or almost $65 million, from a year ago. This is the

third consecutive year-over-year increase we have seen after 18 quarters of declines, adjusted for acquisitions. Sequentially, net sales grew almost $7 million, up approximately 2% from second quarter 2017. I will note that this is not our normal seasonal trend, as we often see net sales decline from second quarter to third quarter with plant shutdowns and summer holidays.

Here's what it meant in terms of our segments. Net sales were higher in all segments when compared to the same quarter last year. Overall, net sales volume was up 14%, with higher volume across all segments and all geographies. Our agricultural segment saw the biggest improvement in net sales, of just over $32 million, or 23%.

Moving on to the gross profit and margin, gross profit for the third quarter was $39.7 million, up 14%, and 10.7% of net sales, versus $34.9 million and 11.4% of net sales on the same quarter a year ago. The decrease in gross profit as a percent of net sales was a result of pricing initiatives to selectively grow market share, primarily in the agricultural segment.

Now let's take a closer look at our three segments. Our agricultural segment net sales for the third quarter were $170.9 million, up $32.3 million, almost 23% over the comparable prior-year period. The North American region grew 26% over the third quarter 2016, with gains experienced in both OEM and in aftermarket. Russia was up 35% during the quarter, while Latin America and Europe both experienced 18% growth in net sales during the third quarter when compared to the same period a year ago.

Our agricultural segment gross profit for the third quarter was $18.9 million, up from $18.6 million in the comparable prior-year period. Gross margin declined 234 basis points in the third quarter to 11.1% of net sales, with a majority of the geographical regions showing reductions over the same period a year ago. As I stated in my overall margin comments, the decrease in gross profit as a percent of net sales was a result of pricing initiatives to selectively grow market share primarily in the segment.

Moving to the earthmoving and construction segment, this segment's net sales for the third quarter of 2017 were $156.4 million, an increase of $27.5 million, or 21%, versus a year ago. All regions improved over the prior-year quarter, with overall volume gains driving the increase. The investment decisions we have made in our ITM aftermarket business have shown positive returns for each of the last four quarters. This segment's gross profit for the third quarter was $14.5 million, up from $11.6 million, or 26%, versus a year ago.

Contrary to my comments about our agricultural segment, this segment experienced a 33 basis point improvement in margin, to 9.3% versus a year ago. Europe drove the majority of this increase.

Now let's talk about our consumer segment. This segment's third quarter net sales were $43.7 million, an increase of $4.9 million, or 13%, when compared to the prior year. All regions improved over the prior-year quarter, with overall volume gains driving the increase. This segment's gross profit for the third quarter was $6.2 million, an increase of $1.4 million, or 30%. Gross margin was 14.2, an improvement of 187 basis points over the same period last year.

Moving on to operating expenses, selling, general and administrative and R&D expenses for the third quarter of 2017 were $42.2 million, an increase of $3.3 million when compared to the prior year. After adjusting for the non-cash accrued contingent liability that Paul spoke about of $6.5 million for a legal judgment, which we will appeal, SG&A and R&D expenses for the third

quarter of 2017 would have decreased $3.2 million, or 8.3%, and just considering SG&A, it would be 9%.

This decrease was in line with Management's continuous improvement initiatives that we started in the beginning of 2017 and, as you recall, focused on reducing both fixed and variable SG&A costs.

As Paul mentioned earlier, also during the quarter, we took another step to reduce SG&A expenses in the future and provide better information to run our global business by choosing a new cloud-based global ERP system to replace our old legacy systems.

And you can ask the question why. Well, as we said, better information for sure, but this I'll point out is cloud versus what we have now on-premise, and a lot of companies -- and if you look at best practices and what's happening out there in the real world, everybody is moving towards the cloud, and you can ask the question why. Well, for one thing, it is easier to implement versus on-premise, not only implement, but ongoing, which means lower costs to implement, but also to ongoing costs, anywhere up to -- it depends upon the company, but it can be huge savings, up to 50% or 60% reductions.

The other thing that it sets the stage for, it is the latest technology. It provides the technology for better information. For example, what is really nice is we can really drill down into product line profitability, et cetera.

Last, but not least, it sets up a stage for -- as Paul alluded to, one of the best practices is shared services, so it facilitates that on a global basis. So we really see this as a huge opportunity on a go-forward basis.

Finishing up on our third quarter operating statement, loss from operations for the third quarter of 2017 was $5.1 million, compared to a loss of $6.3 million for the comparable prior-year period. After giving effect to the previously mentioned $6.5 million non-cash contingent legal judgment recorded in the quarter as a loss from operations, becomes an income amount of $1.4 million, an improvement of $7.7 million.

Royalty expenses of $2.6 million was up $0.3 million, or 14%, due to higher net sales when compared to the prior-year period. Interest expense of $7.5 million was down $1.2 million, or 14%. Foreign exchange gains of $0.8 million was better by $0.4 million when compared to the comparable prior year. Overall, foreign currency gained for the nine months ended September 30, 2017, was $48,000, or nearly even on a year-to-date basis. Other income of $3 million was down 15% from the comparable prior year.

This resulted in a loss before taxes of $8.8 million, or $2.3 million adjusted loss before taxes, for the third quarter of 2017, versus an $11 million loss in the prior-year period. Tax expense was $2.4 million, versus a $2.1 million benefit in the comparable prior-year period. This tax expense was due to losses in the US and foreign currency jurisdictions where the tax benefit could not be recorded due to a valuation allowance and due to non-deductible expenses and income adjustments.

All this led to a net loss of $11.2 million for the quarter, equal to a $0.22 loss per basic and diluted shares, versus last year's net loss of $9 million, equal to a $0.17 loss per basic and diluted shares.

The third quarter 2017 adjusted net loss attributed to Titan was $5.5 million, equaled a $0.09 loss per basic and diluted shares, compared to a loss of $8 million, equaled to $0.15 per basic and diluted share lost in the comparable prior-year period.

For the third quarter of 2017, earnings before interest, tax, depreciation and amortization, EBITDA, was $13.3 million, versus $11.9 million a year ago. On an adjusted basis, excluding both the contingent legal liability and FX, adjusted EBITDA was $18.9 million for the current quarter, versus $11.5 million a year ago. This is an increase of 64%. We use EBITDA as a means to measure the Company's performance. We have a full reconciliation of EBITDA, a non-GAAP measure, to net income in our press release issued earlier today.

Now, I'd like to move on to our financial condition and highlight a few key balance sheet, liquidity and capital items. Our cash balance of $156 million as of September 30, 2017, was $42 million below the December 31, 2016, balance when you include the certificates of deposit at year-end. This decrease was primarily attributable to the increased working capital required to support the sales increases during this year.

We ended the quarter with inventory and accounts receivable balances at higher levels when compared to the prior year, but, however, our overall cash conversion cycle improved by one day over the comparable prior-year period. Compared to the prior-year period, DSO increased three days to 58 days, DSI decreased five days to 95 days, and DPO decreased one day to 53 days. Therefore, as you can see, we continued to diligently manage our working capital as our net sales increased by 21%.

Now, for a comment concerning our debt. Our combined current long-term debt totaled $447 million, which represents a decrease of $4 million during the quarter and $59 million from December. This reflects the previously announced conversion of our convertible debt in January, which also served to reduce interest expense during the quarter.

Capital expenditures for the nine months ended September 30, 2017, were $23.6 million, versus $30.8 million a year ago. Capital expenditures for the remainder of 2017 are forecasted to be in the range of $10 million to $12 million range. Cash payments for interest are currently forecasted to be approximately $15 million for the fourth quarter of 2017, based upon September 30, 2017, debt balances. We believe we have sufficient funds for our operating working capital needs for the near future.

I'd like to say, in summary, there are several positive takeaways from our third quarter 2017 results. One, net sales increased 21%. We increased gross profit by $4.7 million, a 14% year-over-year improvement. Two, SG&A expenses decreased, net of the contingent liability legal accrual by $3 million, or 8.3%, while net sales increased 21%, lowering it to 9% of net sales versus 12% the prior comparable period. And third, adjusted EBITDA increased 64%, or $7.4 million.

With net sales improving for the three consecutive quarters, our results demonstrate continued signs of recovery and provide optimism as we head into 2018.

I will be glad to answer any questions you may have for these or other financial matters. In the meantime, I'd like to turn the call back to the operator for questions. Thank you.

Questions and Answers

Operator: Thank you. We will now begin the question-and-answer session. (Operator Instructions) Stephen Volkmann, Jefferies.

Stephen Volkmann: So thanks for the outlook on 2018. That's very helpful to get a sense of how you think things are coming along, so I certainly appreciate that. I'm curious, Paul, maybe you can dig into that a little bit. What are you thinking in terms of price cost in 2018 sort of built into your thoughts that you've given us? And maybe also mix.

Paul Reitz: Mix. Yes, it's a good question. We feel good about price cost situations now. As we move into 2018, I would say, if anything, it moves to the positive side, meaning that there's a little more pricing power that we're starting to get in certain products and in certain segments. Some of that pricing power just comes from our own internal due diligence that we've been doing. I've been talking about this quite a bit on a number of calls, but we've really worked hard on improving our intelligence on pricing, and we're getting to that point where we're starting to see some benefits from that, not just in the sales side of it.

As you've seen in our filings, we've referenced some of the strategic moves that we've made with pricing and what that's done with, obviously, driving sales, but we're also finding that we can generate some additional benefit with pricing on margins. Now, that's assuming that the raw materials situation stays fairly consistent where it's at today. Can we mitigate the situation again like we experienced this year? I think we can do a better job at it, but you'll never be able to mitigate that extreme volatility that we had, Steve.

We have contracts in place that require us to, in essence, hold pricing firm, and there's a little bit of a lag that we just can't cover through those contracts, through any type of our purchasing decisions. So, absent that, I think going into 2018, I think pricing remains on neutral to on the basic premise, but then some positive things that we can do internally to generate a little bit more pricing power.

Stephen Volkmann: Okay. Good. And I'm just --

Paul Reitz: And looking at the split that you were referencing, I've been out in the field quite a bit with dealers, and I think large ag, when you look at the inventory levels, you look at the dealer sentiment, where you've got 80% of the dealers right now are forecasting next year to be up -- flat to up. Some of them kind of look at the tail end of that bell curve. You've got some dealers up there with double-digit growth. So you've got 80% are in a good mindset, and I think a lot of that is driven by the fact that large ag is on a firmer foundation and they see some positive trends.

As I referenced earlier, our North American wheel business has been hiring, and we're seeing some good leading indicators that come out of that. But then, of course, you've still got 20% of the dealers out there that are in this negative mindset, and if you were to ask them that same question, they'd tell you the world stinks and life is horrible and that it's never going to get better, so you still have a situation where there's not a massive tailwind that's making everything rosy for everybody, but I -- 80% in a good mindset going into 2018, that's significantly better than where it's been in years prior. And again, we've been hiring here in North America in our wheel division, which is 90% OEM-driven, that business, and that's definitely a good leading indicator going into 2018.

Stephen Volkmann: A little bit better mix of large versus smaller ag in 2018? Is that fair?

Paul Reitz: I think so. Yes, I would agree with that.

Stephen Volkmann: But it also sounds like maybe a little bit more OE versus replacement, which maybe isn't great?

Paul Reitz: No, I still see some good trends in the replacement side. I think there's been a lot of new equipment that came into the market, as we all know, kind of in that four-, five-year timeframe -- four or five years ago timeframe, and for us on the replacement side, that gives you a good replacement business that's got some legs behind it. So, no, we're not hearing anything from our dealers that's leading down a path of 2018 looking any different than 2017.

I've got a big dealer meeting coming up here in a few weeks. I'll get a little more indication on where 2018 is going to look precisely, but, no, I think what you're going to see is good solid growth out of both those areas. The question is can you tip into that double-digit range? I'm not sure I'm quite ready to go there yet, don't have enough information on what we're seeing, but I feel pretty good that you're looking in the upper single digits in both areas.

Stephen Volkmann: Okay. Great. And then if I can just go back to pricing one more time, and then I'll pass it on. I think Jim mentioned that pricing was sort of a headwind in the quarter here because you were doing some stuff to gain share, which looks like it's kind of working, but I'm trying to true that up. That would seem to be sort of a pricing headwind, and yet you're talking about sort of pricing tailwind opportunities. Can we just sort of true all that up?

Paul Reitz: Yes. No, he's exactly right, there is a headwind that we've been experiencing because we have made some strategic pricing decisions and initiatives that really goes back to the end of last year. We did a pretty heavy study of the marketplace and really gathered some good intelligence, and so we made some strategic decisions that impacted pricing. It's not a big number, but he's exactly right, there's definitely been a headwind, and so what I'm saying is we feel comfortable that we can remove that headwind. So, in essence, we're creating our own tailwind, Steve, if that makes sense.

Stephen Volkmann: Okay. Yes.

Paul Reitz: Yes, so that we can take away some of those pricing decisions that we've made and just get them back to more of a neutral point, which would be a positive for us.

Operator: Joe Mondillo, Sidoti & Company.

Joe Mondillo: So I wanted to ask about the SG&A, which I have to say you've done an extremely good job on reducing SG&A in the face of seeing such strong revenue growth. But going forward, relative to your 2018 guidance, I'm wondering how much ERP expense is in the budget for 2018 versus 2017?

Jim Froisland: Yes, that's a good question. I mean, we're going through that process right now in terms of total IT costs, as I said, for the cloud versus on-premise are much lower costs. We'll have some overlap, but we'll have a better insight to that after we finish our planning process. But I think that actually towards the tail end of 2018, our total IT costs should start trending down, which is good news.

Joe Mondillo: Okay. I guess what I'm trying to actually end up getting at is relative to your guidance for 2018. So if you sort of use the midpoint of your revenue guidance, call it 10% growth over 2017, and then using the midpoint of your SG&A percent of sales guidance, it looks like it comes out to be somewhere around $163 million of SG&A, and if you exclude the one-time items in 2017, you're looking at SG&A about $135 million in 2017. So $163 million of $135 million is about 20% growth of SG&A expenses, which I would think with all your initiatives, that seems sort of high. So could you just sort of -- is there something I'm missing or if it's ERP costs that are baked in there that are pushing SG&A up in 2018? If you could just sort of clear that up, I'd appreciate that.

Jim Froisland: Well, as you recall, we had what I'll call a couple of unusuals. In this quarter, we had the legal, and then in the first and second quarter, we had some extra legal costs. You have to back those out to get a base case, but I think the best way to answer your question is what is our overall goal for SG&A and R&D, and I think thinking out long term, not only into 2018 but the future as we develop these systems and lower our costs, and our goal is to be below 10% as a percent of revenue.

And as I alluded to, we're looking at all SG&A costs. Clearly, with best practices moving from a decentralized situation globally to a more shared service best practice model, which, oh, by the way, every company is trying to do, you need technology to facilitate that, so I feel confident, very confident, in that goal that we set before us.

Paul Reitz: The other part of your question, about actually SG&A dollars going up, we're still going through the 2018 planning process, and I guarantee you we're not allowing any of our business units to increase their SG&A costs. The only thing that would be baked in there would be your sales-related costs as revenue goes up that are somewhat, I would say, directly tied -- I mean, controllably directly tied to sales growth. But the cost for what we're going to have in the budget for the system implementation will be fairly insignificant in the big picture, and it'll also be offset by some other costs going away with the existing system.

So we'll give you a little more color once we get that 2018 budget process done, and like Jim said, our goals for the future are less than what I had stated in the 2018 comments, so there's probably a little bit of conservativeness in there, but we want to leave ourselves enough room to make sure we are making the right investments in the systems and the decisions we're making. But really looking at that number for the system, from what Jim and I have talked about, it's not a huge number. We're going to break it out over a few years, and it's cloud-based.

Jim Froisland: Yes, you can't compare -- a lot of people have it in their mind about, back to Y2K, on-premise, a lot of programming, a lot of changes. The cloud is a completely different animal. There's no programming. It's all built in. So right there --

Paul Reitz: Actually, Jim, the other thing I just thought of too is in my comments I said SG&A, but that actually includes R&D as well.

Jim Froisland: Right. Right.

Paul Reitz: It's a little bit of a mouthful to say SG&A and R&D, but that may be another part of it as well.

Jim Froisland: Exactly.

Joe Mondillo: Okay. I also wanted to ask just regarding the balance sheet. I know over the last 12 to 15 months, maybe even longer, it's certainly been something to focus on, and I'm just wondering how you're thinking about that, what your sort of goals are. Are you comfortable where the balance sheet is right now? And looking where your business is trending and looking at your guidance for 2018, obviously leverage will come down just as EBITDA improves, so are you sort of comfortable where it is right now and just going to try to ride that trend with EBITDA? And then also if you can update us on TTRC and what you're thinking about that asset up in Canada, how that's going. I know at one point in time, you were thinking about a potential sale. Just update us on the balance sheet goals, I guess. Thanks.

Paul Reitz: Jim, why don't you take the balance sheet part, and then I'll jump in on TTRC after that?

Jim Froisland: Well, first off, as it relates to the balance sheet, it's very important we -- I've talked about the working capital focus. As it relates to our debt, we are looking at different alternatives there, which we shared with the Board. But as you said, with EBITDA improving, that's a good thing, and our working capital management will continue. We'll focus on that and look at it as we go into 2018.

Paul Reitz: From an operational perspective, Joe, we have made investments in inventory, which obviously includes AR, as well as sales have increased this year. My goals for 2018 with the team are that I really don't expect inventory levels to continue to increase, meaning we've already made those strategic investments that are needed to have the right inventory in the right place.

And I'm clearly not looking for the team to be increasing inventory levels anywhere. We may have to reposition some inventory on where we think sales are going differently next year depending on the mix, as we had talked earlier with Stephen's question, but I definitely am not releasing the checkbook to grow inventory in 2018 like we did in 2017. And then --

Joe Mondillo: And then --

Paul Reitz: Go ahead.

Joe Mondillo: Go ahead.

Paul Reitz: No, I was going to jump to TTRC. I've you've got a follow-up question on balance sheet, go ahead.

Joe Mondillo: No, no, I was just going to actually remind you about that. I thought maybe you had forgot. Yes, TTRC, if you could provide an update there. Thanks.

Paul Reitz: Yes, you bet. TTRC, the first thing I want to say on that is our team did a great job in handling the situation. Everybody is safe. They handled it very well, very conscientious, followed protocol. The first responders did a great job with the situation. And so we haven't had to deal with any injuries, we haven't had to deal with any environmental situations, anything that could go down a very serious, difficult, challenging path. So that part -- again, a lot of credit goes to our team and the first responders to handle that situation.

Where we are at now, things are progressing well with the discussions with -- the first part is with our customers up there. We have contracts that we need to address for this situation. Those discussions have all taken place and been handled well. I can't say a lot about where things sit

with the insurance company as you're working through the claim process, but I am comfortable to say today, Joe, that that process is going well, the discussions with the insurance company. They understand the situation, the importance of getting the operation up and running so that we can take care of our customers up there. They've been very respective of the importance of timing.

Our team is very confident in a couple things -- one, what they have learned about the situation, meaning that there is not user error involved. They're very confident with how their team was operating the unit and very comfortable that we will get a good understanding of the situation, and it's something that we will fully be able to rectify and get the business up and running successfully, so they are very confident about that.

So I would say the best way to characterize it, we've -- since the event has taken place, we haven't been thrown any curveballs, haven't been thrown any kind of nasty, ugly situations we have to deal with. We're just going through the process working with the insurance company and the adjusters and kind of having those discussions. But, again, I want to reiterate the team is very confident that the business will be up and running and they will get to that point. It's just we can't give the timing on it yet until you get the insurance claim and you get everything settled, and so I'm not able on today's call to give you really a guidepost as to when we'll have that officially up and running. But, again, their confidence level is extremely high that we'll get to that point.

Joe Mondillo: Okay. I also wanted to ask a question on just the consumer side of the business. I know this is like a non-core sort of type of the business. I think a large part of it is small trucks in Brazil, if I recall, but that seems to be trending really well. The gross margins have been standing well, so it's a little bit -- every little bit counts. I'm just wondering sort of how you're looking at the trends for the first three months of this year -- or three quarters this year and how you're thinking about it going into 2018 regarding sort of revenue growth and gross margins.

Paul Reitz: The consumer basket for us catches a lot of different areas, and like you said, a big component of it is the truck business down there in Sao Paulo. I also look at it a little bit differently. As we move into the future, 2018 and beyond, I think we've got some good potential there to continue getting in other rubber-related products.

So at this point, in both North America and South America, we sell off mixed rubber. So if you could imagine an entire plant, and one of your most important assets and most expensive assets is going to be the front-end processing and mixing of that rubber. There are a lot of companies out there that do not make the investment in these expensive Banbury units because they'll just purchase the rubber from somebody that can do it for them, and so we're seeing opportunities to mix and process more rubber for other companies that are in any type of rubber-based industry.

We're also expanding the business -- because we have all this mixing capability, expanding into other rubber-related products that are kind of mat, farm-related, horse cattle type products that really do have good margins associated with them, looking to expand our small ATV tire business, again, because we have the mixing capability. We have the ability to do it. So I look at it as kind of a sleeper for us to grow.

Now, it may not be big revenue dollars, but, as you said, it's going to be every dollar counts, and these products that we do produce in that consumer area, generally speaking, have good margin associated with them. So I've signed a team that is really, for probably the first time in a long time, truly going to be looking at some of these opportunities further, and hopefully we'll be able to capitalize on them as we move -- not just in 2018, but definitely beyond, into the future.

Joe Mondillo: Okay. And then, just lastly, I wanted to ask, similar to Steve's question, regarding mix at the ag segment. I'm just wondering where we are in terms of mix at earthmoving construction. The gross margin is -- unlike ag, gross margins have expanded. I don't think maybe mix is as big of a deal, except when you're talking about maybe the large mining products, but if you could talk about mix -- has mix been a positive the last quarter or so and sort of where that trend is going?

Paul Reitz: In certain parts of our business, yes, that mix has been a positive. In the undercarriage business, we've seen certain parts of the world where the heavy earthmoving business is doing well and gaining steam. That helps us out in Australia as well. Their margins have seen a good increase this year, good improvement this year from last year's levels, primarily due to the heavy mining industry that's obviously big down there.

As you move into the tire part of the business, Joe, I mean, we have not seen a big mix shift with that product. We're still more heavily focused on the construction and light earthmoving, not necessarily the heavy mining. It hasn't been a focus of our business on the tire side. So it kind of depends which product you're talking about in answering your mix question, but I would say definitely the mix trend in certain parts of the world and with certain products that we produce has created a positive in that segment.

Operator: Larry DeMaria, William Blair.

Larry DeMaria: Sorry if I missed this earlier. Obviously, the 2018 outlook, which is fundamentally encouraging -- can you give us the base case for 2017 -- or the fourth quarter, so we can put that into perspective?

Paul Reitz: Jim, I don't know if you happen to have any comment on that in front of you. I don't have that information in front of me right now, Larry.

Larry DeMaria: Okay. It's obviously going to grow off of this year, but, I mean, is the fourth quarter -- maybe headwinds, tailwinds going into the fourth quarter from the third quarter, just so we can kind of calibrate it?

Paul Reitz: I mean, I think the fourth quarter is looking to be fairly consistent where we've been the first few quarters of this year. You do have, obviously, some seasonality in the fourth quarter with holidays and plant shutdowns. We have seen raw materials stabilize in the third quarter and would expect that trend to continue in the fourth quarter. Pricing levels -- price to cost levels I would expect to be fairly consistent with Q4.

To my knowledge, I don't see any significant deviations in SG&A either, absent any type of legal costs or something like that, that kind of can spring up, but as far as the structure of the business or what we've been talking about with the Oracle implementation, there's not going to be any significant deviations in the SG&A base.

So I think to answer your question, I think things remain fairly consistent with what we've seen in the first few parts of the quarter -- or first few quarters of this year, and don't really anticipate any significant deviations from that.

Larry DeMaria: Okay. Thanks. And then for next year with the guidance, is it safe to assume we have ag outpacing the other segments, and specifically in Brazil? How are you thinking about Brazil? Because obviously we had a strong first half, generally, with the market in Brazil, and

then obviously things have softened out, so I'm curious what you're thinking about Brazil for next year and if you'll have wheels in place there as well.

Paul Reitz: With Brazil, clearly they had a really good 2017, so you're going to have some stronger comps moving into 2018. You're starting to see the OEM business shift a little bit, some of the recent announcements, and I would agree with that as well for the impact to us. We do believe the replacement business in Brazil will continue to be strong, however.

The government is going to continue to support the farm sector down there. With all the economic and political uncertainties, the last thing that Brazil can afford to do at this moment is do anything to slow down their farm sector, so I don't think you're going to experience any significant disruptions where the government pulls the plug and really sends things crooked.

But you are going to be facing, obviously, some tougher comps, and, yes, there are some inventory questions that are going to need to be addressed in 2018. For us and our business in particular in Latin America, we're also starting to find some good opportunities with exporting. Argentina, with their new regime, has opened up -- I don't want to say they've opened up their borders. That's a little too far of a statement, but they've made their borders more open, and that's been a benefit to us. Clearly, it's still not a free-based economy, but with our products, our good brand name, it's something -- our products are definitely desired across the border there in Argentina coming out of Brazil.

We continue to see Colombia and some of the other ag-based economies there as good areas for us to export. Depending how you treat Mexico, if you call it South America or North America -- it depends who you ask that question. We also see some opportunities coming out of South America to import into Mexico. We've expanded our reach in Mexico and, again, believe with the strong brand name that we have and the good distribution channel, that should also play out for us in 2018 with some growth in sales.

Larry DeMaria: Okay. Do you have posted in your guidance for next year or your initial outlook growth in LatAm? And also will you have the wheels in place down there?

Paul Reitz: On the wheels side -- so LatAm, again, we're still finalizing everything for 2018, but with all those factors for LatAm, I do still see it as a market that will grow in 2018. As far as the wheel business goes, no, we do not have that currently in our projections for 2018. That's something we're continuing to look at, and we'll continue to evaluate when the right time is there to make the investment and when we believe we'll be able to get a good return on it.

So we're being -- as we've talked about previously, we're being prudent with our capital investments, and that's an area where we have the equipment ready. We certainly believe that there is merit to having a wheel business in Latin America, but, at the same time, we're not looking just to run down there to do it for the sake of saying we've done it.

So when we look at the current projections, right now, as we sit here today, for 2018 we have not included any expectations for a Brazilian wheel business adding incremental revenue to our business. Now, could it happen? Yes, that's still to be determined, but sitting here today, we've not included that.

Larry DeMaria: Okay. I was under the impression you would have that maybe by the end of the year. And then, finally, one last question, a follow up on your price comments. I just wanted to clarify. Is there increased competition in the market that's pressuring things, or is this really

going back to a competitive price next year and now you're trying to reset at better prices and drive efficiencies to capture more net? Or is there increased competition into your incumbent position?

Paul Reitz: No, really what we did for 2017 was internally-driven. The world has always been a competitive place. There was not a dynamic that shifted that caused this. I'm going to point back to kind of summer of last year, where we really looked strategically at where we thought we could make some decisions that would help the Company, and this was an area that we believe by really doing a thorough analysis of our pricing, specifically in North America more so than other places, but really -- we really locked down for a few months, and what we concluded is that if we strategically price some products -- and again, this wasn't across the board. This was intended to grow in some of our weaker spots and leave some of our stronger areas alone, and it's been effective. I mean, we've done a good job with it.

And so where I see us being able to get some relief moving forward isn't driven necessarily by the market. It's really driven by us pulling back on some of the strategic pricing decisions and still believing that we can keep the volume that we have in place. Obviously, in certain areas, when you're making these decisions, you might overshoot on some of your pricing decisions that you made, and I think we're fine-tuning where we can correct it and get back a little bit of margin.

Operator: And next we will take a follow-up question from Stephen Volkmann.

Stephen Volkmann: Paul, I think you mentioned that rubber cost like, what was it, $10 million in the first quarter and $9 million in the second quarter. Do we have the third quarter number for that?

Paul Reitz: Jim, do you have that specifically? I think I just referenced it's been stabilized. I don't know if there's a specific --

Jim Froisland: Yes, to your point, it's stabilized, so I don't -- we haven't calculated it on the same rationale as we did in the first quarter, but, as you said, it's come down. I mean, it went up 30%, 40% in those first and second quarters, and it's come back down to where it was in December. So we don't -- we haven't calculated that.

Paul Reitz: It didn't have a material impact, so we haven't really pulled that number out and isolated it like we did the first two quarters.

Stephen Volkmann: So, sorry, just so I understand, does that mean it was somewhere close to zero, or does that mean it's somewhere close to 10, which has been the run rate?

Paul Reitz: Oh, no, no, it's neutral. Closer to zero.

Stephen Volkmann: Okay.

Paul Reitz: Maybe it was $1 million, a small enough number that it wasn't material, so I would call it basically a neutral conclusion.

Stephen Volkmann: Okay. And then what are you thinking with this Oracle thing? Assuming like, I don't know, 2019 or 2020, whenever you think it kind of gets to normalcy on this, have you thought about sort of the annual run rate of cost saves associated with this project?

Paul Reitz: Yes, we did. I mean, first off, I wonder if the Oracle guys will like it that you called it an Oracle thing.

Stephen Volkmann: It's a technical term, I know.

Paul Reitz: Actually, you might show up in their next ad campaign with that comment.

Jim Froisland: Yes, free advertising.

Paul Reitz: Yes, actually, we did. We did a thorough analysis, Jim and his team that we put in front of the Board, that did show a significant cost savings by doing this. And again, this isn't -- we're not changing how our plants operate. You've been following us, Steve. You know us. We grew in a lot of different areas in a fairly short period of time, and so we've been operating, from a back-office and from a systems perspective, very decentralized, and we've been effective in running the business that way, but it's just inefficient.

So by going to a cloud-based system -- luckily, by delaying this a little bit, we've moved beyond having to do this on-premise and make all those significant upfront investments in mainframes and servers and then you have to deal with all the customization of the software. What we're doing is we're reaching up into the cloud, we're pulling the software off the shelf, and we're going to use it to run our back office, so it's not going to be a risk to our plants and our operations, but it's going to allow us to become less decentralized and be able to become more centralized in certain areas, which is going to drive down costs.

So the overall software itself will ultimately drive down costs, because you'll be able to remove the servers and remove some of these inherent legacy ERP costs that we have, plus we have a lot of disparate systems, so you've got a lot of nickel-and-dime type costs that just add up. So we'll be able to consolidate that, use a cloud-based system, and, overall, it's going to make the Company more efficient, but it's also going to drive a significant cost savings. So that is built into the -- so even the conservative budget or plan that we gave to the Board, I believe we'll do better, but it was still a pretty nice-looking number.

Stephen Volkmann: Maybe another way to ask it, is that upside as we go forward, or is that sort of the way that you get to your SG&A below 10% type of bogie?

Jim Froisland: Yes, it's a way -- to answer your question, it's a way, clearly on the out years, to get below the 10% bogie. I think there will be some savings towards the end of 2018. Again, as I mentioned, with the cloud, you're not dealing with programming, you're not dealing with AS400s, you're not dealing with the decentralization of having IT at every site.

We did the calculation, as Paul said, and one simple metric is payback. It's less than a year, and that was conservative. And as I mentioned, benchmarking out there, cloud usually -- it can be up to 50% savings over a five-year period versus on-premise. Again, this is studies by people smarter than me. But that's just the study. We're going to have to put our actions in place and deliver, which we plan on doing.

Operator: This concludes our question-and-answer session. I would like to turn the conference back over to Mr. Reitz for any closing remarks.

Paul Reitz: Well, I certainly appreciate everybody's time and interest today, and I look forward to talking to again on the next call. Have a good day. Thank you.

Operator: The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.