Global Industrial Outlook: Don't Step in the C.R.A.P.

By Brian Langenberg, CFA

Fourth quarter results were above expectations for most U.S. machinery companies, including significant revenue beats at Cummins, Caterpillar, Oshkosh Corp and PACCAR with strong North American truck demand, improving construction equipment markets and general stability elsewhere.

Regionally speaking, U.S. industrial growth was solid; Europe picked up slightly and Asia grew. We also gleaned generally positive comments and results from the Middle East and broader Asia, excluding of course Australia and mining. Conversely, Latin America and Canada have slowed. The questions are a) why? b) is it sustainable? and c) is it broad-based or sector-specific? This is where it is critical to bore down from the general to the particular.

We are starting to talk with our clients about watching out for C.R.A.P. No, not that kind; but rather, currencies that are tied to resource extraction. In this case C.R.A.P. stands for Canada, Russia, Australia and Peru (really Latin America). Each of these currencies is off 10% or more, year-over-year, and primarily attributable to concerns about anticipated resource demand from China.

If the above trends are telling us something deeper and these currencies continued to fall, we would need to reconsider. We don't think it plays out that way. China steel production grew 8% y/y in the fourth quarter, Korean shipbuilding activity is strengthening somewhat and engineering & construction firms continue to sport strong order books and project activity. Additionally, European industrial production for export markets is stronger and machine tool builders are active. In the end we continue to see solid growth in the global economy.

Oil & Gas. Chatter persists of slowing capital spending activity as large oil companies focus on driving returns and efficiency. General Electric Oil & Gas equipment orders were down y/y, but attributable to a tough comparison. Core sales growth was up 8% and we saw growth at other companies. While pockets of slack are likely, global activity remains solid, including offshore Brazil (Petrobras), the Middle East and Russia. Within the U.S. momentum continues in pipeline building, LNG infrastructure and petrochemicals.

Mining. Still awful — fourth-quarter mining sales at Caterpillar fell 47%. Every major mining company has announced capital spending cuts of another 25-35% in 2014, and the likelihood of further cuts in the next. The silver lining is high utilization driving continued stability in consumables and service. Atlas-Copco and Sandvik saw "only" a 20% decline in 4Q.

Power Generation. Capacity is being added internationally while dormant in the U.S. GE booked 45% order growth in 4Q, including 12 steam turbines and 22 for the full year vs. only 8 in 2012. Gas turbine orders were okay — 24 units vs. 26. U.S. demand is soft overall, given economic efficiency

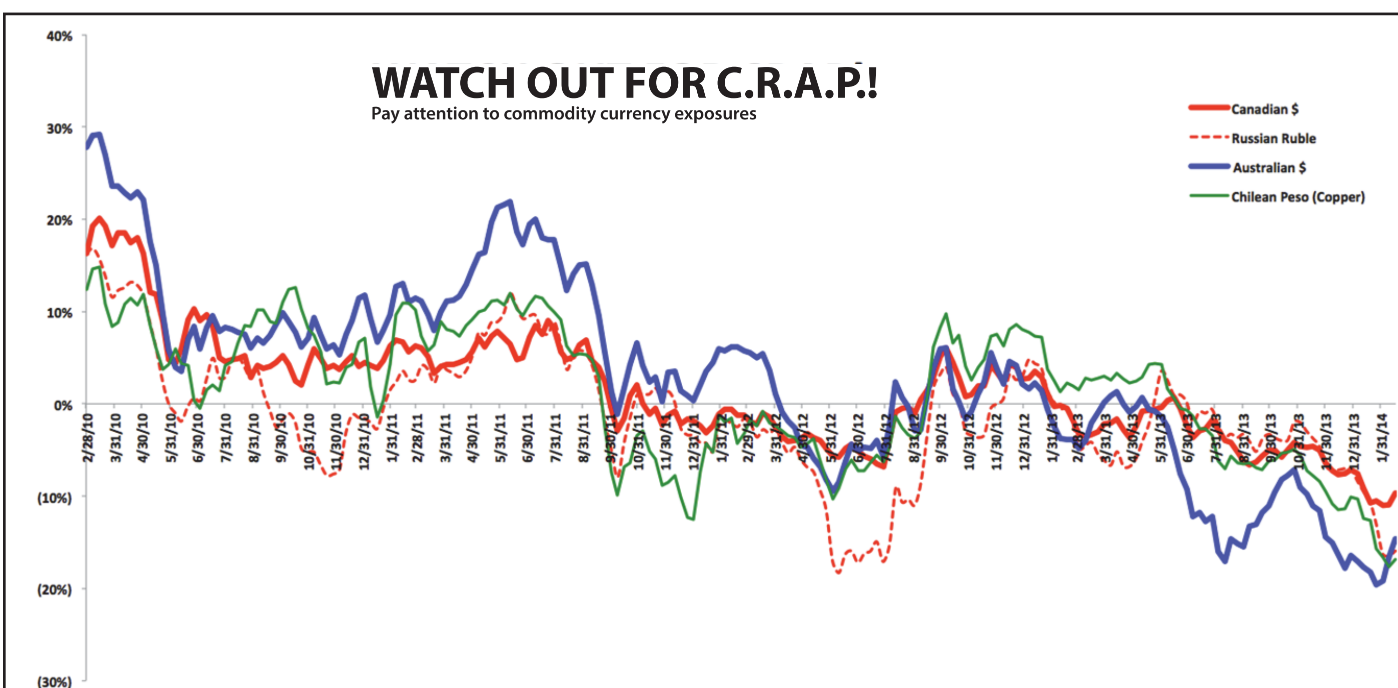

Figure 1 **China continues to grow at a solid pace, but slower by historical standards. As a result markets have sought to price in slowing emerging market demand, which in turn takes down resource currencies.**

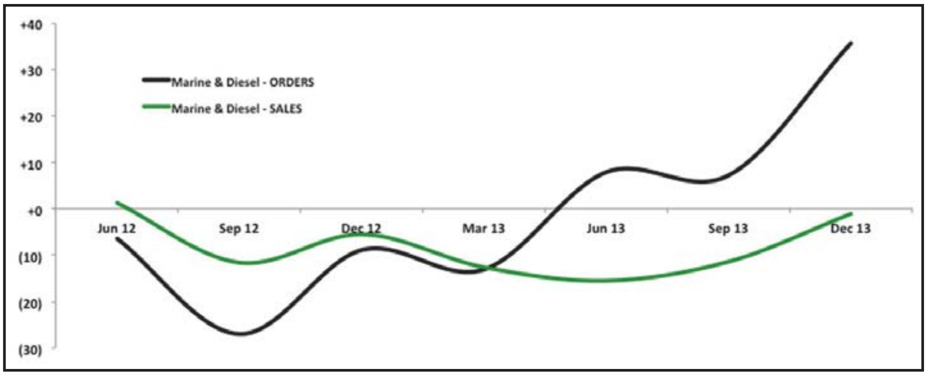

Figure 2 For those of you who sell into marine transportation, I do think the worst is over. Focus Company: Manitowoc Company (MTW)

gains and regulatory hostility to new investment. The exception is wind turbines — a.k.a. Band-Aids — with orders of 875 units in 4Q vs. 412 y/y. Wind turbines are less efficient, but cost only \$2-4M each; and nobody complains, so up they go.

Transportation Infrastructure. U.S. infrastructure spending will remain flat until *late* 2016 at the earliest, as it would require bi-partisan support and willingness to spend on *infrastructure*. But we are seeing improved shipbuilding activity, particularly energy-related LNG and offshore processing capacity. Alfa-Laval has achieved positive order growth in its Marine & Diesel segment three straight quarters now.

Water & Environmental. Municipal demand is improved with positive sales momentum the past two quarters. Improved home prices are contributing to better tone; industrial markets are stable.

Machinery. Overall picture continues to improve — particularly in truck as well as construction equipment. **Construction equipment** – Caterpillar reported 24% growth in 4Q and the industry outlook for '14 is +5-8%. Growth was broad-based: OSK commercial +9%, United Rentals +7% and Manitowoc Company are bullish on 2014 orders. **Mining equipment** remains dismal as miners are projecting 25-35% reductions in capital spending and straining to conserve cash — particularly U.S. coal miners. **Truck**: Continuing growth and acceleration, driven by replacement demand and new product launches versus fleet growth.

Agricultural Equipment. John Deere is calling for 4-6% declines in their fiscal 2014, and we suspect that with declining farm income and a push out of an ethanol mandate that it could be even a bit softer. The international growth focus remains Brazil, Russia and (for AGCO) Africa.

Consumer (auto, appliances). Expect continued strength in automotive production — even as expansion capital spending has flattened out at a high level. Despite some concerns about capacity, we maintain the fleet is old so utilization will remain high. Demand for appliances remains strong, as does refurbishing activity.

Aerospace/Defense. Commercial aviation remains strong at GE Aircraft Engines and Pratt & Whitney, with growth in OE, spares and shop visits as the heavy overhaul work is finally hitting. No reason for conditions to soften. Defense — while the worst is over, the trends should remain soft.

And rather than displaying our Global Industrial Dashboard this time — take a look instead at the improving orders and sales trends for the Marine & Diesel division of Alfa Laval. While freight rates in global shipping remain hideous, there *is* activity – much of it LNG, offshore energy-related — but shipyard work is strong, and on the power generation side there are environmental systems retrofits and power plant related work.

Late-cycle, big-construction projects — wind, power plants, non-residential construction — they all need BIG CRANES. Manitowoc Company was founded as a shipyard in 1905 and now operates in two segments – Crane and Foodservice. Crane orders were up 42% in the fourth quarter — even as backlog fell on improving throughput. But the future is bright; wind turbine activity is already strong, construction markets continue to improve and non-residential construction should uptick in 2014. Globally we see improving demand for cranes, particularly in the Middle East, but also better in Europe.

The company launched 10 new crane products at ConExpo in March, and we suspect the company can generate strong revenue growth in 2014 and beyond.

(Our Integrated Company Dashboards (ICD) will give a better sense of these trends. These analyses are available on our website for \$199, but readers of *Power Transmission Engineering* magazine can email me directly at Brian@Langenberg-llc.com and ask for a copy by putting "*PTE* Offer" in the subject line and the ticker for which company they want – choose 1 from: ALFA.IX, AME, ATCOB.IX, CAT, CMI, DOV, EMR, HON, MMM, MTW, ROK, SDVKF, SKFB, UTX, or XYL. We also offer subscriptions at special rates for *PTE* subscribers.) **PTE**

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