# Back to Work

By Brian Langenberg, CFA

Little has changed since our prior installment, "DAS (HUMAN) KAPITAL," which is to say August is a slow month with very few reads from companies.

Kennametal reported 5% core order growth for three months ending July 31, the sixth straight month of positive growth. Is this meaningful? Our Kennametal orders analysis indicate easy comparisons should drive positive "growth," at least through October, but growth against weak comparisons isn't really growth. Sometimes, in order to get the right perspective, you have to take a wider view of the situation (see Figure 1). As we wrote in our blog (*thefirstshift.langenberg-llc.com*), a few points stand out:

1. Kennametal core orders went negative in mid-2012 until October 2013.
2. The positive comparisons since February are "comparison" driven, not really growth.
3. Real demand remains well below peak.

Aerospace, automotive and truck markets remain positive, but we are seeing continued deterioration in agricultural equipment (lower production and layoffs at Deere).

The reality of current and near-term demand growth was borne out in last quarter earnings releases where several heavy machinery companies missed forecasts (Fig. 2).

Manufacturers of construction equipment, in particular, continue to see "just in time and just enough" buying behavior from rental houses and E&C companies. The three big potential drivers, along with our outlook:

- Highway Bill – unless 10-15 bridges collapse, nothing before '17.
- Non-residential Construction – ABI index consistently positive; expect some growth in '15.
- Power Generation – weak electricity demand, regulation = little US activity except wind.

**Figure 1** **Here is the wrong way to study orders and sales trends.**

Updated views on end markets:

***Oil & Gas***: Offshore should accelerate in (late) 2015, possibly closer to 2016. Closer to home, midstream expansion continues to support upstream production (from hydraulic fracturing) to refineries and increasingly exports (condensate recently approved).

***Mining***: Still wretched, but the worst is over. Don't expect a rapid upturn given awful coal market conditions exacerbated by weak China demand for iron ore, coal and capital. Offsetting these challenges are capacity cuts and narrowing losses at some miners.

***Power Generation***: No change. Wind is solid, natural gas up, coal dead.

***Transportation Infrastructure***: Stagnant.

***Water & Environmental***: Municipal budgets and tax receipts are funding catch-up capital spending, not real growth.

***Machinery***: Expect continued growth in truck, stability to modest growth in construction equipment and slowing agricultural equipment production.

***Consumer (auto, appliances)***: Auto demand will remain strong, and improving home prices signal gradual improvement in construction equipment.

***Aerospace/Defense***: Commercial air transport remains strong, and the recent Farnborough air show yielded strong orders for Boeing, General Electric and United Technologies. Aftermarket activity remains robust. Defense related declines have moderated, and war is, unfortunately, not obsolete.

Focus Company: Atlas-Copco

Atlas-Copco is a premier industrial machinery company with extremely strong global market shares in industrial compressors, mining and rock project engineering, equipment, parts and service. Following the company gives us a great read on short-cycle and late-cycle activity as well as mining. Even better — we get geographic detail by segment.

Mining has proven a major sales drag. In 2Q it represented 27% of rev-

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| MACHINERY | TICKER | SURPRISE REV | SURPRISE EPS | STOCK STK | STOCK MKT | CONSENSUS REV | CONSENSUS EPS | ACTUAL REV | ACTUAL EPS |
|---|---|---|---|---|---|---|---|---|---|
| Caterpillar | CAT | (2) | +11 | (2) | +0 | 14,450.0 | 1.52 | 14,150.0 | 1.69 |
| Manitowoc Company | MTW | (4) | (17) | (13) | (1) | 1,050.0 | 0.42 | 1,013.0 | 0.35 |
| Terex Corporation | TEX | +5 | (6) | (9) | +0 | 1,960.0 | 0.81 | 2,055.1 | 0.76 |
| Oshkosh Corporation | OSK | +1 | (10) | (10) | +0 | 1,920.0 | 1.37 | 1,930.0 | 1.23 |
| United Rentals | URI | +3 | +15 | +6 | +0 | 1,358.0 | 1.43 | 1,399.0 | 1.65 |
| Cummins | CMI | +0 | +2 | (3) | +0 | 4,820.0 | 2.39 | 4,835.0 | 2.43 |
| PACCAR | PCAR | +4 | +1 | +2 | +0 | 4,410.0 | 0.89 | 4,570.0 | 0.90 |
| Sandvik | SDVKF | (1) | (8) | -- | -- | 22,250.1 | 1.32 | 22,051.0 | 1.22 |
| SKF | SKFB.SS | +1 | (13) | -- | -- | 17,836.0 | 2.93 | 17,955.0 | 2.54 |

Source: Langenberg & Company

**Figure 2** A number of heavy machinery companies have missed their forecasts recently.

enue and fell (19%) year over year but rose 2% quarter over quarter. On the positive side, orders are finally stabilizing, albeit at a low level. This is consistent with our views on mining.

The $64,000 question remains late-cycle, heavy capital investment that supports demand for construction equipment and heavy machinery. Consistent with our Kennametal commentary, the picture is mixed.

Here is what we gleaned from the Compressor Technique segment.

- Small- and medium-size compressor orders have remained in a modest uptrend. These are a good read on short-cycle industrial (maintenance capital spending, replacement demand).
- Larger machine orders fell for the 5th straight quarter. Market remains dead.

Multiple headwinds. China is rooting out corruption, which means decision makers are running scared, not ramping big projects. Latin America is off, and both Europe and the Middle East have war on their hands.

The best growth market, perhaps in spite of ourselves, is the United States. **PTE**

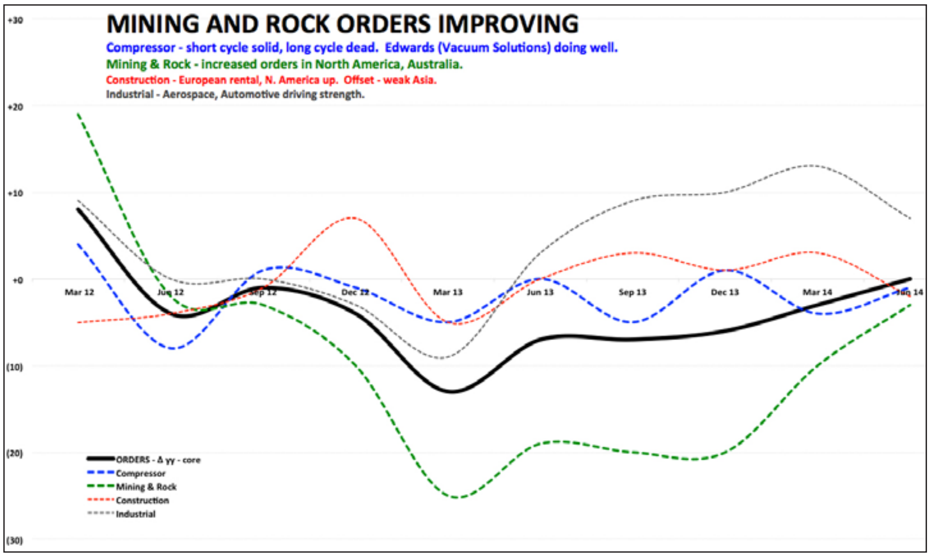


**Figure 3** Mining and Rock Orders Improving.

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**Brian K. Langenberg, CFA,** has been recognized as a member of the Institutional Investor All-America Research Team, a *Wall Street Journal* All-Star, and *Forbes/Starmine* (#1 earnings estimator for industrials). Langenberg speaks and meets regularly with CEOs and senior executives of companies with over $1 trillion in global revenue. His team publishes the *Quarterly Earnings Monitor/Survey*—gathering intelligence and global insight to support decision-making. You can reach him at *Brian@Langenberg-llc.com* or his website at *www.Langenberg-LLC.com*.