

# SECTOR SPOTLIGHT

## INDUSTRIALS



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# RECENT INDUSTRIAL ACTIVITY UP SMALL

AAR NORTH AMERICA TOTAL CARLOADS ORIGINATED  
YOY%, 6-WK MA



DATA SOURCE: AAR, HRM ESTIMATES

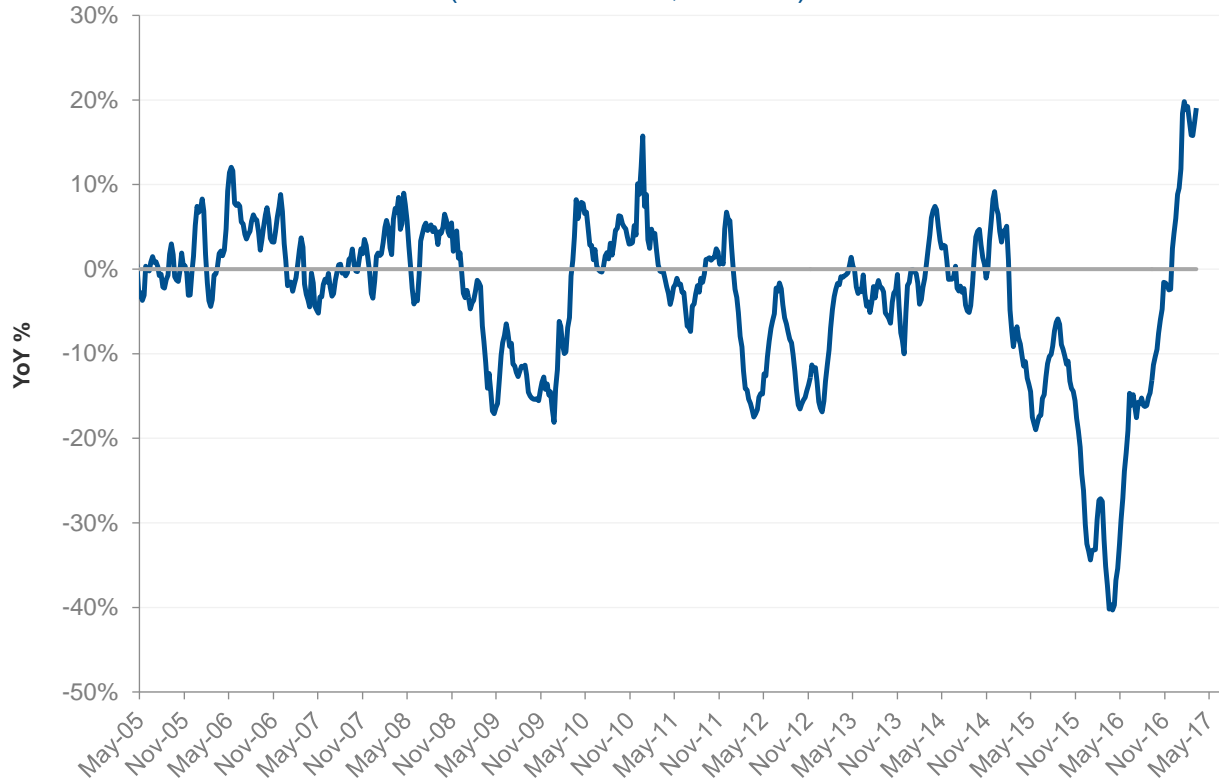
Most of the rails shares have rallied significantly. Accompanies broader improvement in activity.

- 1) \*NORFOLK SOUTHERN LONG REMOVED FROM BEST IDEAS LIST AT HEDGEYE
- 2) \*NORFOLK SOUTHERN LONG ADDED TO BEST IDEAS LIST AT HEDGEYE

Transstate Co.  
BFW 01/26  
BFW 09/15

# MOSTLY ON A BIG BOUNCE IN COAL

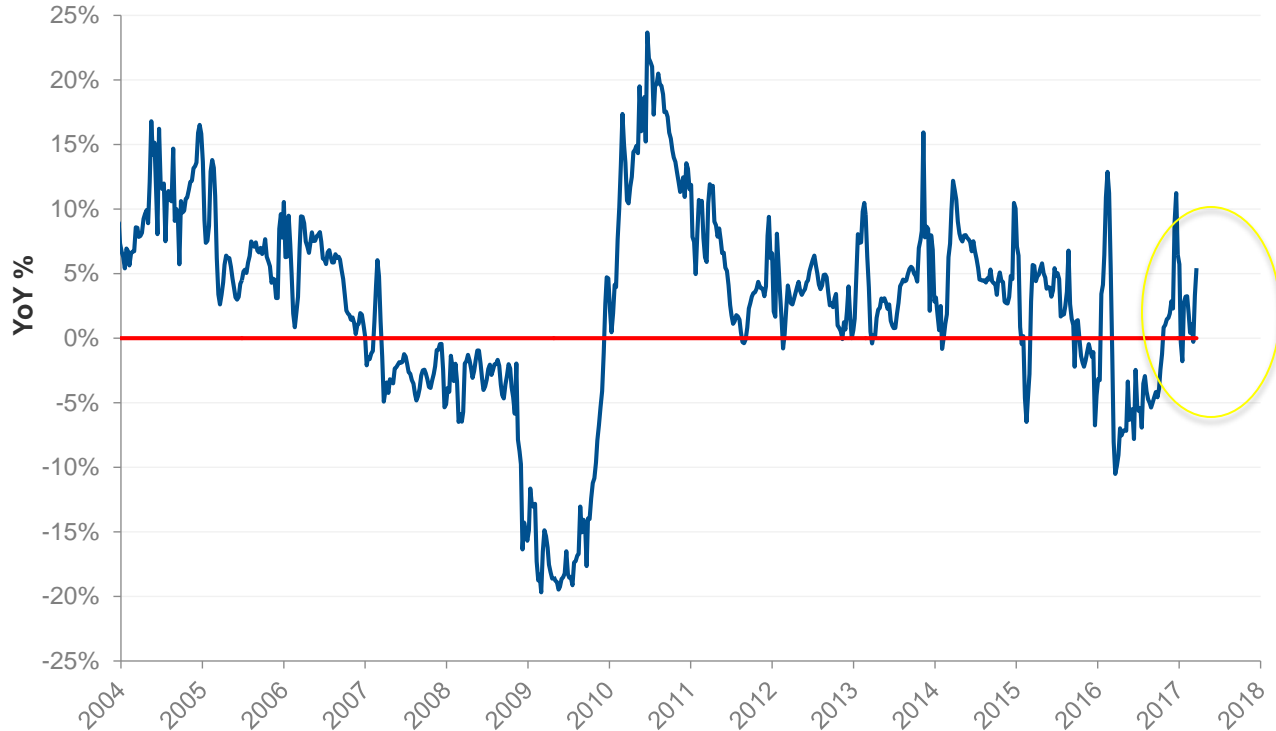
AAR US COAL FREIGHT CARLOADS  
(4-WEEK SUM, YOY %)



Coal is in a slow secular decline, but it is lumpy. Coal is also not going away (at all) in most utility forecasts.

# INTERMODAL UP LOW SINGLE DIGITS

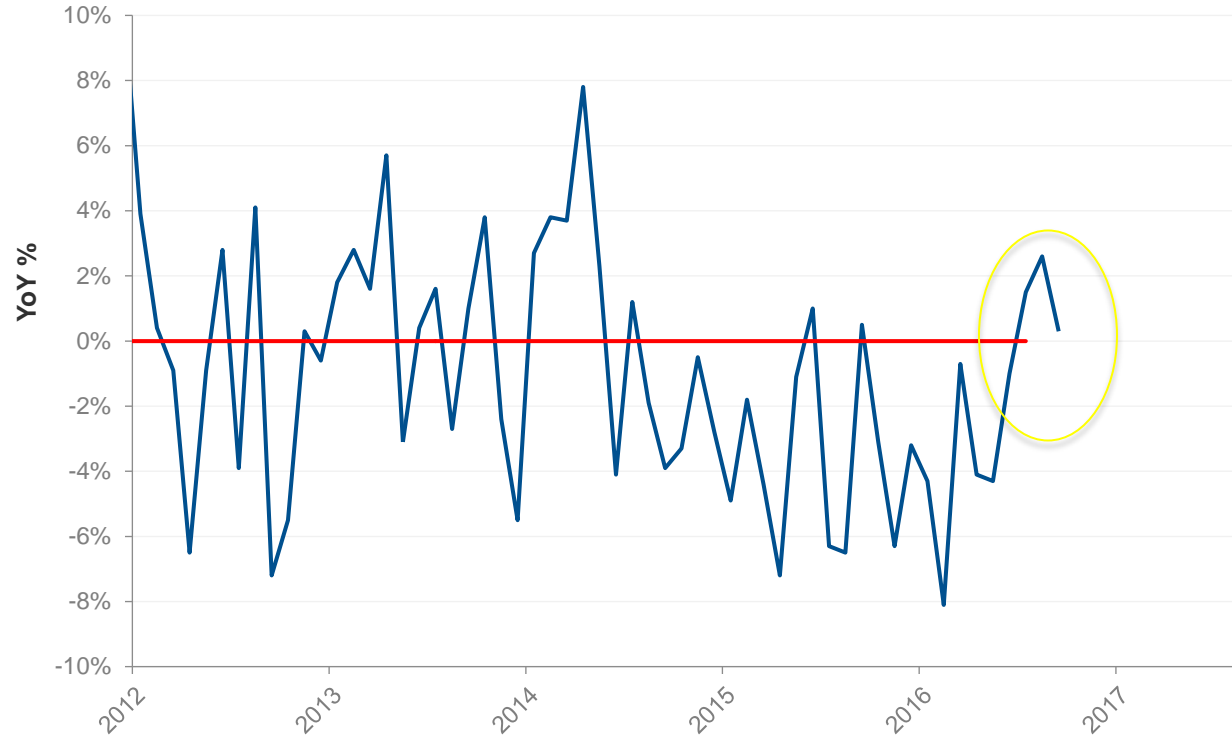
AAR U.S. INTERMODAL FREIGHT CARLOADS  
(4 WEEK AVG, YOY %)



Broad measure,  
better than bad.

# NEW ORDERS LESS BAD ON EASING COMPS

**CAPITAL GOODS NEW ORDERS NONDEFENSE  
EX AIRCRAFT & PARTS, YOY %**



Several indicators, like capex plans, suggest continued positive readings.

# MACRO CALLING REFLATION'S PEAK

## IRON ORES FINES 62% FE OFFSHORE EXPORT PRICE AUSTRALIA TO CHINA CIF



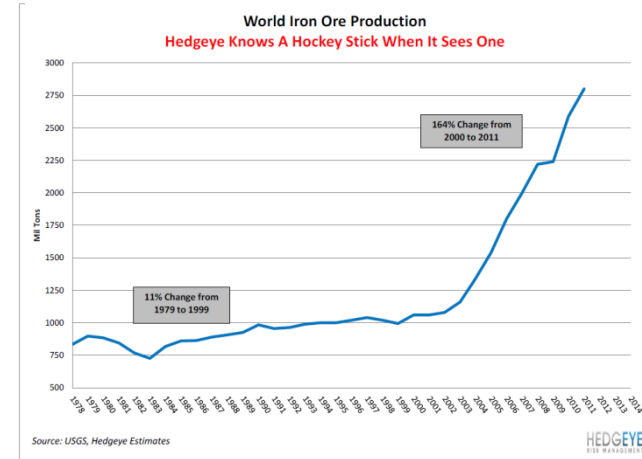
SOURCE: BLOOMBERG, HEDGEYE ESTIMATES

Growth accelerating, but rate ROC in commodities may be peaking.

05/09/13 03:02 PM EDT

### COMMODITY BUBBLE BUST

*A capital equipment supplier to a cyclical industry is almost always more cyclical than the cyclical industry itself. Bearish on commodities? Short CAT.*

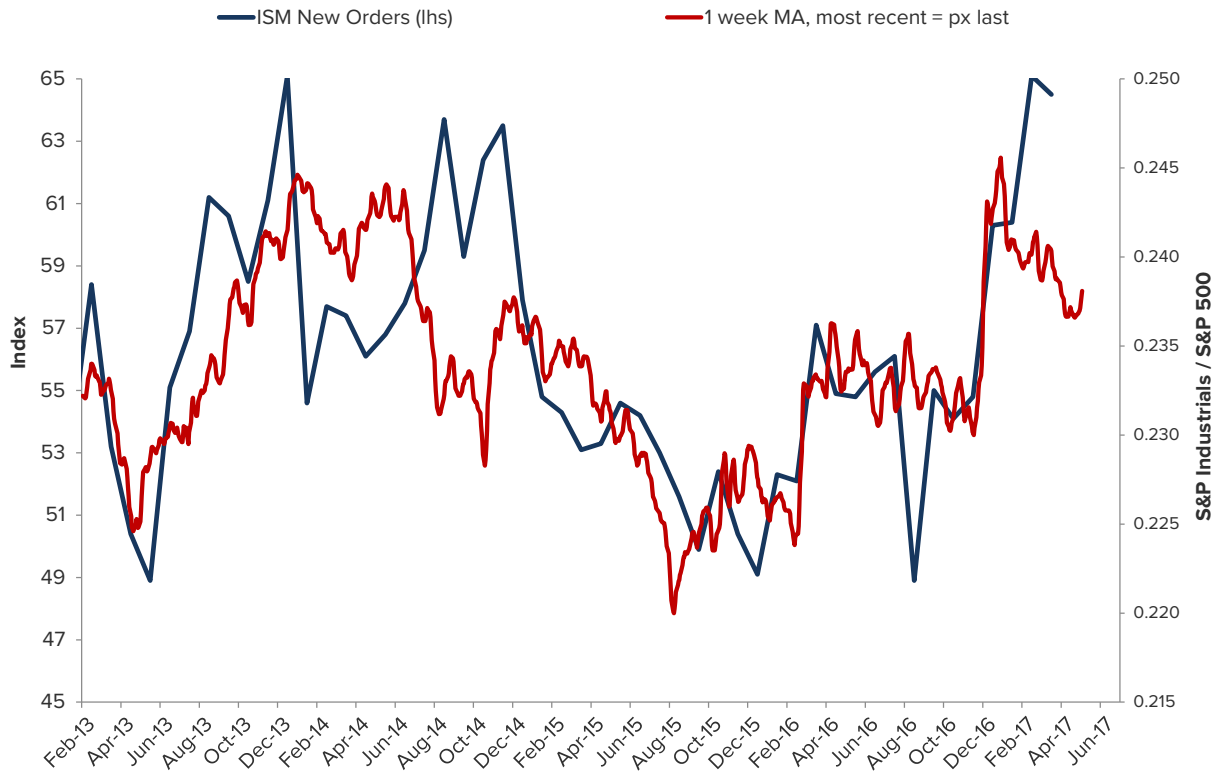


Source: USGS, Hedgeye Estimates

(Iron Ore mining is at least a couple of thousand years old)

# SECTOR GIVING BACK ELECTION POP

## S&P INDUSTRIALS RELATIVE TO S&P 500 VS. ISM NEW ORDERS



DATA SOURCE: BLOOMBERG, HRM ESTIMATES

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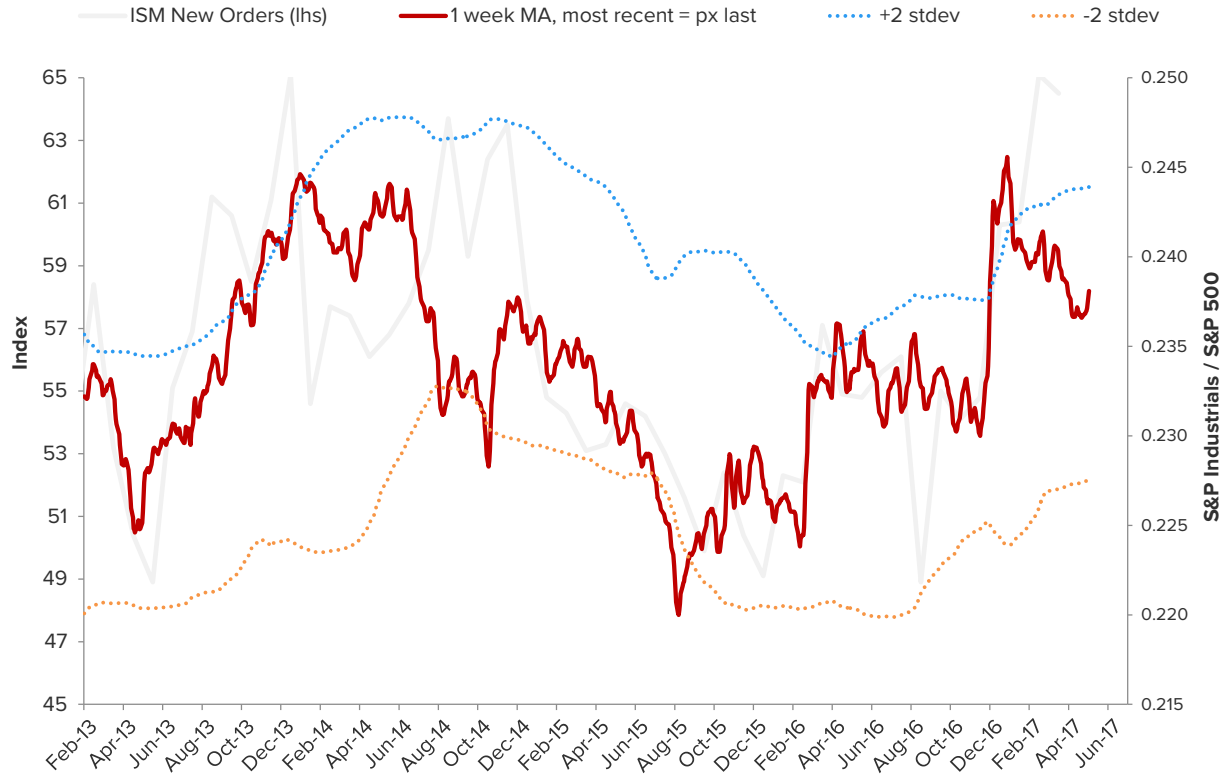
**Faded Election:** Policy unlikely to be disproportionately positive for sector, despite initial hopes.

**Process:** Politics can't change many key demand drivers.



# LESS 'OVERBOUGHT'

## S&P INDUSTRIALS RELATIVE TO S&P 500 WITH 2 SIGMA BANDS

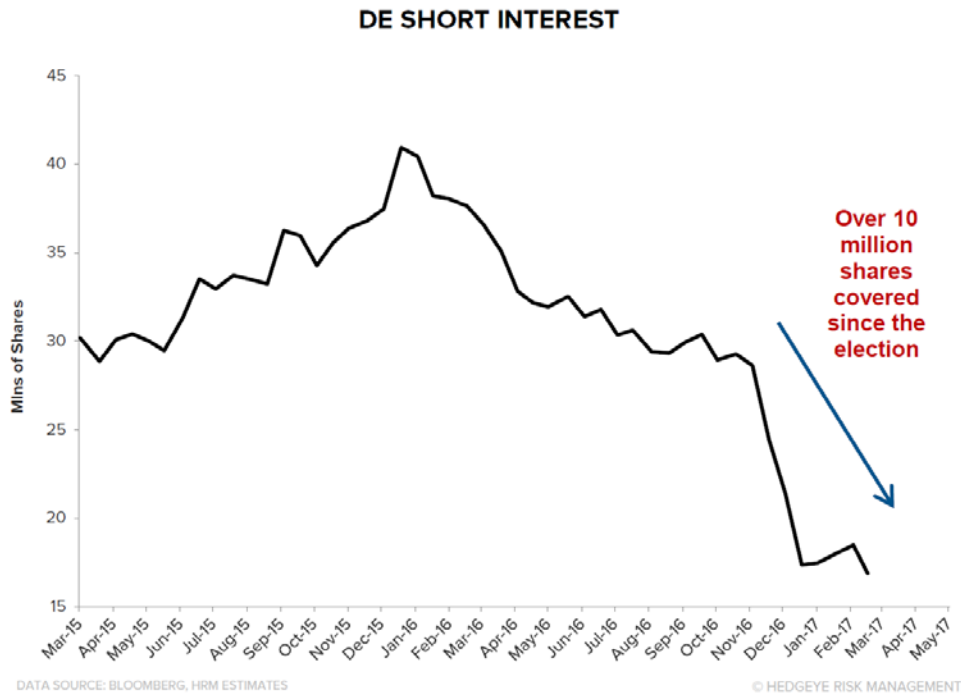


**Not Exactly Down,  
Though:** Supported by  
improving – better, if  
not remarkable - data.

DATA SOURCE: BLOOMBERG, HRM ESTIMATES

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# SHORT COVERING A FACTOR



...and an opportunity.

05/22/2015 14:47:19 [BFW] Translate to... ☆ <Find in Page>

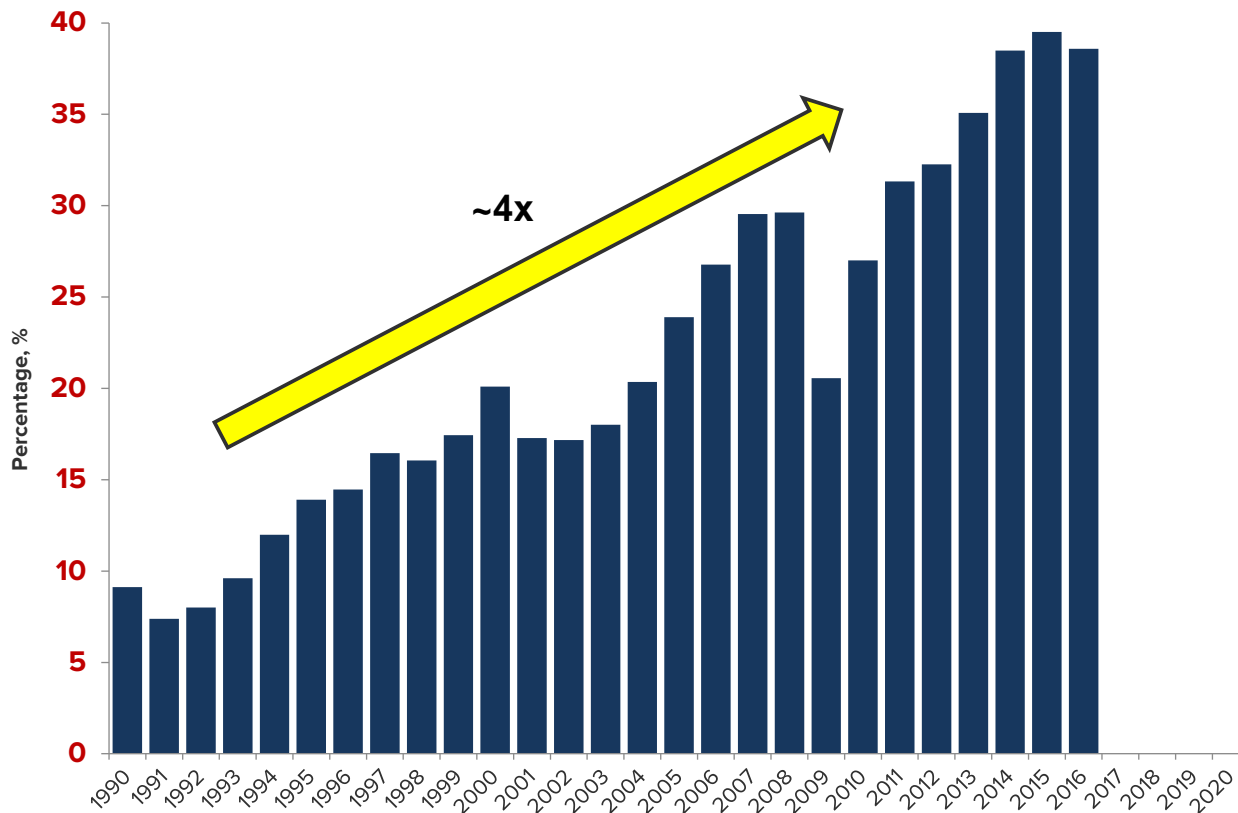
**\*HEDGEYE ADDS DEERE TO BEST IDEAS LIST IN 'SHORT-A-SQUEEZE' CALL**

--RACHEL LAYNE

-0- May/22/2015 18:47 GMT

# HOW COULD POLICY BE MORE FAVORABLE?

## S&P 500 GICS INDUSTRIAL OPERATING MARGIN



DATA SOURCE: BLOOMBERG, HRM ESTIMATES

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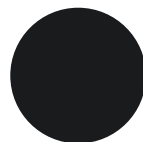
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# SOME SECTOR THEMES



## **POLICY DISAPPOINTMENTS**

Tax reform itself may prove challenging, and the Boarder Adjustment Tax seems increasingly unlikely. Deficit neutral infrastructure is not an oxymoron, but it seems close.



## **EMERGING POCKETS OF 'IRRATIONAL EXUBERANCE'**

Automation Takes Over World (we like automation long side, just lower), Machinery Cyclical Recovery (DE a notable example, a top short for us), but many 'Trump Trades' have faded a bit relative to a strong equity market.

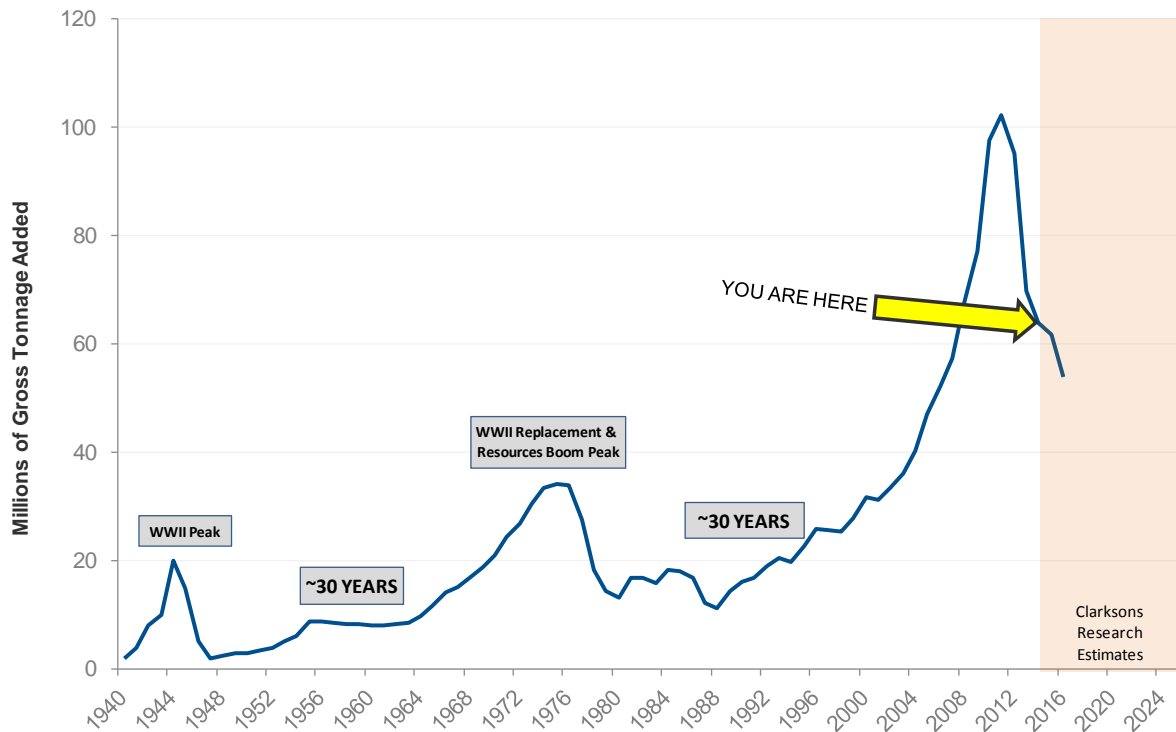


## **NOT MUCH LOVE IN A FEW PLACES**

KSU An Industry Laggard (Mexican trade barrier would be broadly negative for rails), Finning Idiosyncratic and Cheap. We like TXT, and also would note that package/reflation themes should be interesting in 2017.

# PROCESS DISCUSSION

## GLOBAL SHIPPING TONNAGE ADDED



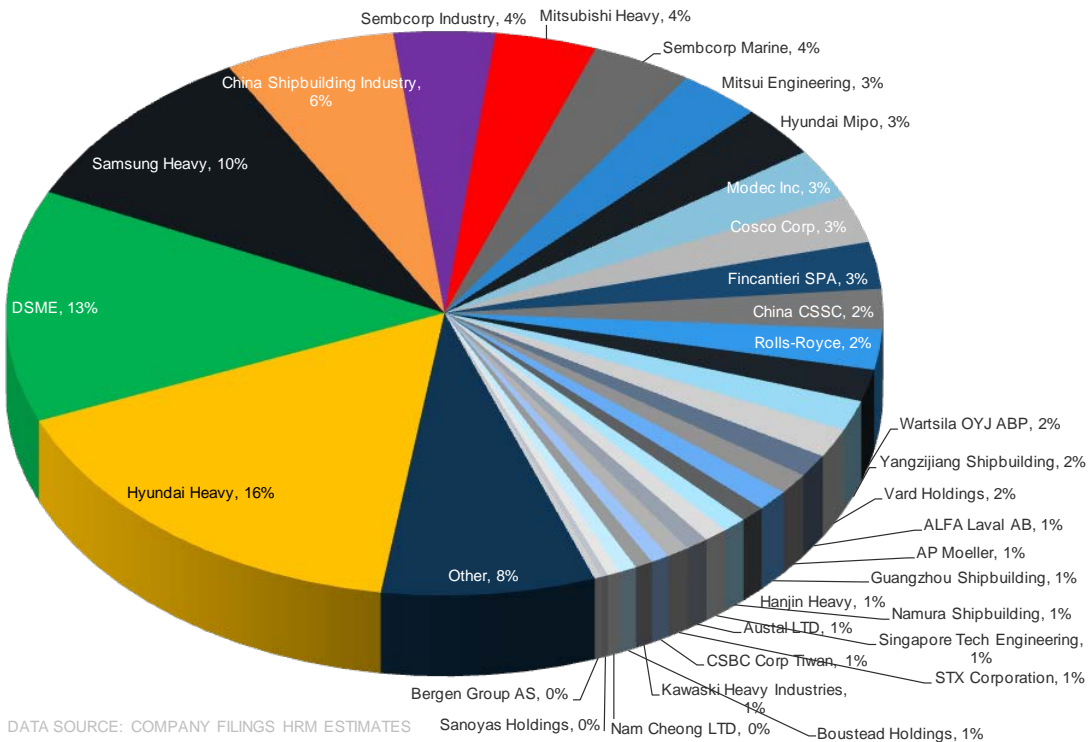
DATA SOURCE: SHIPBUILDINGHISTORY.COM, CLARKSONS RESEARCH, WARTSILA, CARGOTEC, LLOYD'S REGISTER, HRM ESTIMATES

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Policy doesn't impact the installed base all that much.

# INDUSTRY STRUCTURE & VALUATION

## ESTIMATED MARKET SHARE (2014E REVENUE)



DATA SOURCE: COMPANY FILINGS HRM ESTIMATES



krw 24000 - 28000



krw 10000-14000

10/07/14 09:29 PM EDT

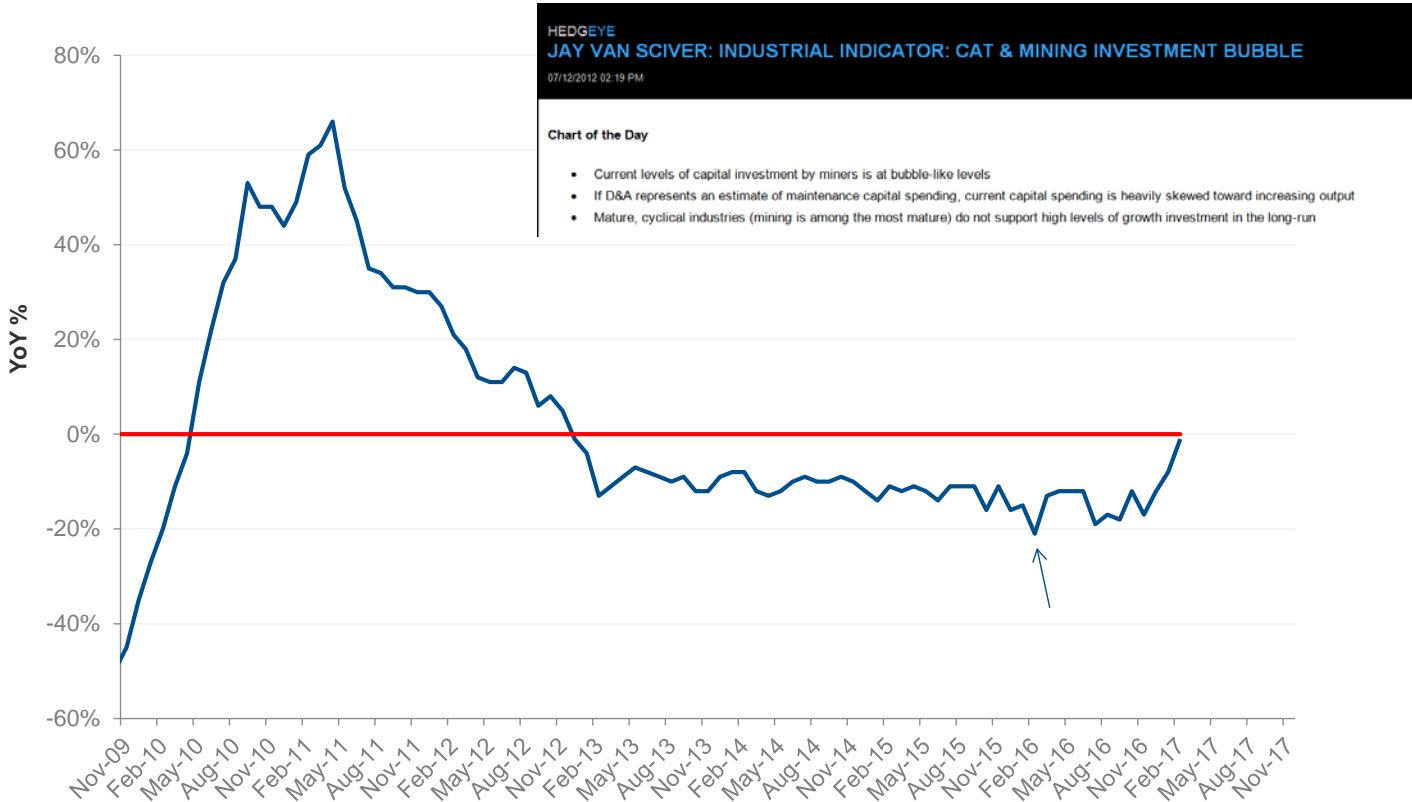
## SHIPBUILDING SHORT UPDATE: SINKING FAR FROM PORT

### Summary

We typically introduce the Hedgeye Industrials research process using the shipbuilding cycle and industry structure as an illustration. The discussion typically goes something like “after WWII, war related tonnage was converted to commercial use, but ships last for only, give or take, 30 years, so there was a replacement cycle in the mid-1970s”...and so on. But shipbuilding is not just an example of a capital equipment cycle and a flawed industry structure, it has also been, and will likely continue to be, a **once in a career short opportunity**.

# IT HAS BEEN ALMOST 5 YEARS

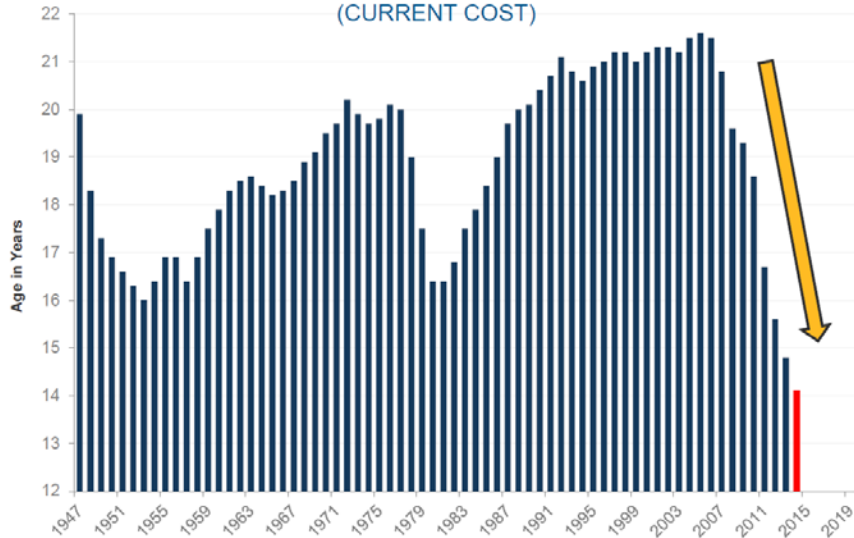
## CAT DEALER RETAIL SALES - MACHINES GLOBAL



**Implied Orders, Not Dealer Sales:** And machine retail sales are still down yoy, on a down 21% comp.... Investors who plan to look through a major capital equipment cycle may not have the ability to do so. What does mid-cycle mean?

# WHAT WORKS ANYWAY? FLEET DEMOGRAPHICS

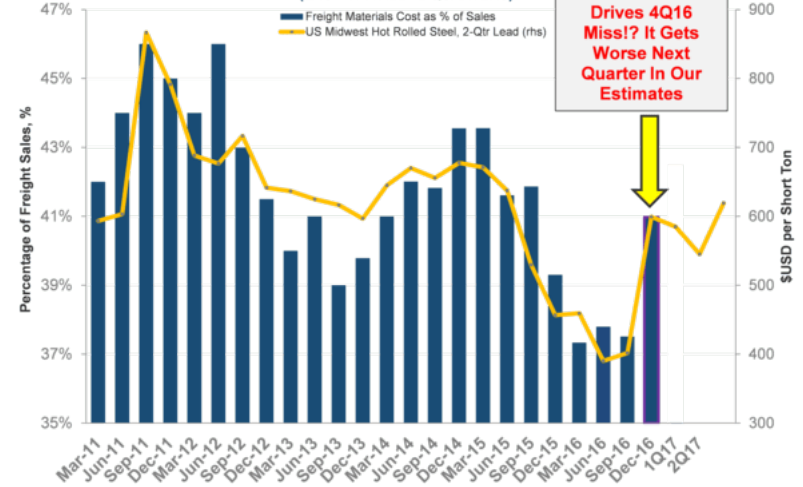
**AVERAGE AGE OF PRIVATE RAILROAD TRANSPORTATION EQUIPMENT (CURRENT COST)**



DATA SOURCE: BEA, HRM ESTIMATES

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**WAB FREIGHT MATERIALS COST AS % OF SALES VS. AVERAGE HOT ROLLED STEEL PRICE, LAGGED BY 2 QTRS (LAG TYPICALLY 2 QUARTERS)**



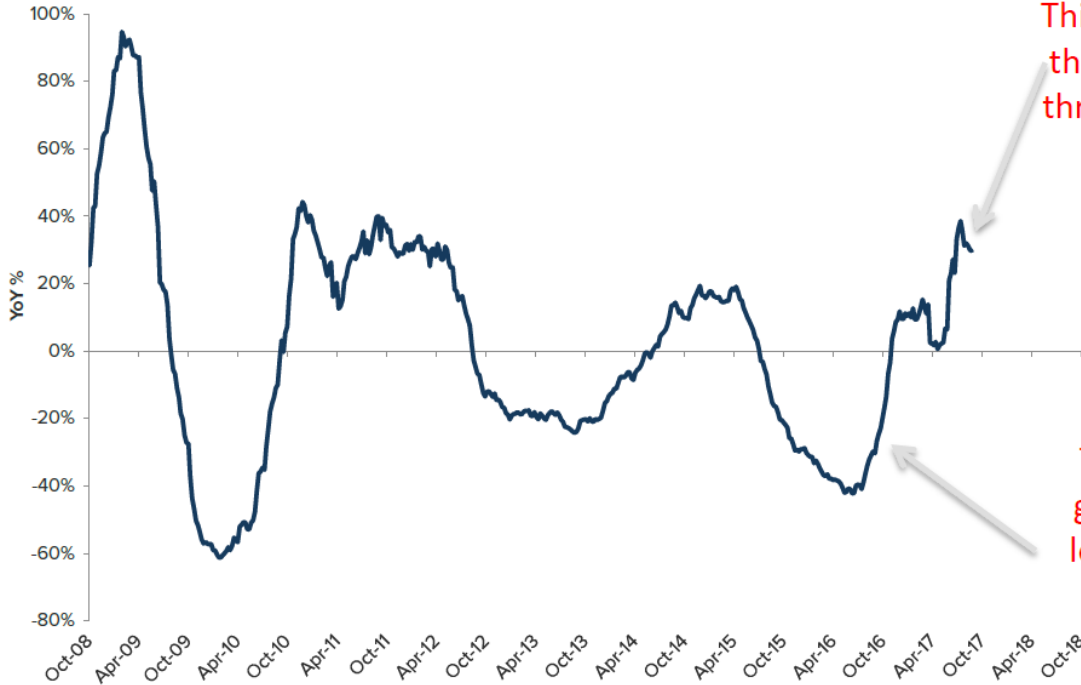
DATA SOURCE: COMPANY FILINGS, ISMB, HRM ESTIMATES

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# WATCH FOR IMPACT OF HIGHER STEEL

HOT ROLLED STEEL YOY %, LAGGED 6 MONTHS



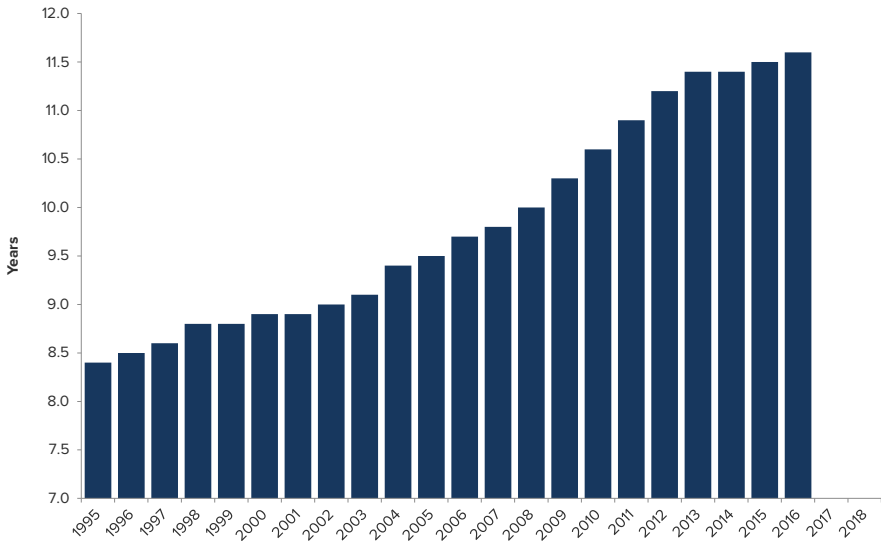
This is the cost increase that should be flowing through, perhaps now?

The whole machinery group benefitted from lower steel, and recent results have shown a negative impact.

Higher commodity costs flow through on a lag

# AUTOS LOOK UNREMARKABLE SHORT SIDE

## U.S. AVERAGE AGE OF LIGHT VEHICLES

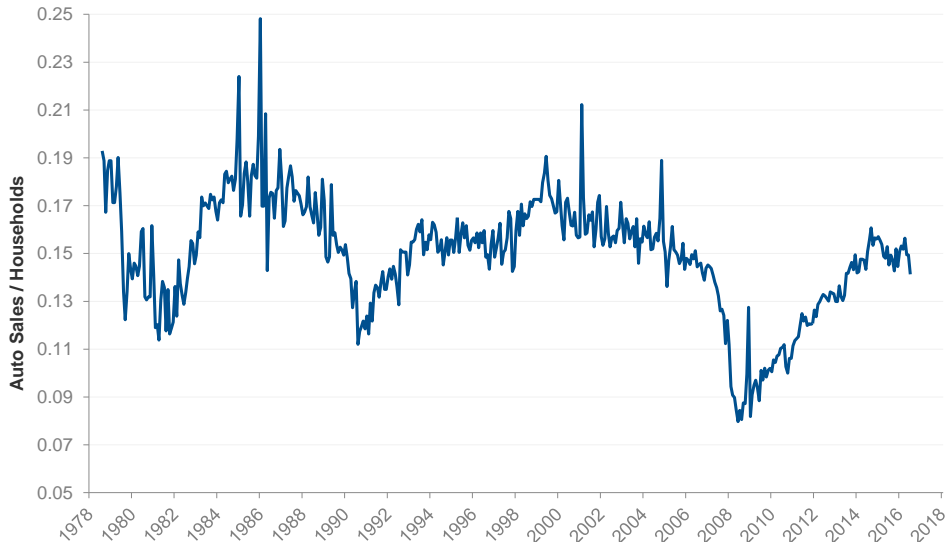


DATA SOURCE: DOT, IHS, HRM ESTIMATES

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(credit, dealers may be more interesting)

## U.S. AUTO SALES PER HOUSEHOLD



DATA SOURCE: CENSUS BUREAU, BLOOMBERG, HRM ESTIMATES

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