

# **U.S. Machinery/Multi-Industry What Lies Ahead For Capital Goods**

Bear, Stearns & Co. Inc.

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**Machinery/Multi-Industry Sector Rating: Market Weight**

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\*\*\*Investors should consider this report as only a single factor in making their investment decision.

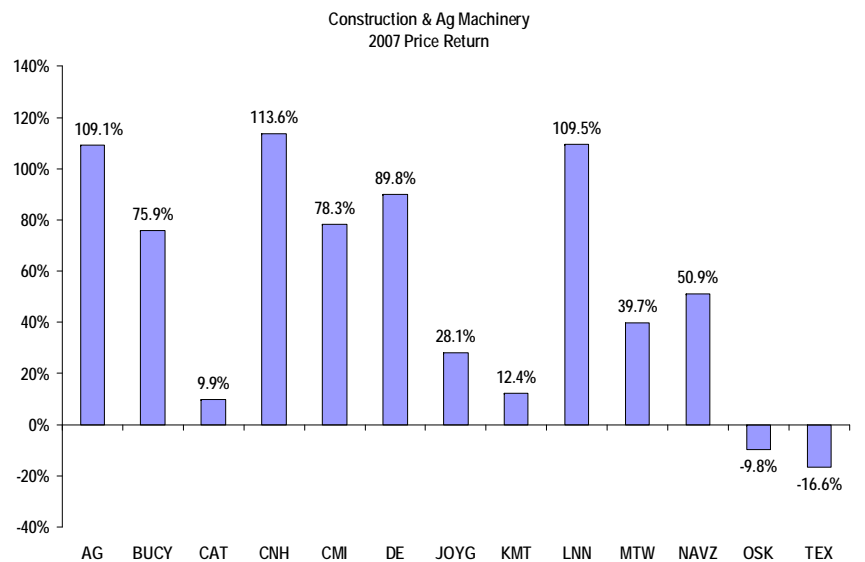
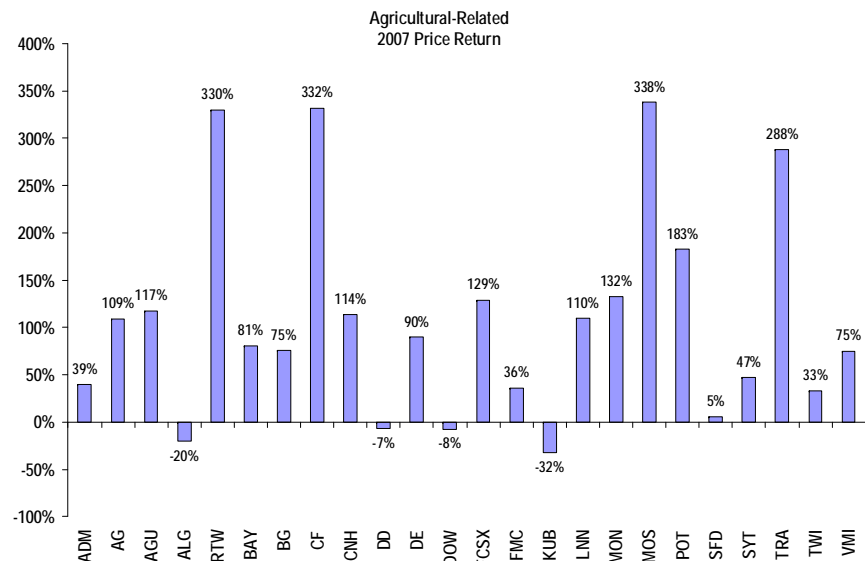
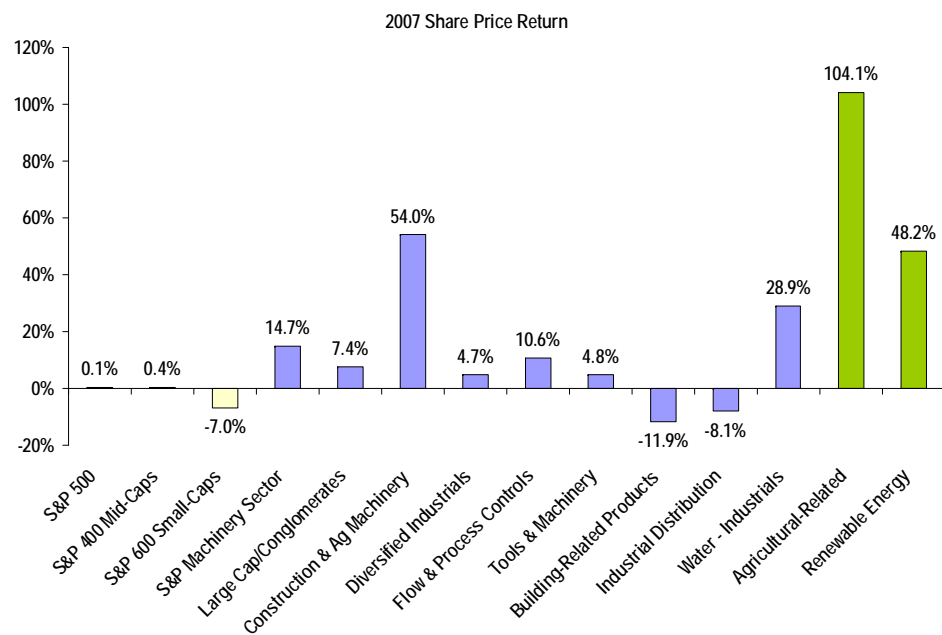
\*\*\*PLEASE READ THE IMPORTANT DISCLOSURE AND ANALYST CERTIFICATION INFORMATION IN THE ADDENDUM SECTION OF THIS REPORT.

## Construction/Ag Machinery Best Performer 2007 +54%

Sector	Price Return				Div Yield	P/E 2008	EPS Growth		
	Weekly	YTD	2007	YTD'08			2006	2007E	2008E
<b>S&amp;P 500</b>	<b>-1.9%</b>	<b>-3.3%</b>	<b>0.1%</b>	<b>-3.3%</b>	<b>1.9%</b>	<b>14.4</b>	<b>16%</b>	<b>4%</b>	<b>7%</b>
S&P 400 Mid-Caps	-4.0%	-5.9%	0.4%	-5.9%	1.4%	NA	NA	NA	NA
S&P 600 Small-Caps	-3.6%	-5.8%	-7.0%	-5.8%	1.1%	NA	11%	NA	NA
Large Cap/Conglomerates	-4.5%	-6.3%	7.4%	-6.3%	2.1%	14.2	14%	11%	13%
Const. & Ag Machinery	-8.5%	-9.1%	54.0%	-9.1%	0.7%	14.2	51%	37%	30%
Diversified Industrials	-8.2%	-10.1%	4.7%	-10.1%	1.6%	13.2	16%	13%	15%
S&P Machinery Sector	-7.7%	-10.1%	14.7%	-10.1%	1.4%	12.8	21%	14%	14%
Flow & Process Controls	-5.5%	-7.6%	10.6%	-7.6%	1.0%	15.8	29%	23%	17%
Tools & Machinery	-7.7%	-11.4%	4.8%	-11.4%	1.5%	12.4	43%	19%	19%
Building-Related Products	-4.3%	-6.9%	-11.9%	-6.9%	2.1%	12.4	13%	0%	7%
Industrial Distribution	-6.8%	-10.3%	-8.1%	-10.3%	1.8%	12.3	20%	18%	15%
Water - Industrials	-3.9%	-5.0%	28.9%	-5.0%	0.9%	20.5	8%	26%	26%

Sources: FactSet (priced at 4pm); Bear Stearns & Co., Inc.

## Ag Related Sector Outperforming

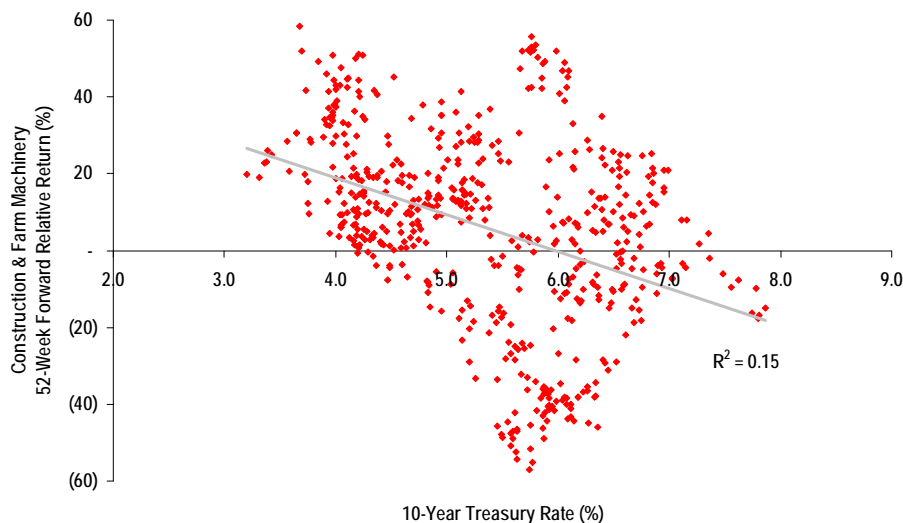


## **Our Outlook For 2008**

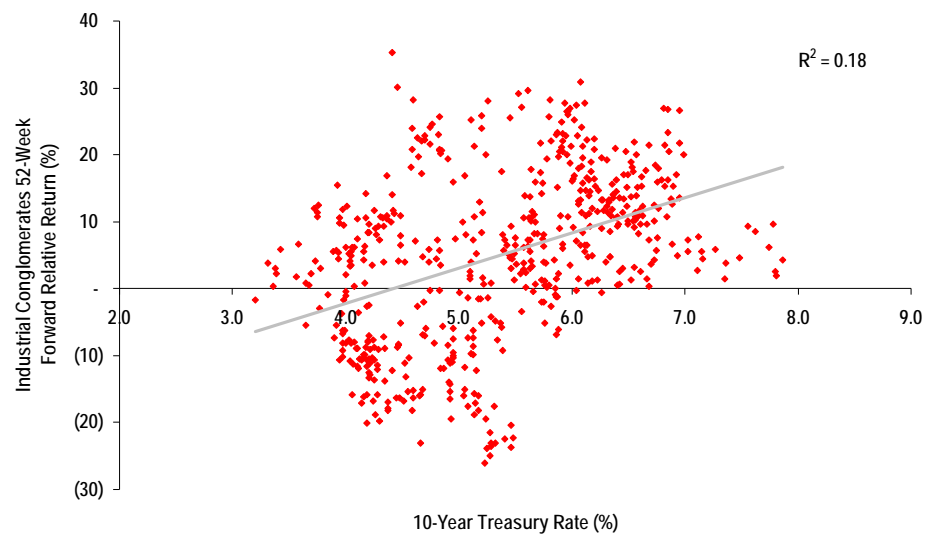
- **Mixed macro environment outlook for the machinery group**
  - If we have a recession, lower interest rates could provide cheap capital; inflation may become an issue
  - A weakening ROW is less able to offset U.S. weakness
  - Weak dollar is marginally a positive for the group
- **Easy comparables exist for H1'08 in several machinery-related sectors**
  - Housing starts tumbled in Q1'07
  - Auto and Truck production expected to be past trough also
- **So the key for investors is lower beta (less cyclical), more defensive names vs. higher beta names leveraged to “recovering” end markets**
  - We prefer stocks with company-specific catalysts
- **Additionally, we like the Agriculture sector**
  - Corn, soybean, and wheat prices are near historical highs as global inventories are close to or approaching historical lows
  - Growth in biofuels expected to continue on a worldwide basis
  - 2007 Energy Bill will likely set a new biofuels mandate—36 BGY by 2022

# We Are Cautious On The Group As The Machinery Sector Tends To Underperform When LT Rates Rise

Construction & Farm Machinery 52-Week Forward Relative Return (To S&P 500)  
vs. 10yr Rate (1995 - Present)

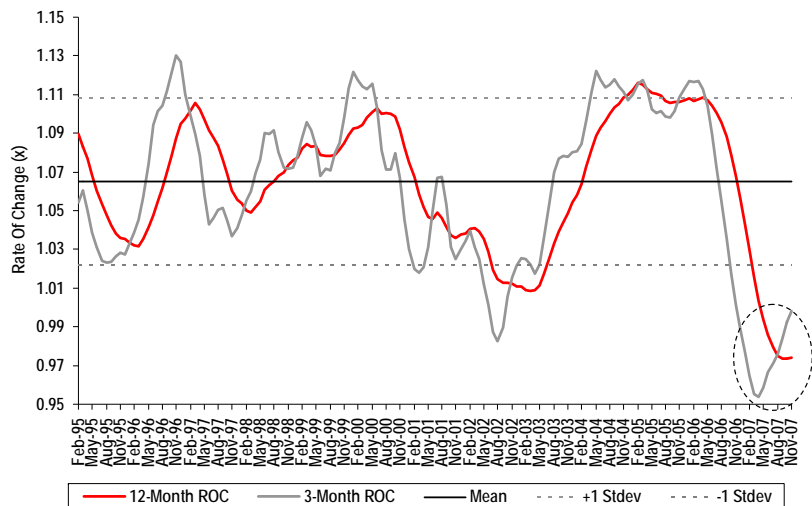


Industrial Conglomerates 52-Week Forward Relative Return (To S&P 500)  
vs. 10yr Rate (1995 - Present)

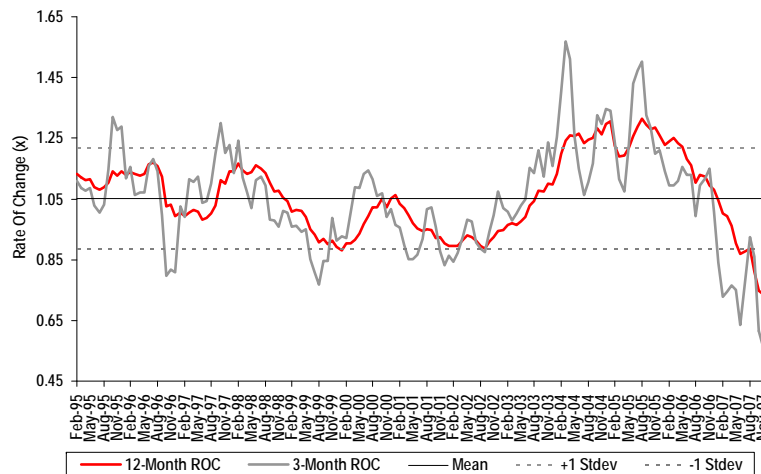


## Potential Recovery In Residential Construction Offset By Likely Decelerating Non-Res Construction

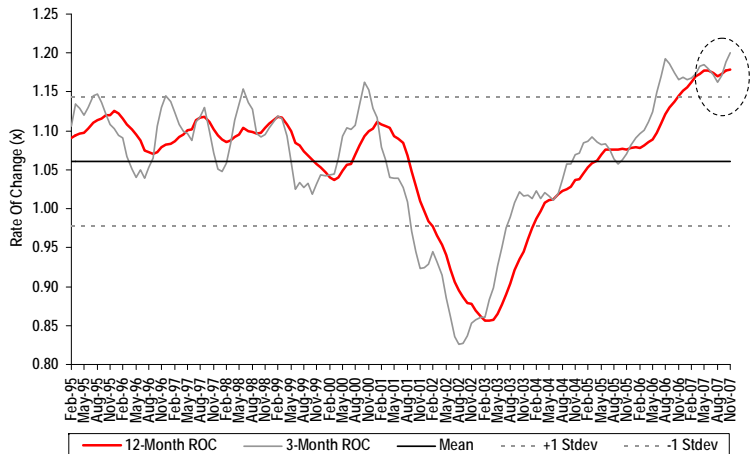
Total Construction - Value Put In Place, SA



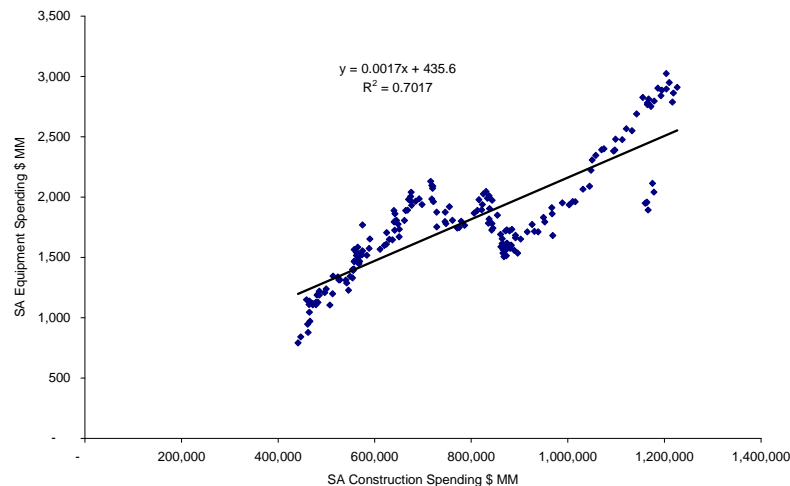
Construction Equipment - New Orders - SA



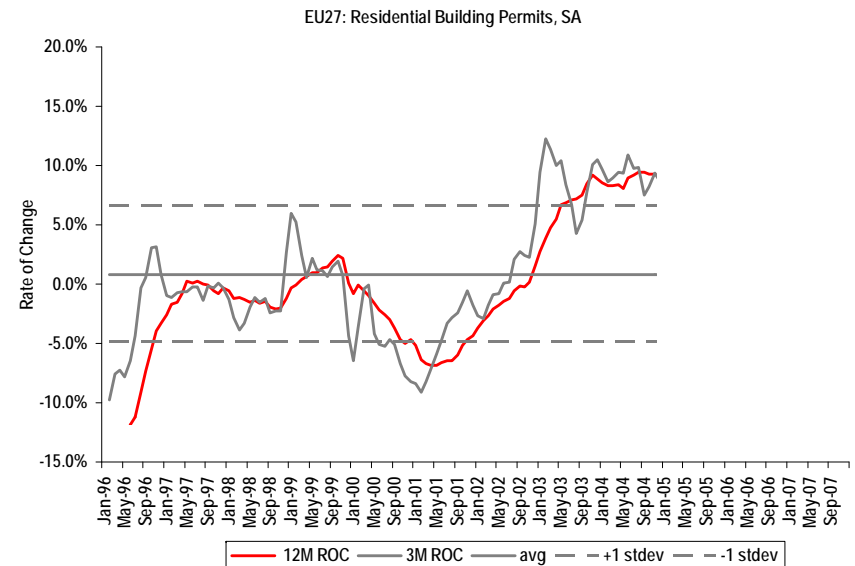
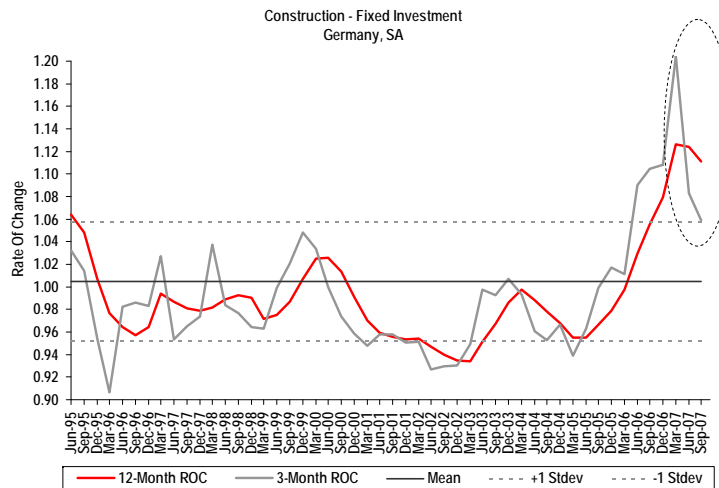
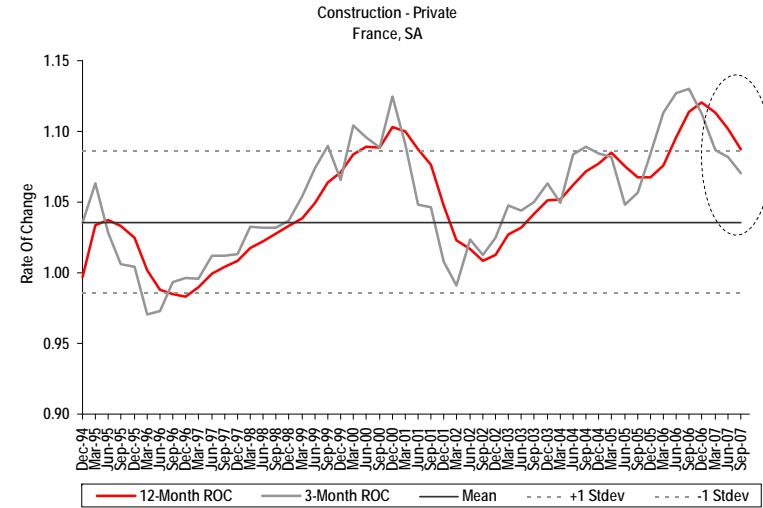
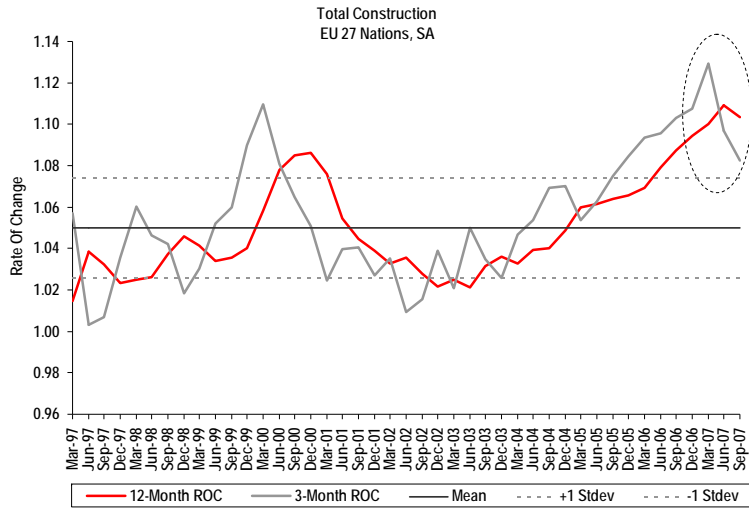
Non-Residential Total  
Private Construction - Value Put In Place, SA



Correlation Construction Equipment Shipments with Total Construction Spending

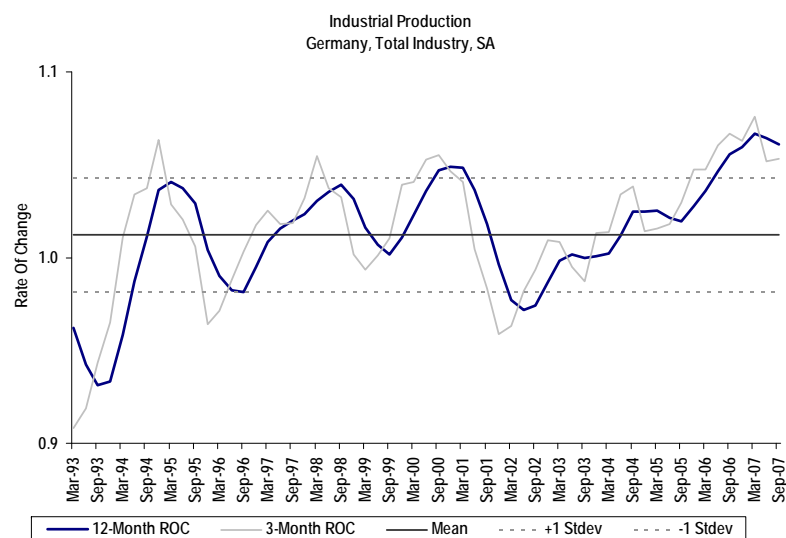
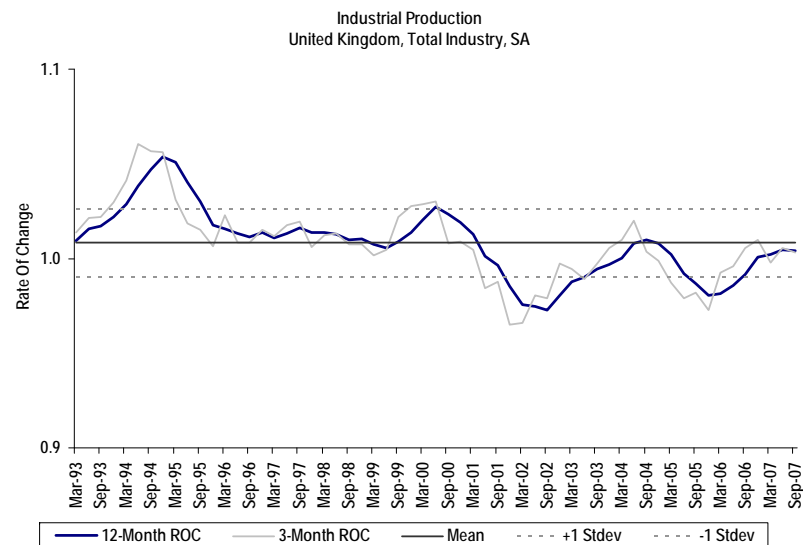
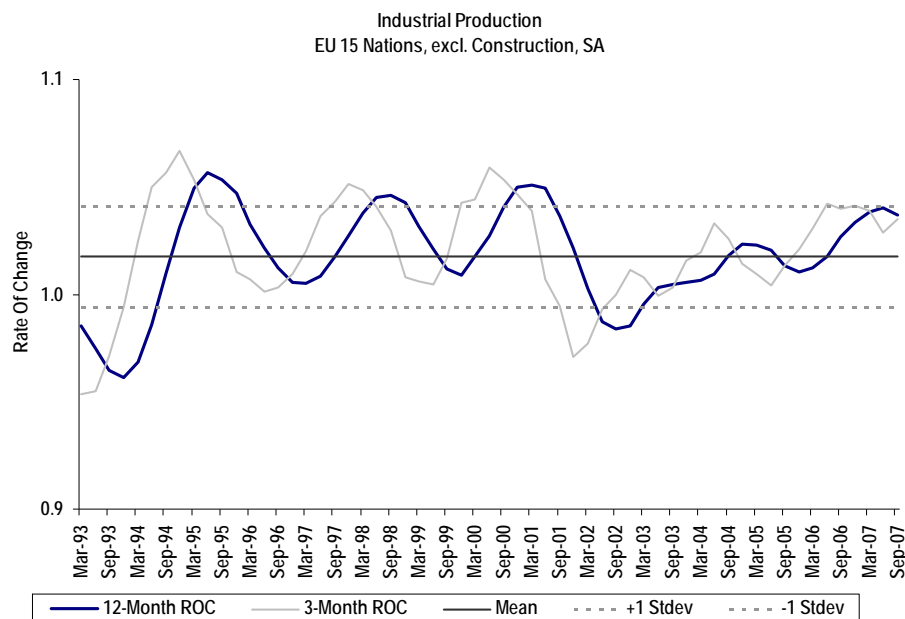


## Though EU Construction Served As Recent Tailwind, It Is Decelerating...

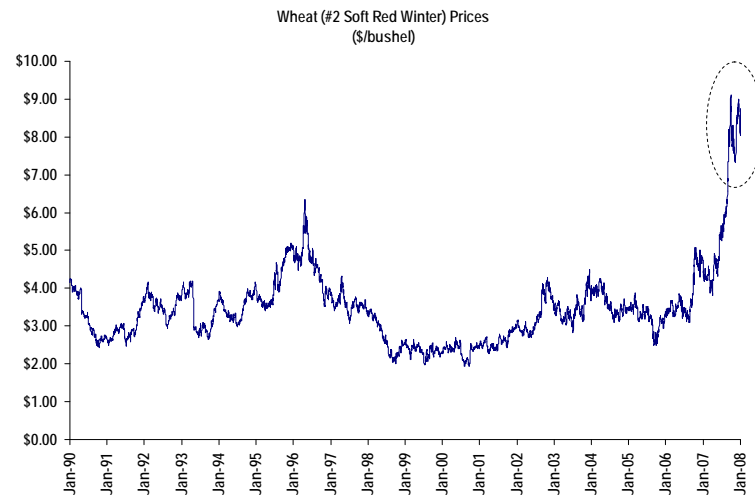
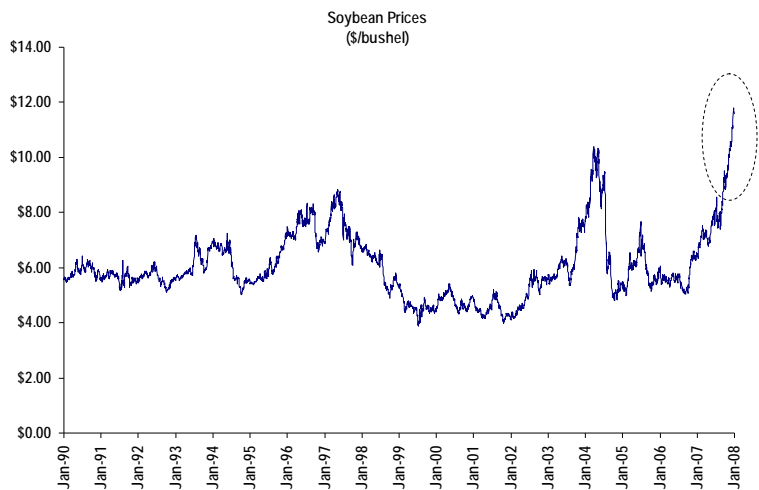


Sources: Haver Analytics, Bear Stearns & Co., Inc.

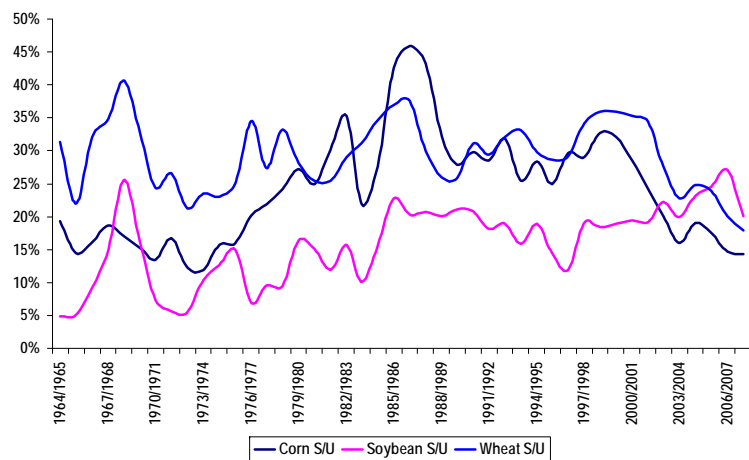
## ...As Is Industrial Production Likely Due To Reduced Exports As A Result Of A Stronger Euro



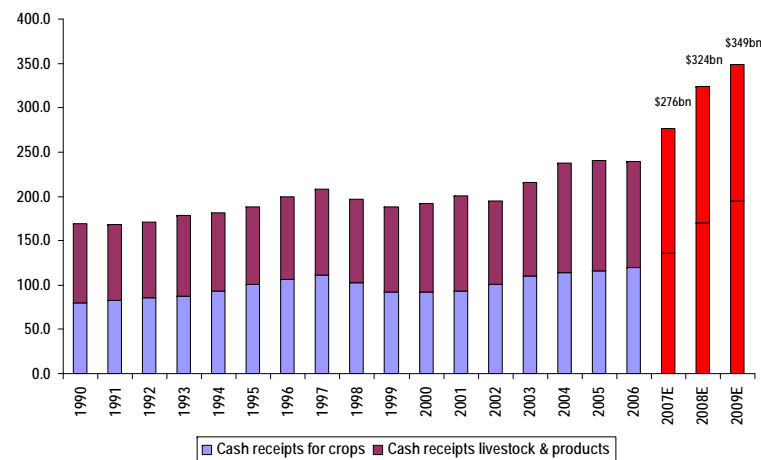
## We Believe The Ag Sector Is Uniquely Positioned To Outperform



Global Stocks-To-Use



Total Farm Cash Receipts



BSC Forecast

## **We Prefer Stocks With Company Specific Catalysts And The Ag Sector**

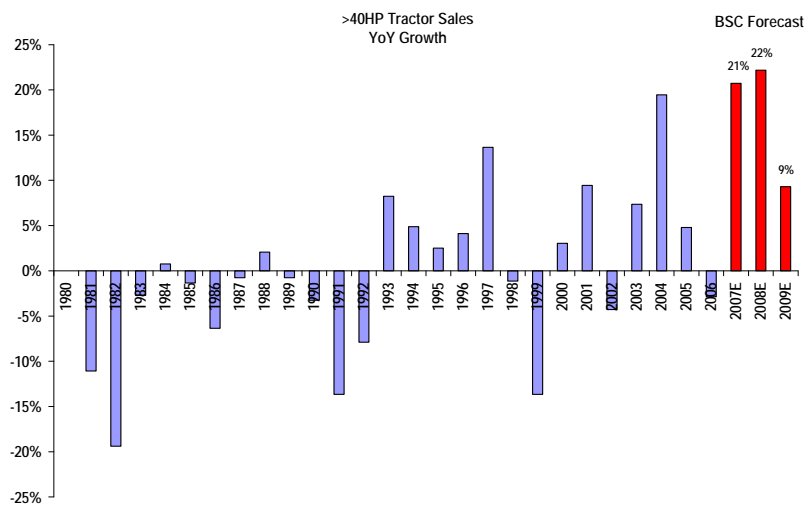
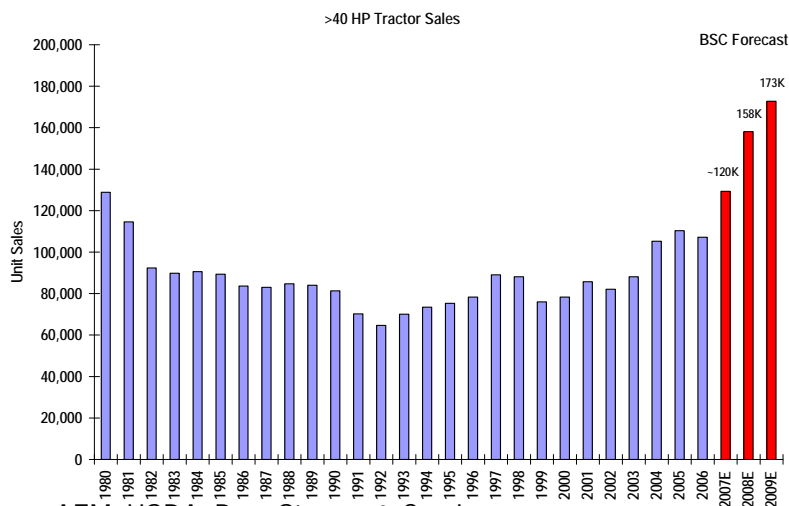
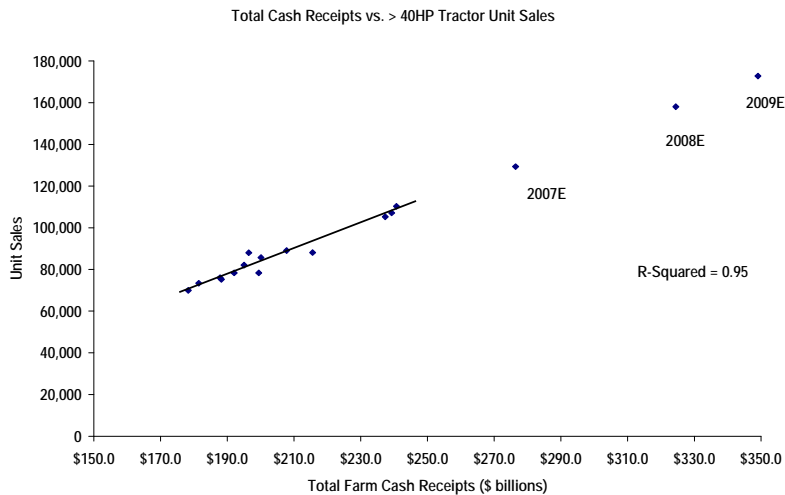
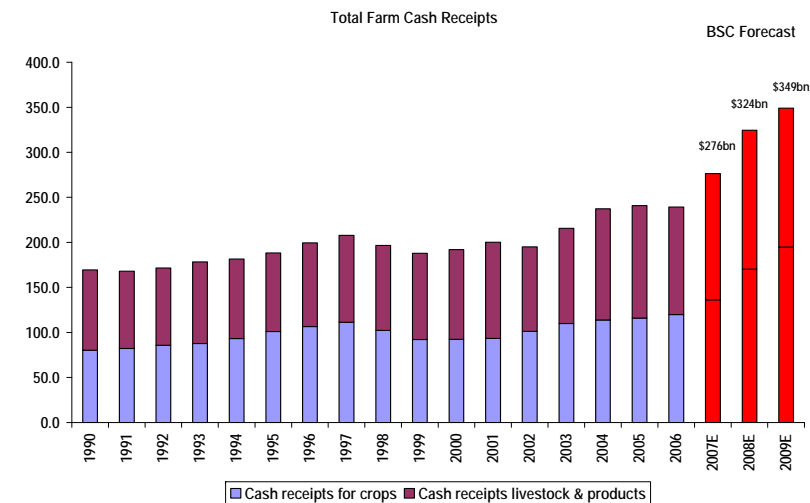
- **DE, CNH and AG will likely benefit from the agricultural cycle driven by global biofuel demand which is pushing commodity prices higher**
  - AGCO –best play on Brazil. TP \$70
  - DE/CNH- benefit more from U.S. trends. TP DE: \$99; CNH \$70
- **DHR: Should benefit from the reduced competition of acquisitions as it is valued on Rel P/S. TP \$98**
- **IR: While the market reacted negatively to the TT acquisition, in our view, it is a good deal LT as TT broadens IR's portfolio and should result in a higher multiple. TP \$60**
- **ETN: Should benefit from NEXT truck prebuy as well as strong late-cycle exposure. TP \$111**
- **GE: Continues to benefit from WW demand for infrastructure and will rebalance GE Capital portfolio to take advantage of market opportunities. TP \$46**

## Valuation Summary

Company Name	Ticker	Rating	Current Price 1/10	Calendar EPS>>>			P/E>>>		'07E	'08E	Enterp. Value-EBITDA	Market Cap. \$ Mil.	Return Ratios>>>		Liquidity N/Debt: Cap <sup>a</sup>	FCF>>>		Yield>>> Div Yield <sup>f</sup>	2006 Share Return	'07 YTD Share Return	'08 YTD Share Return	Weekly Share Return
				2006	2007E	2008E	2007E	2008E					EBITDA Margin	Ptax ROIC <sup>a</sup>		FCF Yield <sup>b</sup>	FCF Conv <sup>b</sup>					
Summary -- Group Averages																						
S&P 500	SPX		\$ 1,420	\$ 88.18	\$ 92.08	\$ 98.74	15.4	14.4	4%	7%								1.9%	13.6%	0.1%	-3.3%	-1.9%
S&P 400 Mid-Caps	MID		\$ 808	\$ 45.52	NA	NA	NA	NA	NA	NA								1.4%	9.0%	0.4%	-5.9%	-4.0%
S&P 600 Small-Caps	SMLK		\$ 372	\$ 20.37	NA	NA	NA	NA	NA	NA								1.1%	14.1%	-7.0%	-5.8%	-3.6%
S&P Machinery Sector							14.3	12.8	14%	14%	9.5	\$ 15,555	15.6%	23%	16%	6%	87%	1.4%	20.5%	14.7%	-10.1%	-7.7%
Large Cap/Conglomerates							16.1	14.2	11%	13%	10.0	\$ 35,581	17.6%	22%	22%	7%	102%	2.1%	10.5%	7.4%	-6.3%	-4.5%
Construction & Ag Machinery							19.0	14.2	37%	30%	10.9	\$ 9,118	13.6%	23%	18%	4%	60%	0.7%	45.6%	54.0%	-9.1%	-8.5%
Diversified Industrials							15.3	13.2	13%	15%	8.5	\$ 4,896	14.6%	17%	32%	6%	97%	1.6%	12.4%	4.7%	-10.1%	-8.2%
Flow & Process Controls							18.9	15.8	23%	17%	10.6	\$ 2,285	16.9%	17%	21%	5%	91%	1.0%	25.3%	10.6%	-7.6%	-5.5%
Tools & Machinery							15.2	12.4	19%	19%	7.8	\$ 2,021	13.4%	23%	11%	5%	69%	1.5%	23.0%	4.8%	-11.4%	-7.7%
Building-Related Products							13.0	12.4	0%	7%	7.1	\$ 4,217	13.3%	21%	35%	10%	120%	2.1%	11.5%	-11.9%	-6.9%	-4.3%
Industrial Distribution							14.0	12.3	18%	15%	7.7	\$ 2,614	11.7%	29%	4%	5%	74%	1.8%	8.6%	-8.1%	-10.3%	-6.8%
Water - Utilities							27.7	23.3	-3%	15%	12.5	\$ 458	35.3%	7%	48%	-3%	-102%	2.5%	5.6%	-3.9%	0.3%	1.3%
Water - Industrials							26.3	20.5	26%	26%	13.5	\$ 3,694	13.7%	20%	2%	4%	75%	0.9%	25.7%	28.9%	-5.0%	-3.9%
Agricultural-Related							25.4	18.2	52%	34%	14.1	\$ 16,004	15.2%	20%	16%	2%	39%	0.7%	39.5%	104.1%	-1.1%	-3.0%
Renewable Energy							50.2	40.1	-2%	59%	15.0	\$ 3,532	14.7%	-9%	-29%	-17%	9%	0.7%	-6.6%	48.2%	-4.6%	-10.1%
Average (w/o min/max)							19.2	15.7	16%	20%	10.5	\$ 6,394	14.9%	19%	18%	4%	70%	1%	18.3%	16.1%	-7.1%	-6.0%
Sector Min / Max							13/50	12/40	-3/52	7/59	7/15		12/35									

# **The Agricultural Sector**

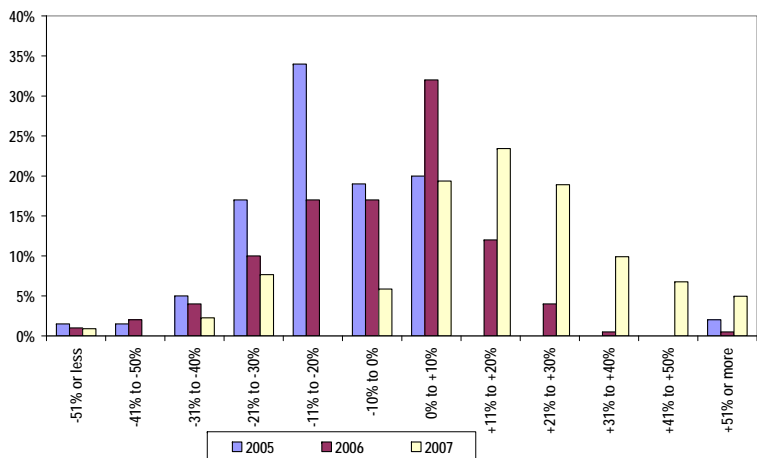
## Record U.S. Farm Cash Receipts Will Likely Lead To Record Equipment Sales In 2008 And 2009



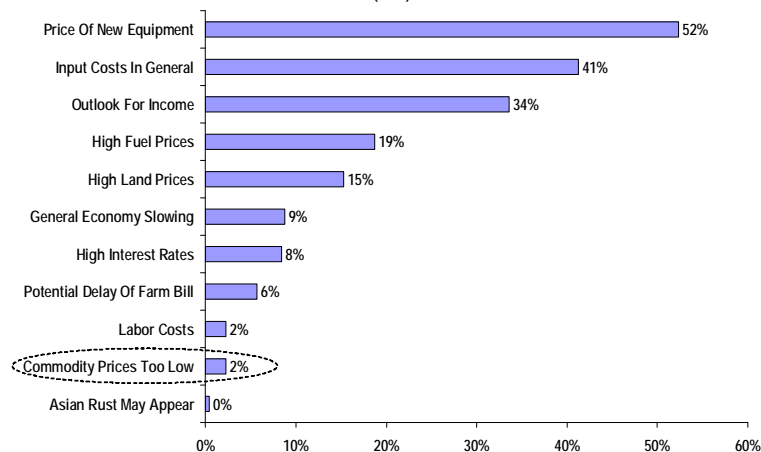
Sources: AEM, USDA, Bear Stearns & Co., Inc.

## Farmers Are Upbeat This Year And Focus On Volume Times Price...Will Spend On Equipment

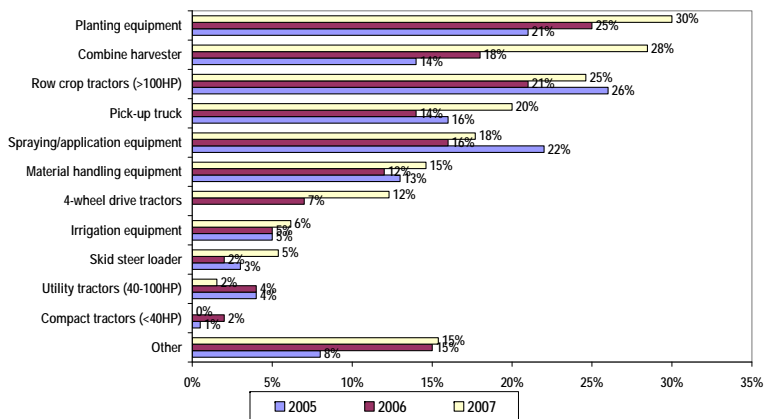
Do You Expect To Earn More Money This Year Than Last Year?  
Survey Responses In 2005, 2006, 2007



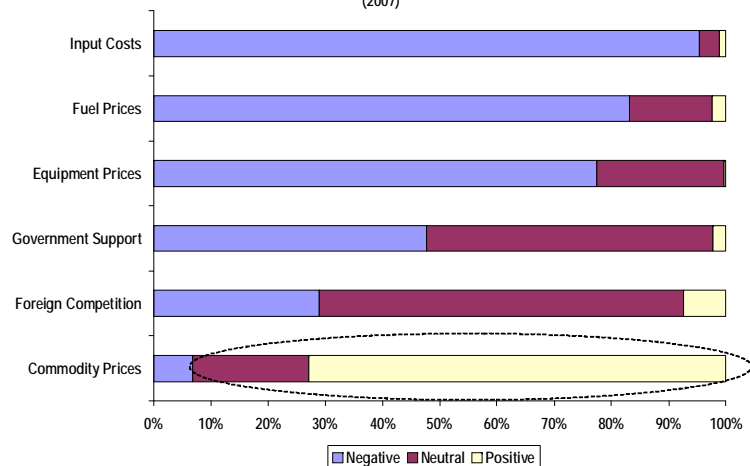
If You Are Undecided About Purchasing Equipment, What Is Holding You Back?  
(2007)



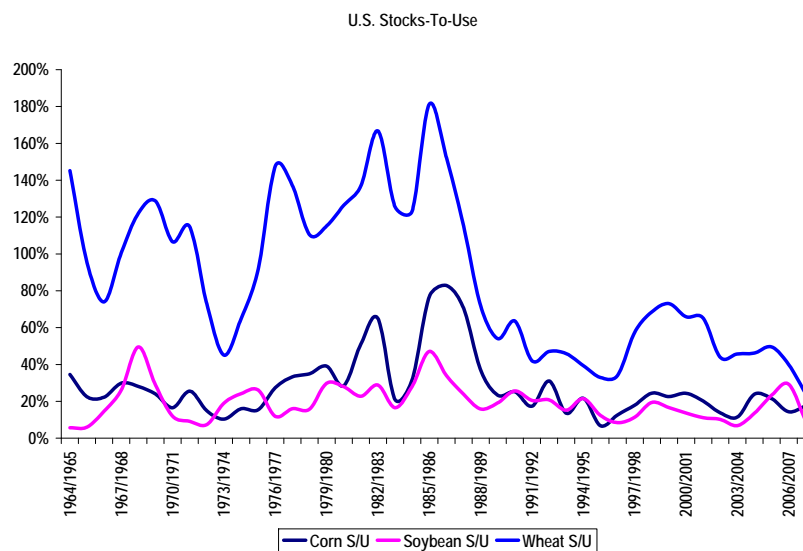
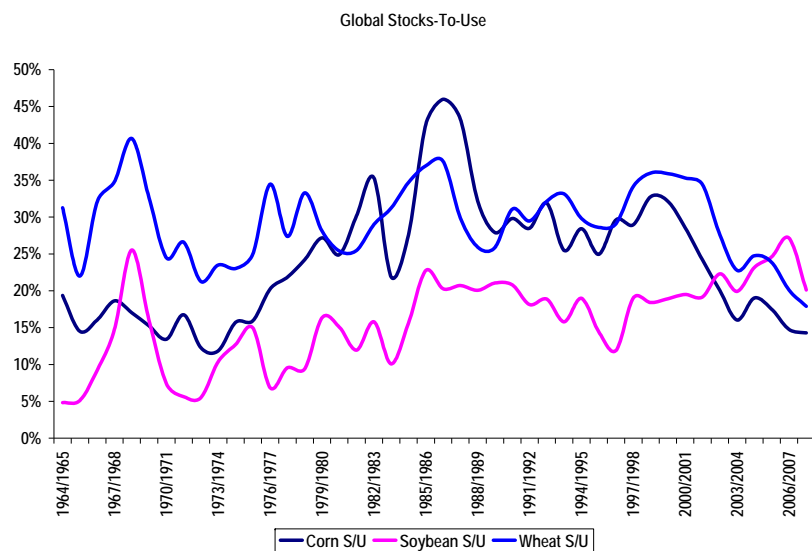
If You Are Planning To Purchase Or Have Already Purchased Equipment THIS YEAR,  
What Will, Or Did, You Buy? Survey Responses In 2005, 2006, 2007



How Do You Feel About The Future Of Each?  
(2007)

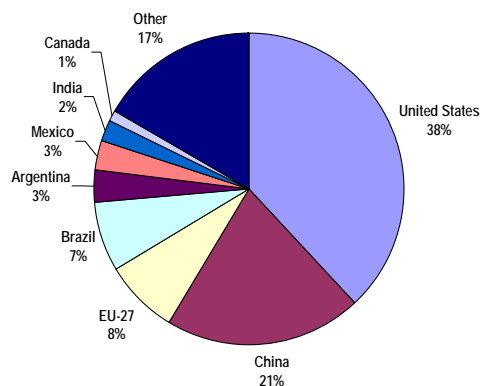


## Lower Ending Inventories For Corn, Soybeans, And Wheat

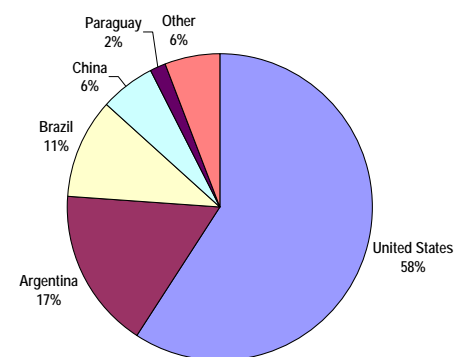


## Strong Demand For Corn By Ethanol Continues To Push Corn Prices Close To \$5/Bushel

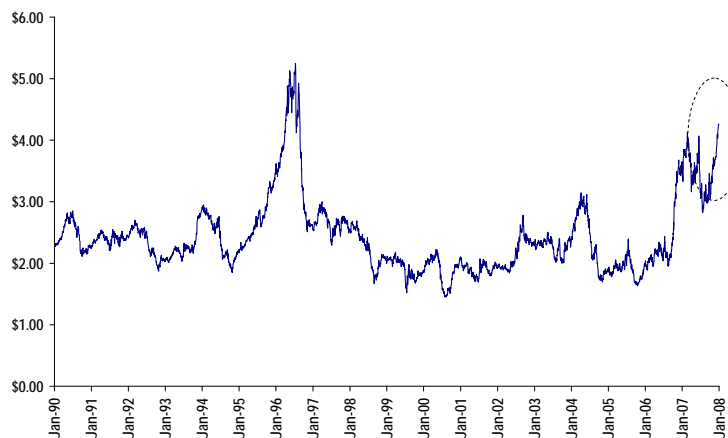
2006/2007 Global Corn Production  
Total = 27.7 Billion Bushels



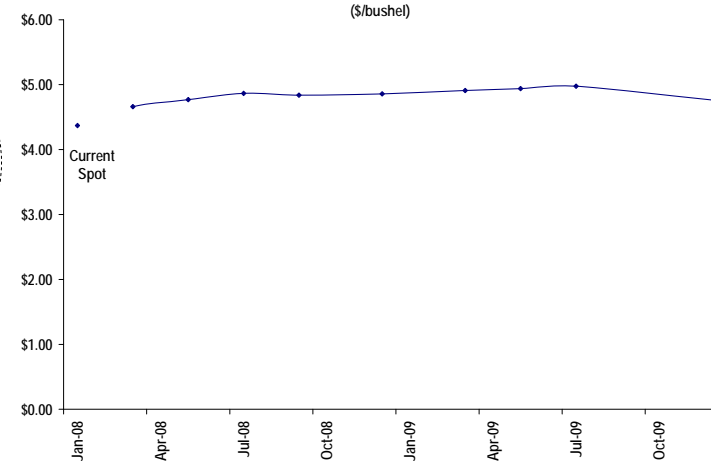
2006/2007 Global Corn Exports  
Total = 3.6 Billion Bushels



Corn Prices  
(\$/bushel)

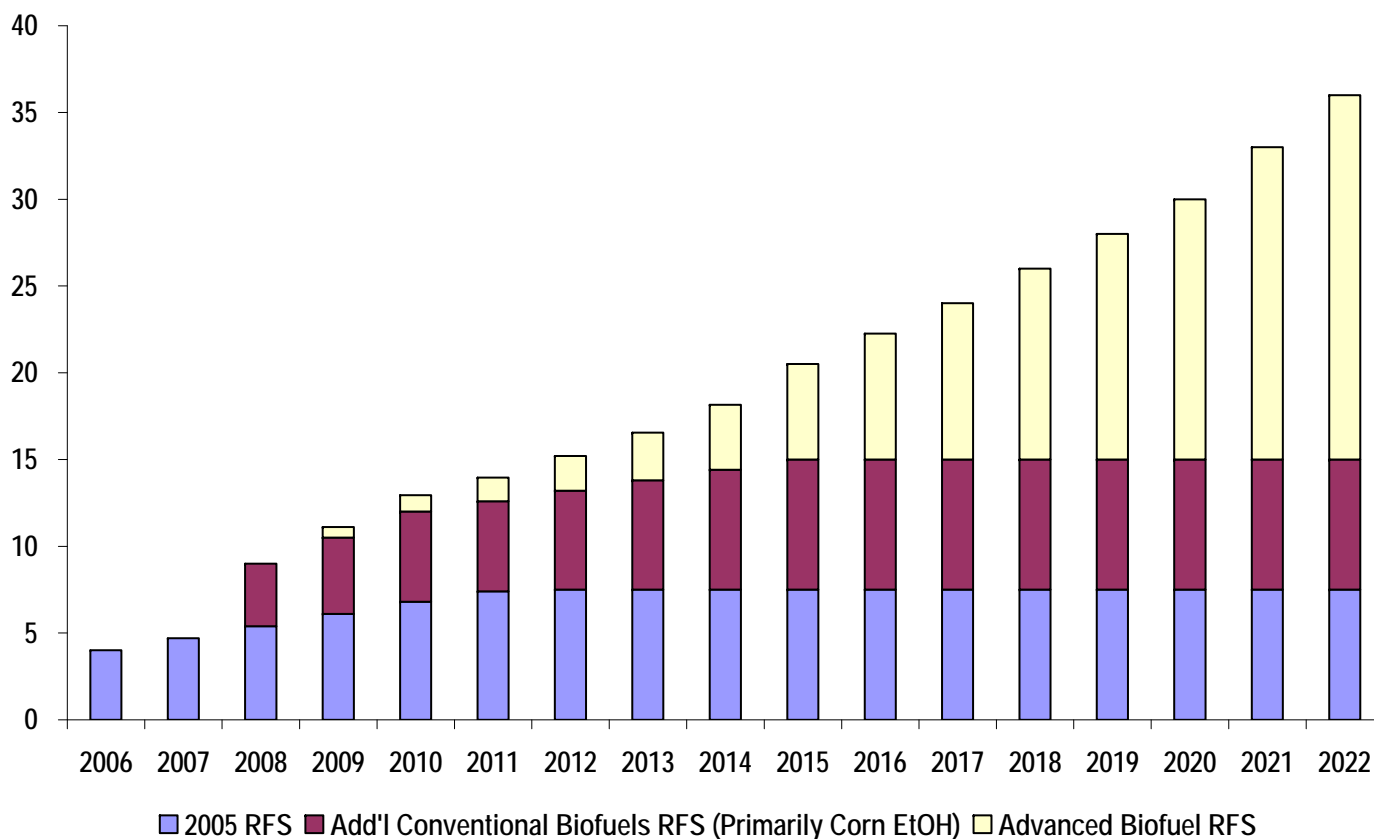


Corn Futures  
(\$/bushel)

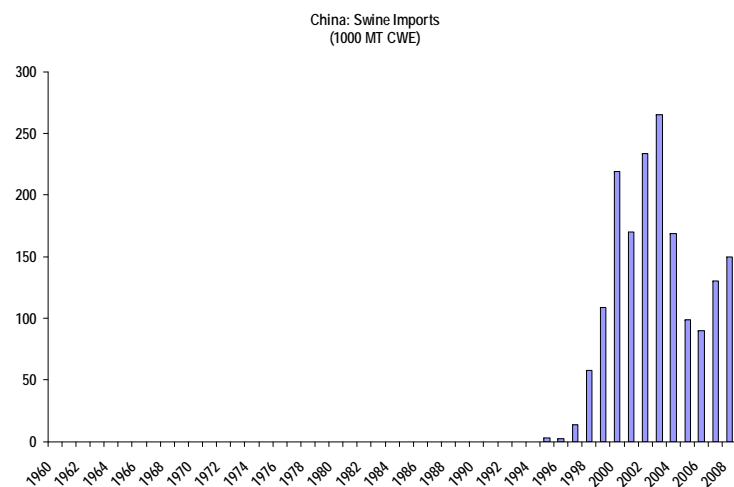
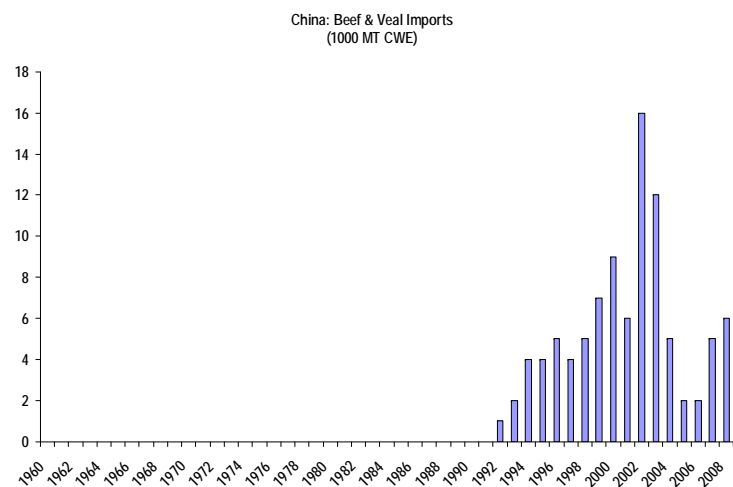
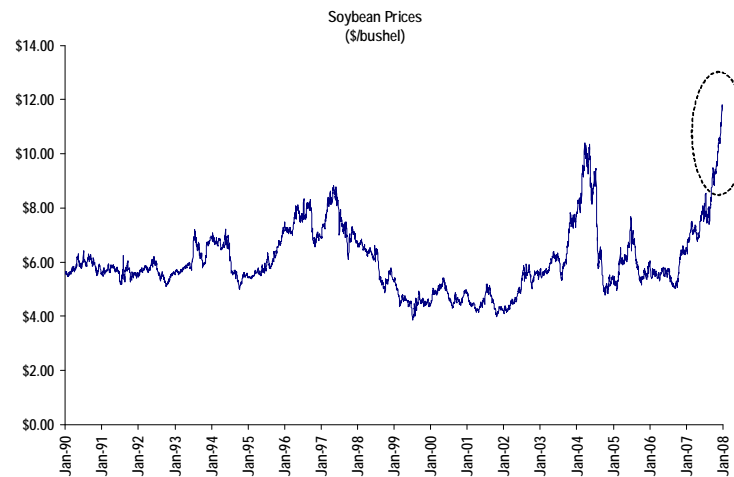
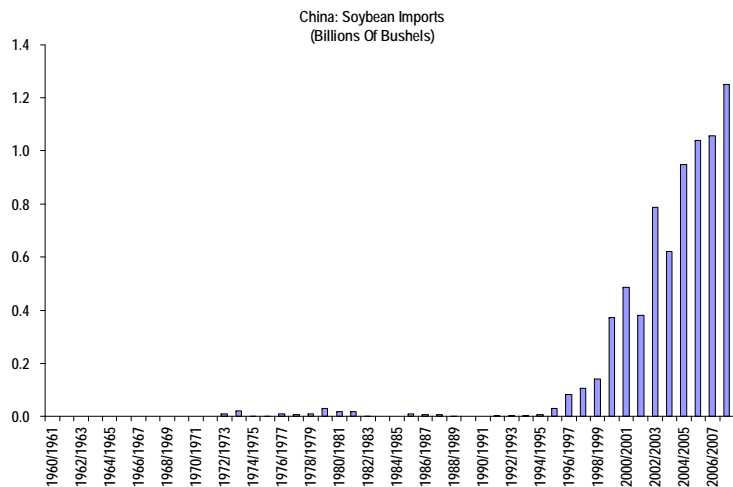


## Strong Demand For Corn By Ethanol Continues To Push Corn Prices Close To \$5/Bushel

2007 U.S. Energy Bill -- Renewable Fuel Standards  
(In BGY)



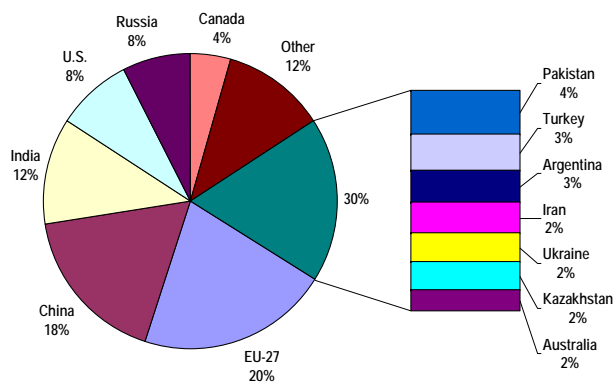
## China's Demand For Beans Is Increasing Rapidly—Driving Soybean Prices To ~\$12/Bushel; China Will Likely Increase Beef & Pork Imports



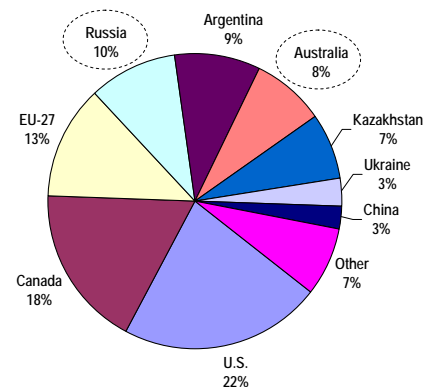
Sources: USDA, Haver, CBOT, Reuters, Library of Congress, Biodiesel Magazine, Bear Stearns & Co., Inc.

## In '07, Wheat Beat Previous All-Time High By ~35%; Russia Will Constrain Supplies Into '08 By Limiting Exports With Its New Export Tariff

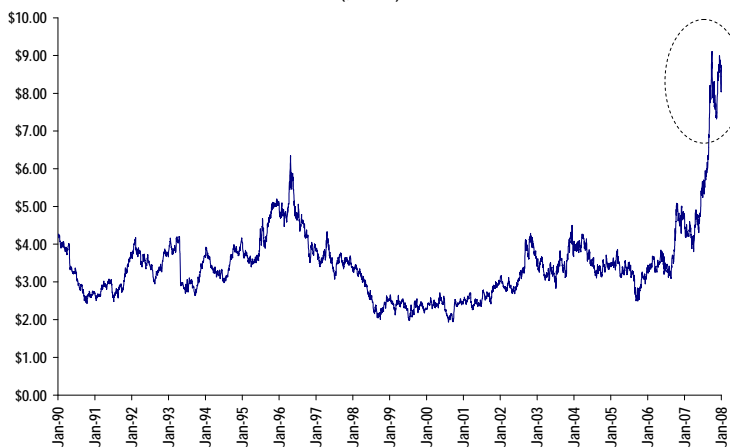
2006/07 Global Wheat Production  
Total = 22 Billion Bushels



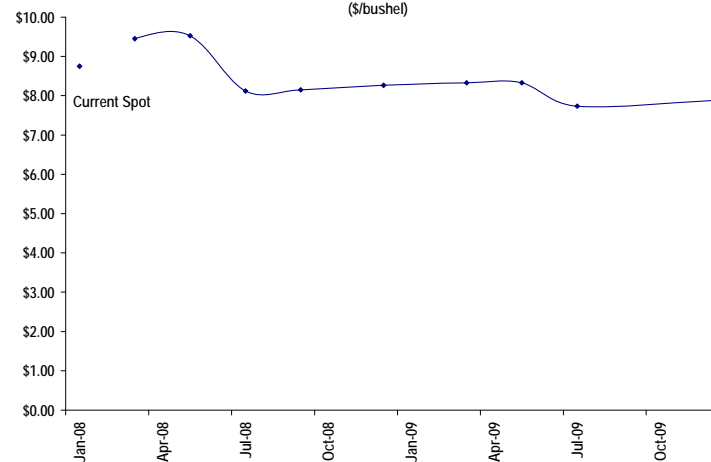
2006/07 Global Wheat Exports  
Total = 4 Billion Bushels



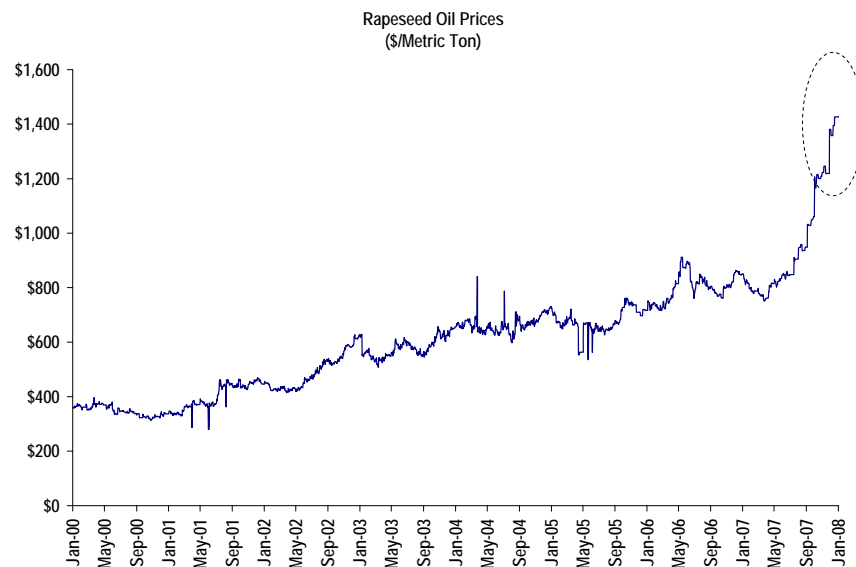
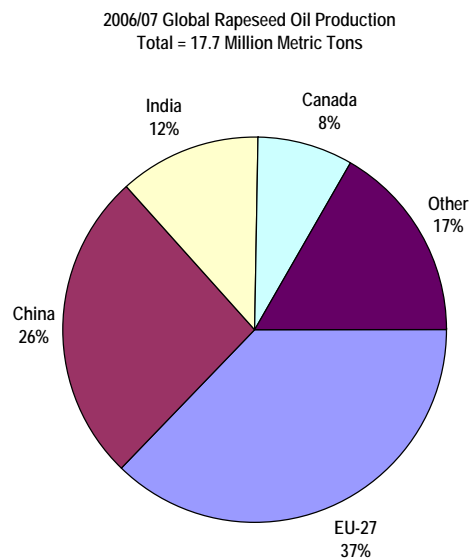
Wheat (#2 Soft Red Winter) Prices  
(\$/bushel)



Wheat Futures  
(\$/bushel)

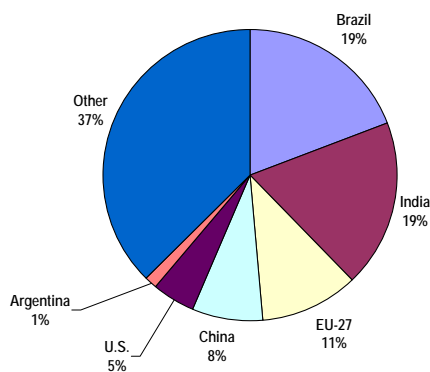


# The Price Of Rapeseed Oil Has Increased ~400% Since 2001

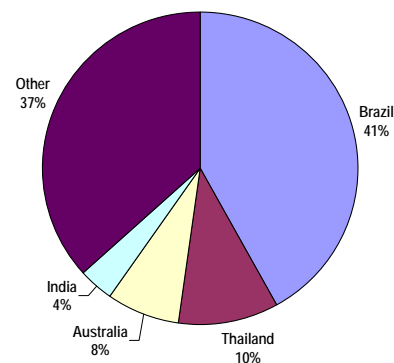


## Projected Ethanol Growth In Brazil Will Continue To Drive Ag Equipment Sales

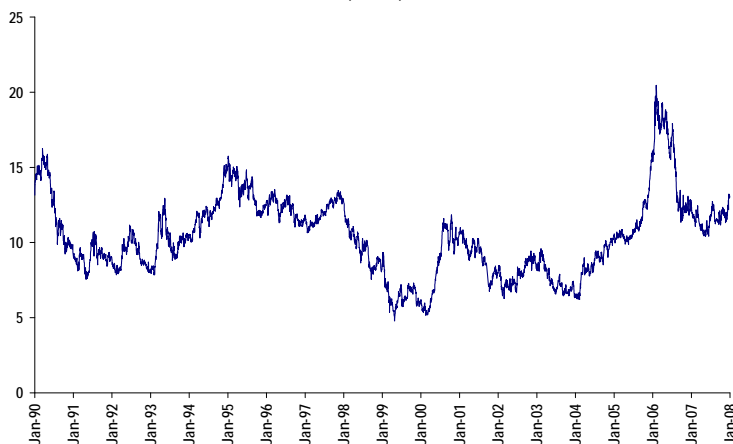
2006/2007 Global Sugar Production  
Total = 164 Million MT



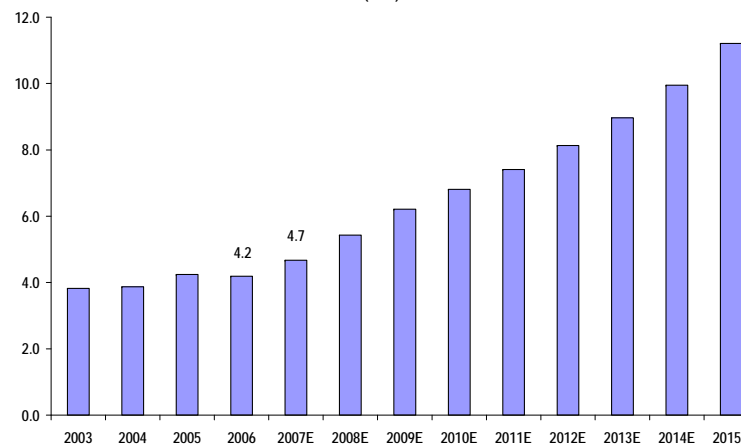
2006/2007 Global Sugar Exports  
Total = 50 Million MT



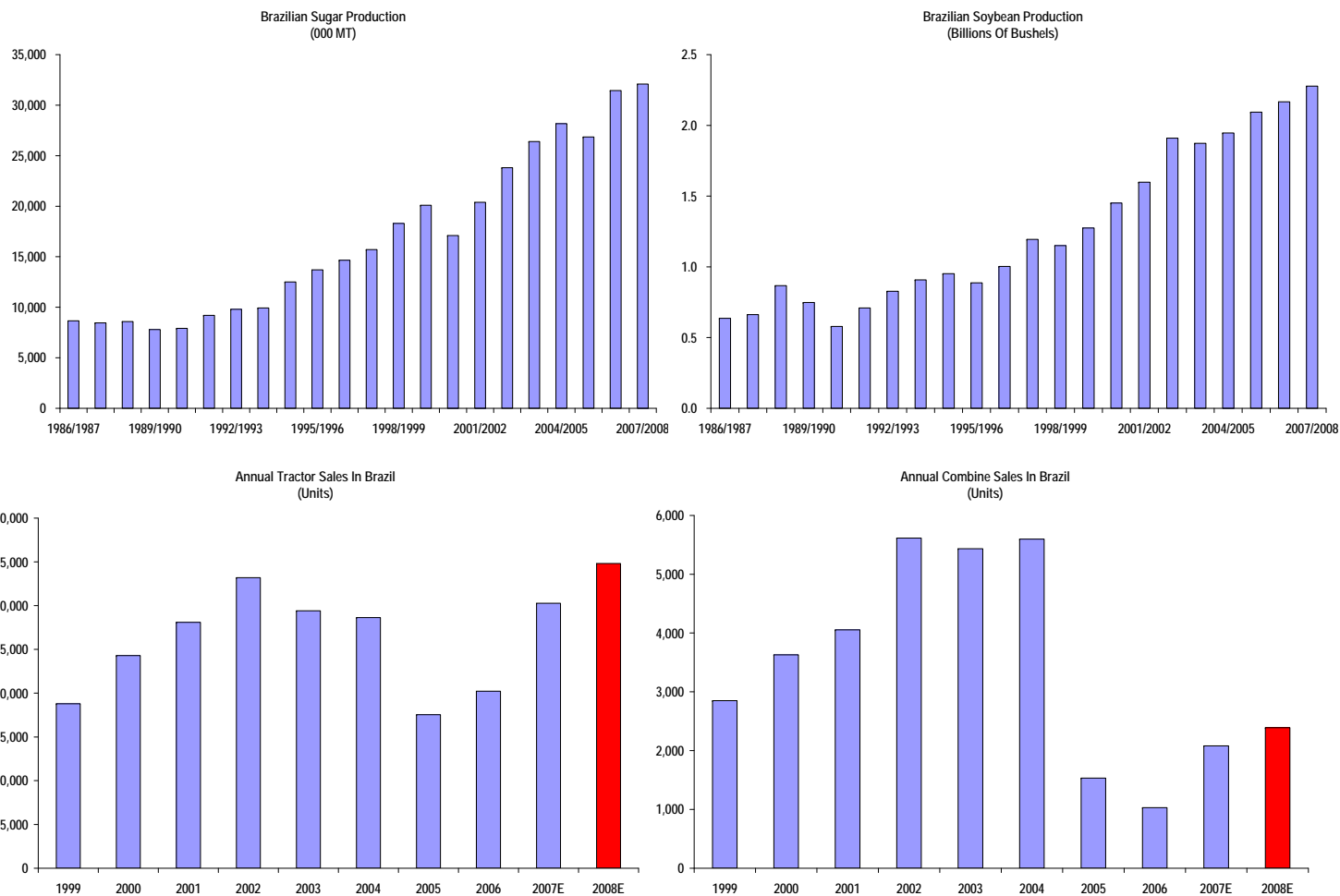
Sugar Prices  
(cents/lb)



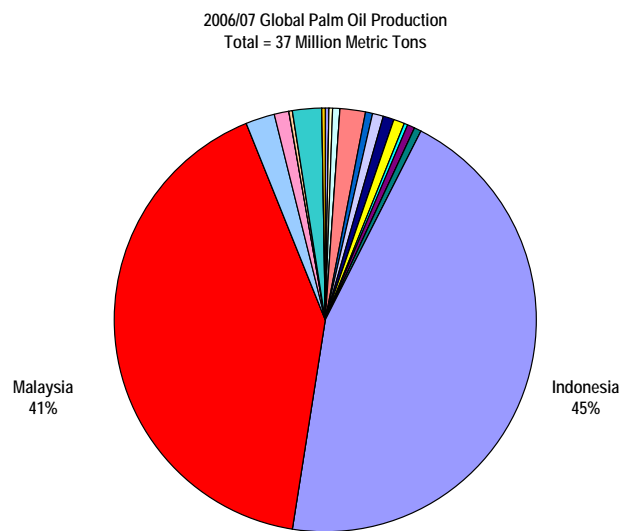
Brazilian Ethanol Production  
(BGY)



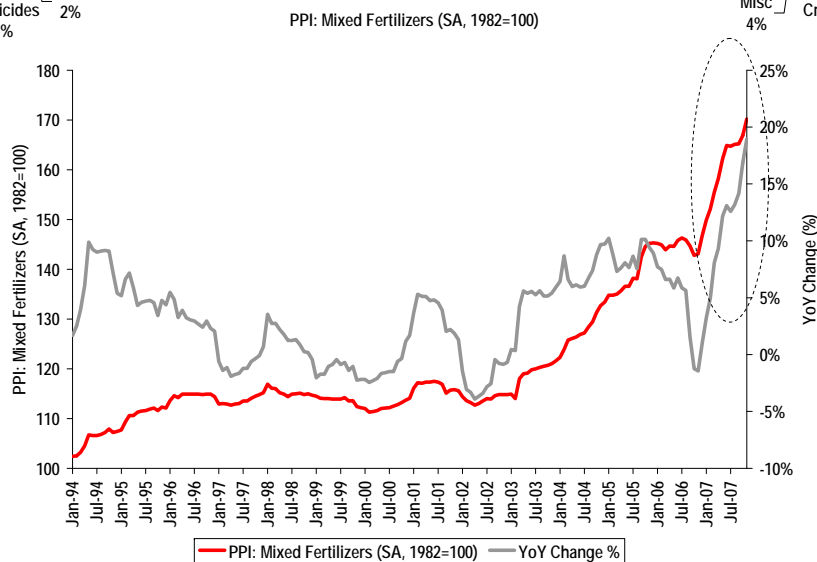
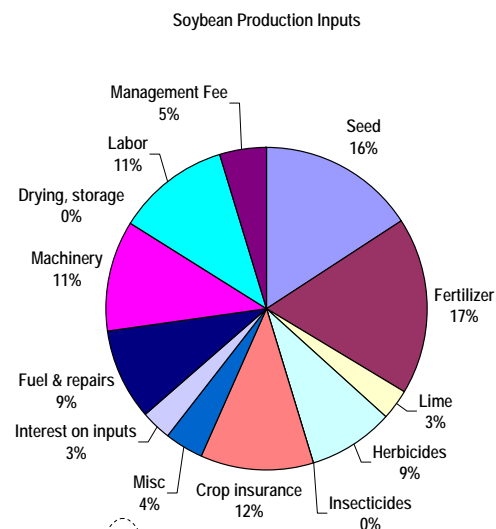
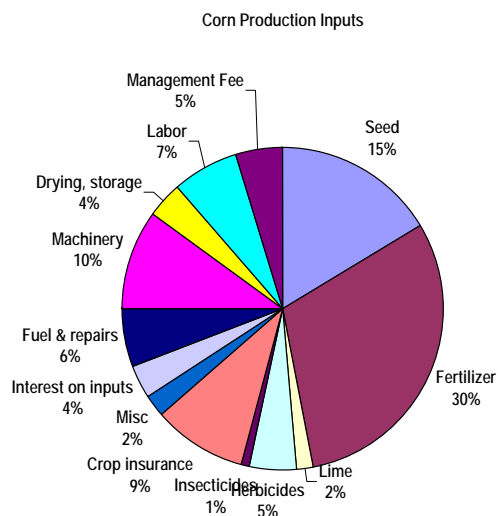
## We Expect The Growth In Sugar And Soybean Production To Continue Resulting In Continued Strong Machinery Growth Into 2008



# Palm Oil Prices Are Currently ~\$930/Metric Ton, +430% Since 2001; Primary Beneficiaries Are Indonesia And Malaysia



## Biggest Concern: Seed And Fertilizer Costs Represent Nearly 50% Of Corn Input Production Costs And 34% Of Soybean Costs



## Companies Analyzed

Company Name	Ticker/Price Chart	Closing Price (1/9/08)	Rating	Target Price	Risk (If target is included)	Methodology (If target is included)
Parker-Hannifin Corp.	<a href="#">PH</a>	65.68	Peer Perform			
Illinois Tool Works	<a href="#">ITW</a>	49.04	Peer Perform			
Ingersoll-Rand	<a href="#">IR</a>	40.44	Outperform	\$60	capital allocation disappoints	rel p/ne
Eaton Corporation	<a href="#">ETN</a>	88.18	Outperform	\$111	truck recovery takes longer	rel p/ne
Danaher Corp.	<a href="#">DHR</a>	82.58	Outperform	\$98	Limited acquisition targets and acquisition integration	rel p/sales
Deere & Company	<a href="#">DE</a>	90.24	Outperform	\$99	lower cash receipts	rel p/avg e
CNH Global	<a href="#">CNH</a>	58.30	Outperform	\$70	lower cash receipts	rel p/ne
Caterpillar	<a href="#">CAT</a>	67.41	Peer Perform			
AGCO Corp.	<a href="#">AG</a>	64.71	Outperform	\$70	lower cash receipts	rel p/ne
General Electric Co.	<a href="#">GE</a>	35.92	Outperform	\$46	macro slowdown	rel p/ne

ADDENDUM  
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Lead Analyst Name



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Underperform (U) - Stock is projected to underperform analyst's industry coverage universe over the next 12 months.

Ratings for Sectors (vs. regional broader market index):

Market Overweight (MO) - Expect the industry to perform better than the primary market index for the region (S&P 500 in the US) over the next 12 months.

Market Weight (MW) - Expect the industry to perform approximately in line with the primary market index for the region (S&P 500 in the US) over the next 12 months.

Market Underweight (MU) - Expect the industry to underperform the primary market index for the region (S&P 500 in the US) over the next 12 months.

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