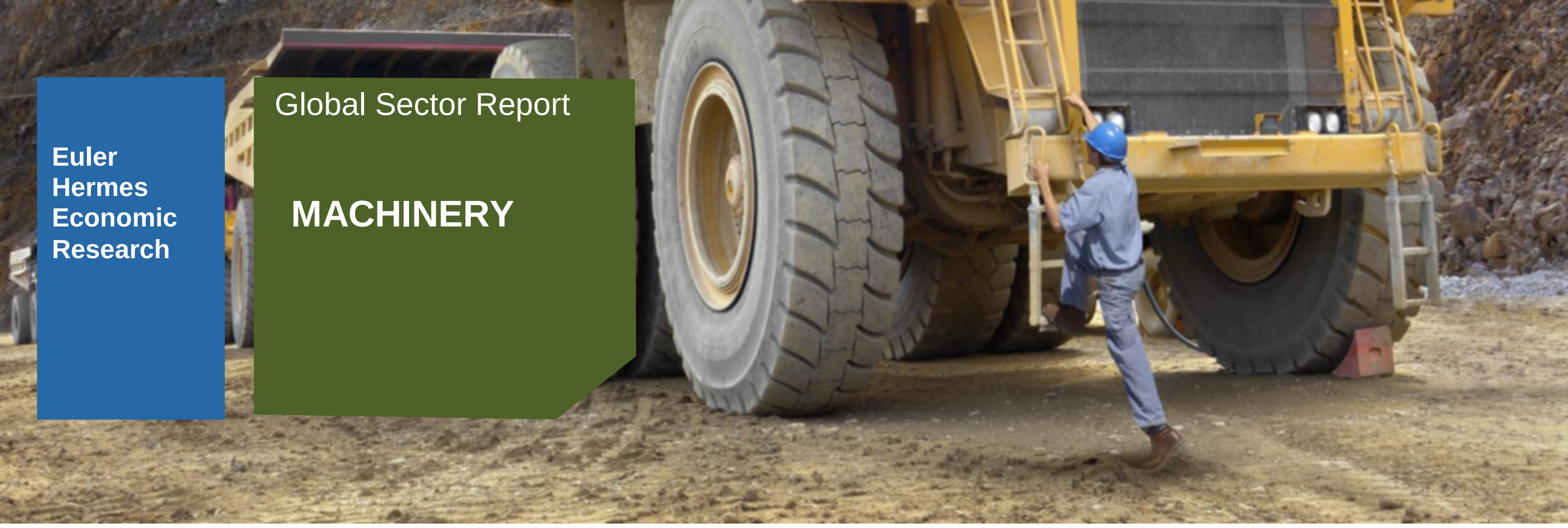
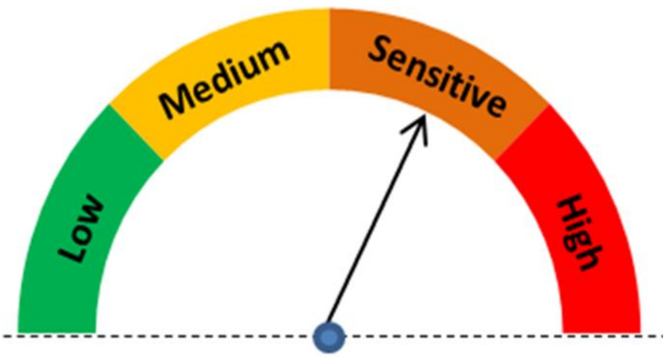


Euler Hermes Economic Research

Global Sector Report

MACHINERY

Sector Risk Rating



What to Watch?

- Reflation and Fed rate hikes to increase input and financing costs. This could result in further cash flows deterioration if revenue growth is insufficient where activity is resuming
- Companies' ability to grow order books as the Construction and Energy sectors are set to be in a better shape in 2017
- Currency pressures should be monitored. We expect volatility against the USD in a context of diverging monetary policies

Time for agility as revenues and input costs face a spike

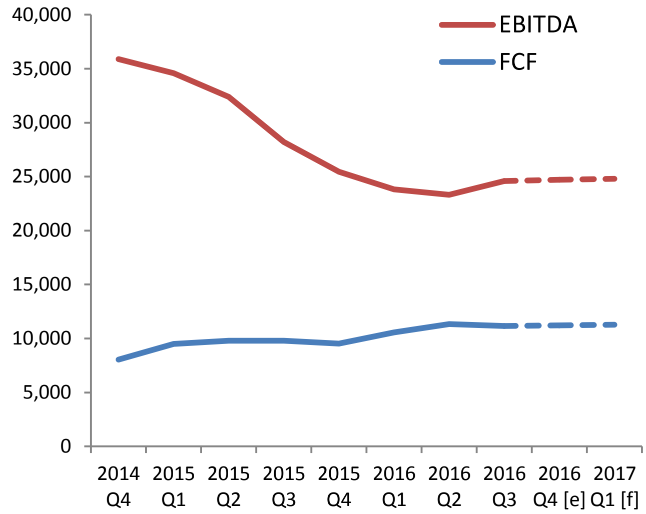
The median revenues of machines manufacturers suffered a -12.7% drop in 2016 (after -2.4% in 2015). This reflects the progressive depletion of backlogs over the period as protracted low prices deterred investment decisions by clients from outlet sectors (for example construction and energy). This resulted in a decline in new orders.

As a consequence, Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA) has kept decreasing since mid-2014. EBITDA in 2016 stood at 20% below 2015 level.

The stabilizing Free Cash Flow (FCF), therefore, stems from cash management rather than activity. Indeed, cash inflows have improved thanks to a tighter management of working capital requirements: inventories were down -15 days due to lower income and accounts payables were up +11 days, reflecting longer payment days to suppliers. Investments outflows have decreased -5% and are set to stabilize in 2017.

We forecast revenues to rise by a mere +1% in 2017 as investments are not set to surge. Yet longer-run prospects are more favorable. Oil-related investments should eventually resume (+4%) while the Construction sector is set to take off and boost the Machinery sector.

Operating profit and Free Cash Flow of Bloomberg Intelligence panel companies, rolling 4 quarters in USDbn



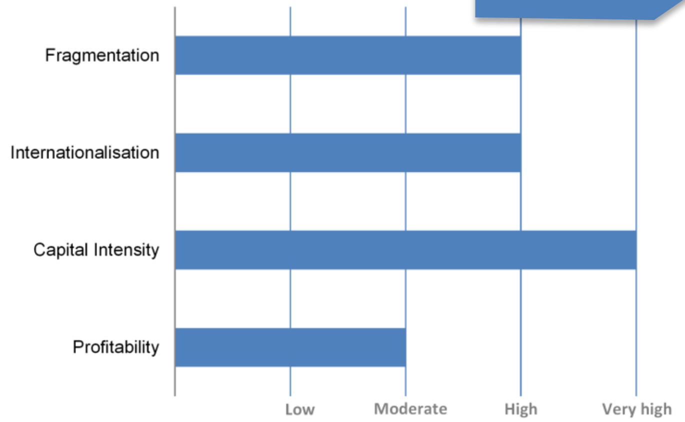
Sources: Bloomberg Intelligence, Euler Hermes calculations
Global Machinery Bloomberg Intelligence panel comprises 45 companies of the sector

Key Players

Country	Role	Sector Risk
China	#1 producer #1 exporter #2 importer	
United States	#1 importer #2 producer #3 exporter	
Germany	#2 exporter #3 importer	

ID Card

Sector Value:
2,178bn
USD



Strengths

- High-end technology and skilled labor requirements leave little room for new market players. Established leaders have little reason to worry about fresh competition
- Long-run business cycle serves as a buffer to short-term market variations

Weaknesses

- Dependence on structural trends of end sectors such as Manufacturing, Oil & Gas, Construction, and Agrifood
- High financing requirements to fund R&D and capital expenditures

Subsectors Insight

Mining and Energy: Exploration & Production capital spending should rise by +4% in 2017, after tumbling by -31% in 2016 in accordance with recovering oil price.

Construction: A growing divide between improving advanced markets and less buoyant emerging markets.

Agriculture: Recovering Agrifood commodities price (+12% y/y in December 2016) should trigger more investment decisions in 2017.

Recent Sector Risk Changes

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Contact Euler Hermes Economic Research Team
research@eulerhermes.com

Last review: February 2017
Sector Risk Analyst: Farah Allouche
farah.allouche@eulerhermes.com