Capital Goods

Signposts for investing in Cap Goods: Warming up

Industry Overview

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Equity
Pan European
Capital Goods

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Six signs to watch on cyclicals: 2 +ve, 4 neutral

Slightly more positive macro indicators MoM, but signs are still mixed. Top down, we have seen positive PMI momentum (+), and positive OECD LI momentum (+) from Europe & China. Valuations are above the pre-COVID average but below the 10-year average (=), with fundamentals falling but companies providing mixed 2024 guidance vs expectations (=). Consensus expectations are troughing but still remain buy weighted vs history (=), and February FMS suggest positioning is positive, albeit only just (=); worth noting the shift to u/weight in US industrials though. Stocks we expect to outperform in this environment are names where expectations have already fallen in anticipation of a weak environment, such as **Sandvik**, **Hexagon.** We avoid names where expectations remain high despite weaker end markets, e.g. **Legrand, Weir, Rexel** and **Epiroc**.

OECD Lead Indicators: Inflection in Europe/China (+)

The Chinese and European 6m/6m appear to have inflected positively, but with the US and Japan declining slightly. Trends (YoY) are mixed with US, Japan still trending up, China & Europe fading with the former more clearly past the peak.

PMIs: Stable, but much improved vs December (+)

European PMI fell c0.1ppts MoM to 46.5, but is still +2.1ppts vs December. Jan saw the biggest MoM improvement since March 2021, breaking a streak of 8 consecutive readings <45, the first time this occurred since 2008. US PMI was +1.9ppts MoM

Valuation: Below 10y Avg., but above 10-'19 Avg. (=)

The sector is trading on c13.6x 12m fwd EV/EBITA, +9% vs the pre-COVID ('10-'19) average of 12.5x, but 5% below the 10y avg of 14.5x. It was 11.5x at the end of October.

Positioning: Overweight in February (=)

Investors switched back to 3% overweight in European Industrials, vs 17% underweight in January. Investors are 9% overweight global Cap Goods, vs 6% in January; more positive global interest in the sector could translate to European names.

Fundamentals: Slowing, guidance mixed (=)

Revenue growth has slowed to in Q4 from fading volumes and pricing, and margins fell QoQ. However, 2024 guides (see note) have been mixed, coming in 2% below expectations across our short cycle names, but ahead at some names (e.g. ABB, SKF).

Consensus expectations: Troughing, but Buy weighted (=)

2024 operating profit expectations have fallen 6% vs July'23, with organic growth of 2% expected for 2024. However, both appear to be troughing, with the debate whether expectations are sufficiently cautious given the current fundamental weakness.

Exhibit 1: Where is the interest?
Links to our recent and popular reports

Most read	Potentially missed
Siemens Energy	FLSmidth
Iveco	Ariston
NIBE	Industrie De Nora

Source: BofA Global Research
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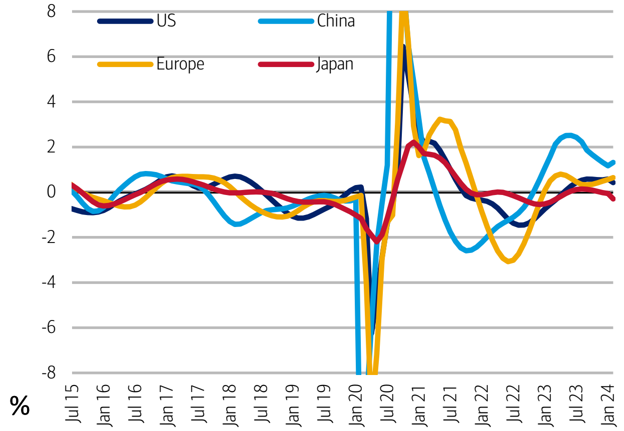
Latest Signposts note:

February 2024: Balancing act
December 2023: Negatively weighted
November 2023: Pointing down
October 2023: Negative overall

6 Key Charts

Exhibit 2: Regional OECD Lead Indicators: 6m/6m change = inflection
The European OECD has seen increasing momentum in January



Source: OECD

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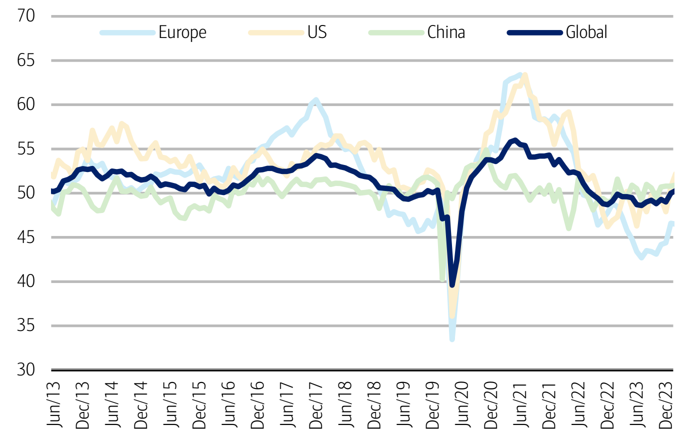
Exhibit 3: Global PMIs, by region (2013-present)
European PMI is lagging well behind US and China PMI's



Source: BofA Global Estimates, Bloomberg

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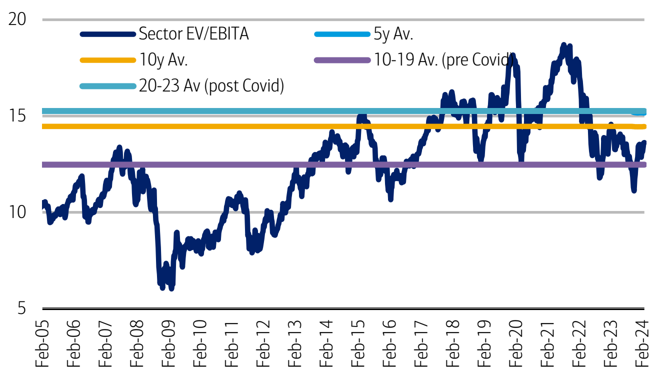
Exhibit 4: Sector 12mth FWD EV/EBITA
The sector valuation is in line with the 10y average



Source: BofA Global Research estimates

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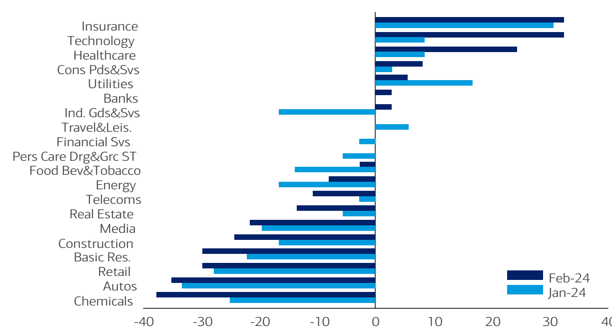
Exhibit 5: Current EUROPEAN sector snapshot (% saying overweight-% saying underweight)
Investors move to overweight positioning in European Industrials in February



Source: BofA Regional Fund Manager Survey

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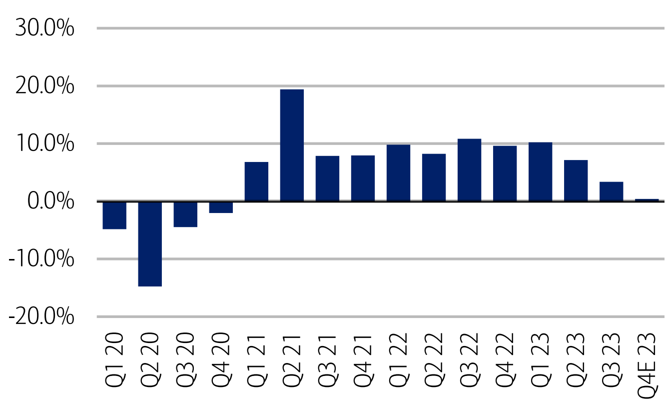
Exhibit 6: Organic sales growth, y/y
We expect organic sales with the sector to fall further in Q4



Source: BofA Global Research estimates, company report

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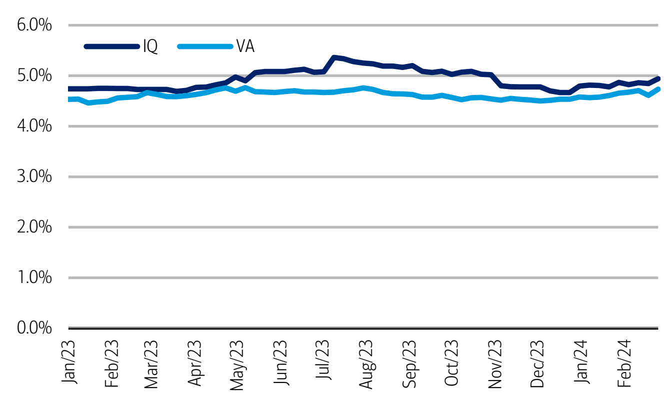
Exhibit 7: 2025 Revenue organic growth – BofA vs VA
BofA 2025 organic growth estimates have stayed stable at c5%



Source: BofA Global Research estimates, Visible Alpha

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Reading the signs

Overall, we see two indicators as positive, with four neutral. As we have progressed through the last 6mths the indicators have become generally more positive.

Exhibit 8: Summary of the indicators
We see two indicators as positive, four as neutral

#	Indicator	Conditions required to invest in Cyclicals	Cyclical Conditions Met	Comments
1	OECD LI	Inflection Rate neutral to positive and improving.	+	6/6m indicators appear to have inflected positively in China and Europe. In the US we appear to be rolling, and Japan has inflected negatively
2	PMI	Troughing in PMIs, with positive momentum	+	The PMIs are low, but appear to have troughed within Europe and the US
3	Valuation	Valuations cheap relative to history and to the market	=	12m fwd EV/EBITA = 13.6x, below the 10y avg above the '10-'19 avg
4	Positioning	Positioning underweight	=	Positioning 3% overweight
5	Fundamental Outlook	Companies seeing a troughing in demand	=	Revenue is slowing and margins getting softer. However, guidance for 2024 has been slightly stronger than expected
6	Consensus Expectations	Low or falling consensus expectations	=	2024/2025 operating profit estimates appeared to have troughed. Although consensus Buy ratings are falling. They remain elevated relative to wider history

Source: BofA Global Research estimates, company report

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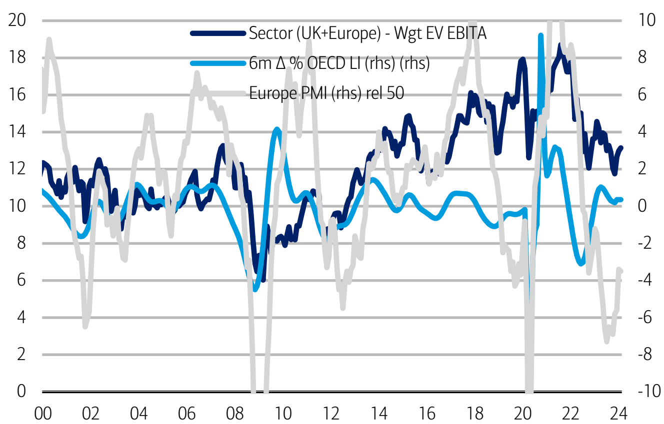
Since 2022, we have seen broad de-rating across Europe. However, within that, in the period October 2022- March 2023 we saw cyclical firms outperform vs quality firms by 13%, but then in the period March through to July underperform by 9%. Since August 2023, performance in both cyclical and quality firms has been similar.

Comparing 12m fwd P/E levels now suggests that 'quality' is now trading at a c102% P/E premium to more cyclical stocks, slightly above the average since 2019 (100%) and still elevated vs wider historical levels.

Exhibit 9: Sector 12m fwd EV/EBITA vs OECD LI & PMIs
Sector multiples have followed OECD LIs rather than PMIs



Source: BofA Global Research estimates, Refinitiv

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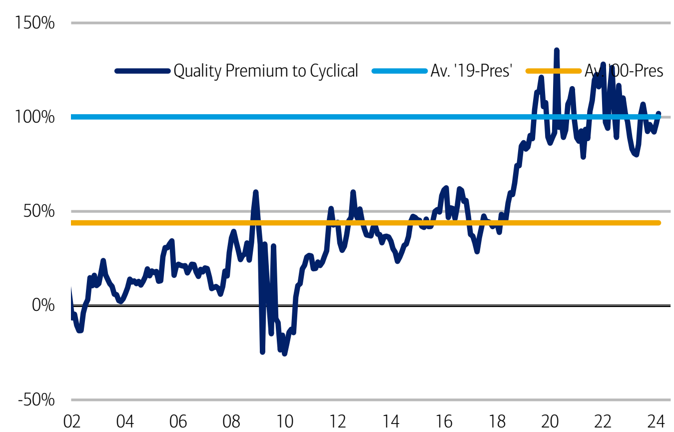
Exhibit 10: 12m fwd premium of quality names vs cyclical names
The quality premium is now back in line with the average level seen since 2019



Source: BofA Global Research estimates, Refinitiv
Cyclical: Sandvik, SKF, Volvo, Morgan Advanced, Bodycote, Aalberts. Quality: KONE, Atlas Copco, Assa Abloy, Spirax-Sarco, Halma, Legrand

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1. Leading indicators: mixed signals

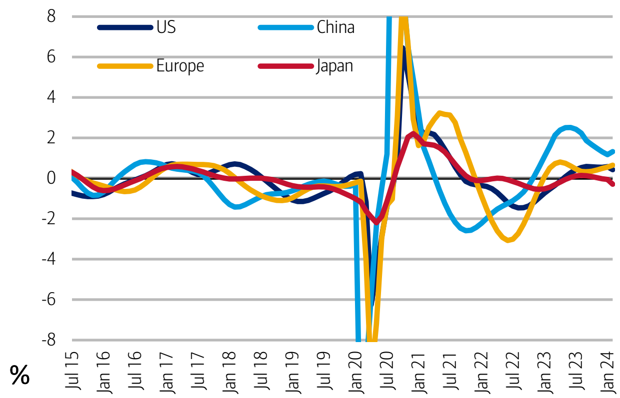
Leading indicators (LI) from the OECD remain a key indicator of sector performance EPS revisions and investor positioning, while PMIs are more coincident indicators. Inflection points are typically indicated by the 6mth/6mth change, while trends are better reflected in the YoY change. Historically LI momentum leads PE multiples, PMIs, industrial production, EPS revisions and analyst ratings.

Recession risks dominated investor sentiments through most of 2022, but the indicators improved globally from Q3/Q4 2022. However, this momentum peaked in Q1/Q2 2023, and since we have seen negative momentum across all regions.

However, it looks as though we have seen a turning point in the European momentum (6m/6m indicators), and may have seen signs of momentum stabilisation in China. In the US, momentum appears to be peaking, whereas momentum is falling in Japan.

Trend rates are also mixed, with China peaked YoY and Europe fading slightly. The US remains on an upward trajectory YoY where Japan appears to have fallen slightly in February following slight positive momemtum.

Exhibit 11: Regional OECD Lead Indicators: 6m/6m change = inflection
All regions inflected near the end of 2022, and then across Q1/Q2 2023



Source: OECD

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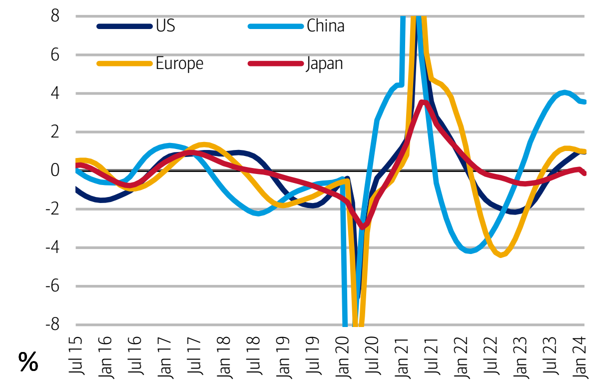
Exhibit 12: Regional OECD Lead Indicators: YoY change = trend
The trend rate suggests similar or slightly better macroeconomic activity YoY, though Europe & China are inflecting



Source: OECD

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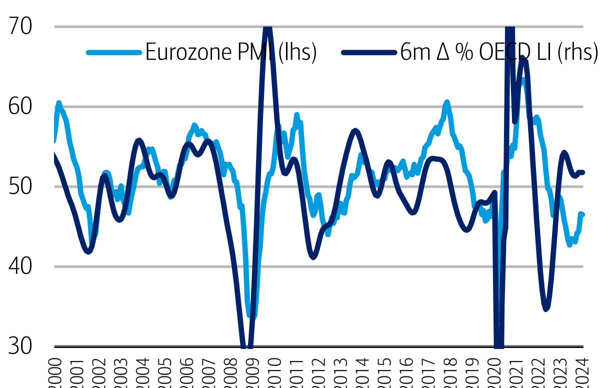
Exhibit 13 and 14 show how historically the OECD lead indicators lead PMIs. In the last 6m we have seen the data diverge, driven by the broader scope of the data feeding into the LIs vs PMI being simply a survey of sentiment.

Exhibit 13: Eurozone PMI vs 6m % change in OECD LI
The 6 month European LI has improved since the 2022 trough



Source: BofA Global Estimates, Bloomberg

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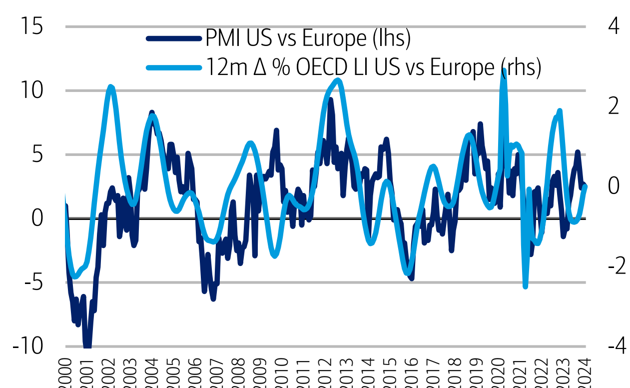
Exhibit 14: Spread between EU & US PMI vs y/y % change OECD LI
US PMI has been stronger vs Europe since 2022 with the same trend



Source: BofA Global Estimates, Bloomberg

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2. PMIs: positive signs despite flat PMI MoM

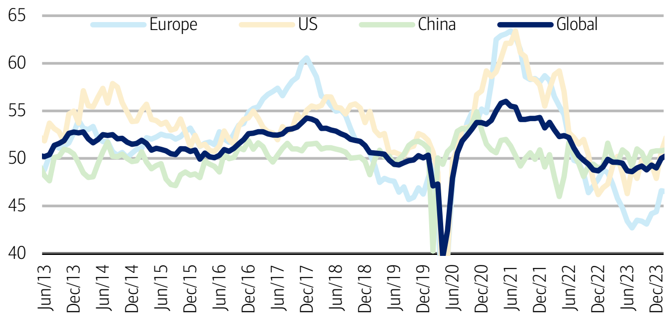
For an in-depth analysis of the PMIs, read European Industrials: Short Cycle Tracker: Positive signs despite flat PMI MoM

We have seen PMIs deteriorate globally since 2021, especially in Europe. However, since the start of the year we have started to see a recovery. Although there was limited MoM movement in the PMI in February, this is against the biggest positive MoM movement seen since March 2021 in January PMIs. European PMI fell c0.1ppts MoM, however the new order PMI grew 0.6ppts MoM.

The European PMI remains weak relative to other regions, with the US, Chinese and Global PMIs all consistently >49 in the last few months. However, we still remain positive on the European PMI given the positive momentum.

With c46% of revenue within Capital Goods within Europe, European PMI tends to be the most important PMI in determining future demand. c11% of the revenue within Asia relates to China. Although this might indicate China PMI might be of low importance, given a lot of indirect end market consumption occurs in China (e.g. 50% of all metal demand is from China, which drives Mining demand and hence Mining equipment demand), the Chinese PMI tends to be more important that Cap Goods direct revenue exposure would indicate.

Exhibit 15: Global PMIs, by region (2013-present)
European PMI is lagging well behind US and China PMIs



Source: BofA Global Research, Bloomberg, Refinitiv

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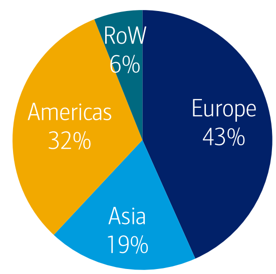
Exhibit 16: Capital goods revenue split by end market (2022)
The European Cap Goods sector unsurprisingly has Europe as its highest end market exposure



Source: BofA Global Estimates, company reports

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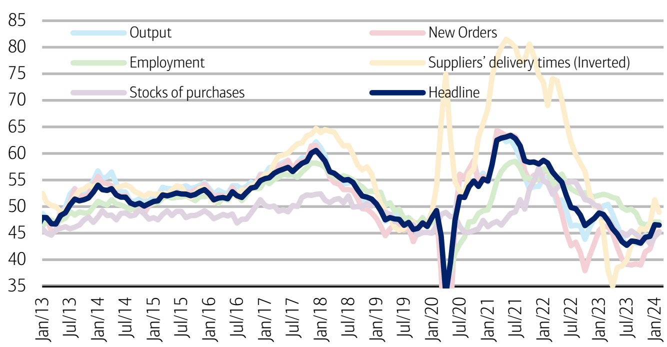
Europe: coming off a period of sustained weakness

European PMI fell c0.1ppts MoM to 46.5, however we interpret the score as positive for three reasons: 1) The New Order PMI grew 0.6ppts MoM; 2) There was a c0.4ppts headwind to headline PMI from easing concerns in the Red Sea; 3) The PMI is usually c0.3ppts weaker in Feb vs Jan.

The gap between European output and new order PMIs has narrowed to c1.3ppts (10y Av: 1.2ppts), normalising vs a 4.1ppt gap in October.

Exhibit 17: European PMIs, by component (2013-present)
The PMI appears to have troughed, with recent improvement



Source: BofA Global Research, Bloomberg. High scores on "Suppliers; delivery times" supports PMI scores, and implies a long period of time to deliver

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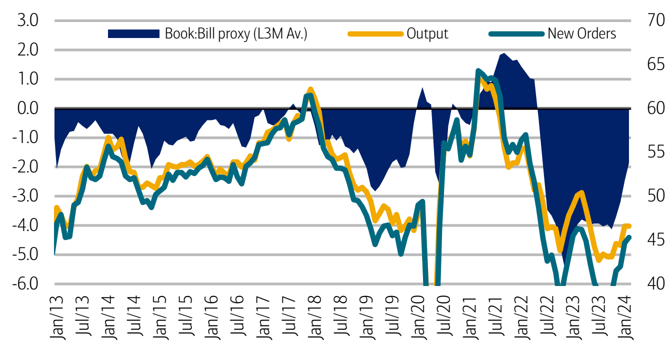
Exhibit 18: Book:Bill effect (2013-present)
Output continues to be far higher than new orders relative to history



Source: BofA Global Research, Bloomberg. Methodology at back of report

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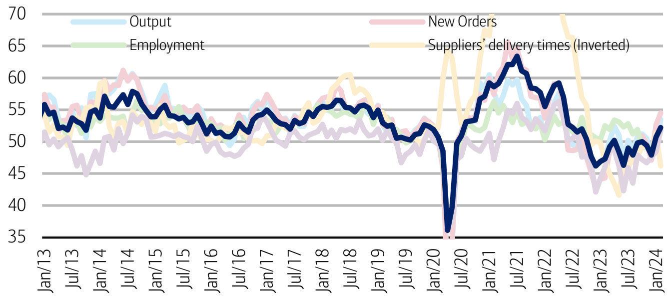
United States: Strong positive momentum seen

In the US, the February PMI of 52.2 improved MoM, with the New Order PMI score of 54.5 the highest New Order PMI since May 2022, improving 1.9ppts MoM (following 5.5ppts MoM improvement in January, the fastest single month increase since June 2020. Downward pressure on the US PMI has been less than in Europe, with Book:bills now recovered and the price/cost dynamic largely neutral.

US PMI is >5ppts stronger than Europe, meaning we continue to expect demand to be more positive in the US vs Europe.

Exhibit 19: US PMIs, by component (2013-present)
US PMI's are now above 50 after a shortfall in Oct/Nov 2023



Source: BofA Global Research, Bloomberg. High scores on "Suppliers; delivery times" supports PMI scores, and implies a long period of time to deliver

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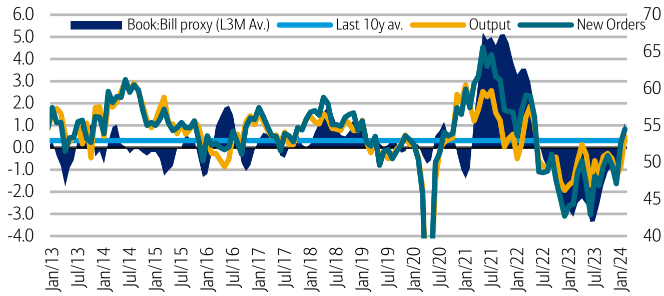
Exhibit 20: Book:Bill effect (2013-present)
The disparity between output and new orders still has been elevated relative to history



Source: BofA Global Research, Bloomberg. Methodology at back of report

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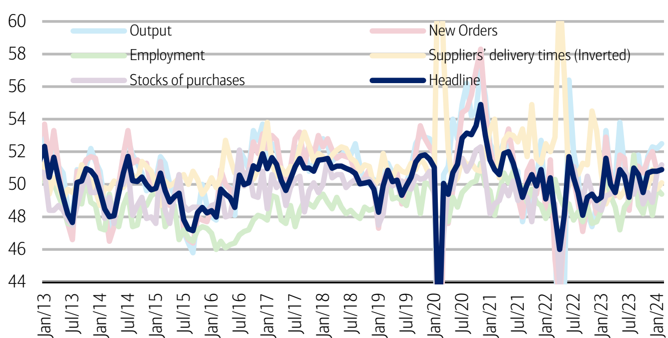
China: momentum volatile but improving

In China there has been slightly positive PMI momentum when looking back to April 2022, although taking conclusions on MoM basis is tough given the volatility. The PMI continues to be boosted by orders and output, while employment and stocks of purchasing indicators are weaker.

In both China and US the PMIs are not indicating any significant destocking trends (stocks of purchases roughly in line with stocks of finished goods). In Europe we have seen indications of significant destocking since Q1 2023, but this now appears to have peaked. We believe we are coming close to the end of the destocking stage.

Exhibit 21: China PMIs, by component (2013-present)
The trend rate of the PMI has been slowly increasing since mid-2022



Source: BofA Global Research, Bloomberg

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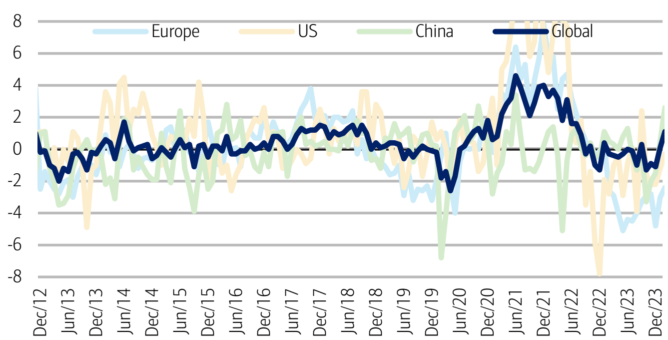
Exhibit 22: Inventory build expectations, be region (2013-present)
Expectations of inventory build peaked in 2021



Source: BofA Global Research, Bloomberg, Refinitiv. Methodology at back of report

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3. Valuation: >5% below the 10y avg., but c10% above vs 10-'19 avg.

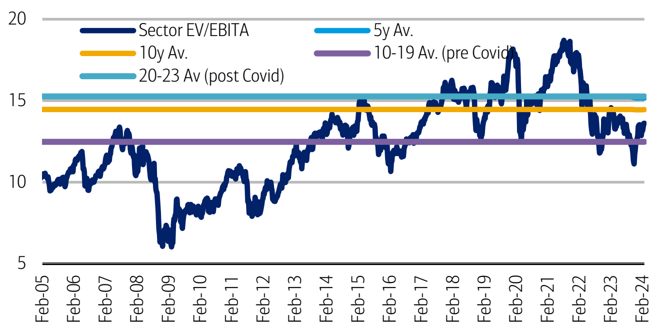
Since January 2022, the European Cap Goods sector has gone through a broad de-rating cycle, moving from a c18x 12m fwd EV/EBITA in Jan'22 before finally troughing at c11.1x in October 2023. The main factors driving this included a cooling of demand following higher interest rates, combined with lower demand following period of pre-ordering and higher demand during Covid-19.

We saw a small period of re-rating between September 2022 and February 2023 (from 11.8x to 14.5x) on the easing of supply chains and input cost normalisation, but the overall trajectory has been negative.

Since the October 2023 trough however we have seen the sector re-rate to 13.6x today on the expectation of peaked interest rates. This multiple is >c5% discount to the 10-year average for the sector (at 14.5x EV/EBITA), and a >10% discount to the 5 years average. However, it is at a 9% premium to the 2010-2019 average for the sector, pre-Covid. The sector valuation multiple has a higher correlation with the OECD Lead Indicators than the PMIs, which explains why multiples initially held up while PMIs initially fell. Our target sector multiple for 2025 is currently at c11x.

Our "Equity Strategy Team" (see note) are underweight capital goods, expecting Cap Goods to underperform vs European equities by 5 – 11% in the next 12 months, following a 15% outperformance since October. They also remain negative expect European equities, expecting them to return (-3%) – (-15%) in the next 12 months. They remain negative on Capital goods given the weak Euro are growth momentum, and on weaker China PMIs.

Exhibit 23: Sector 12mth FWD EV/EBITA
The sector valuation has re-rated to c13.6x 1yr forward EBITA



Source: BofA Global Research estimates

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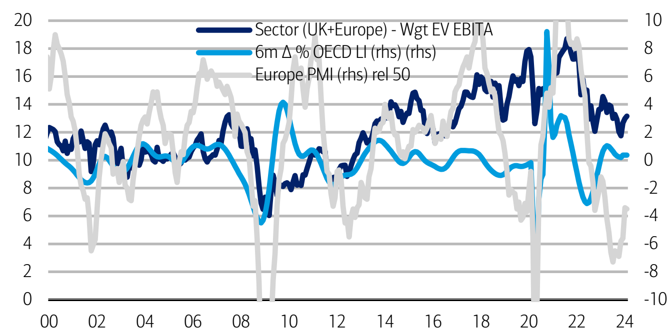
Exhibit 24: Sector 12m fwd EV/EBITA vs OECD LI & PMIs
Sector multiples have followed OECD LIs rather than PMIs



Source: BofA Global Research estimates, Refinitiv

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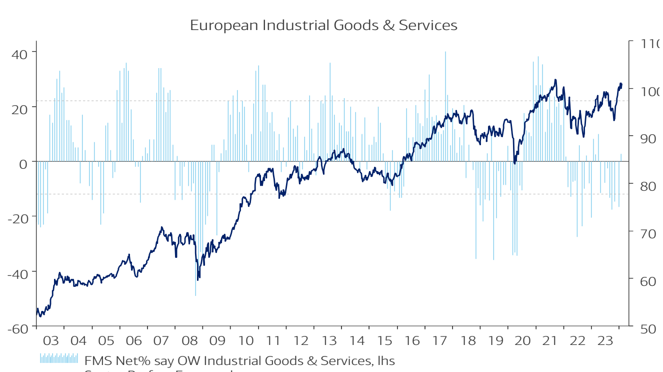
4. Positioning: investors overweight on European Cap Goods

In the February Fund Manager Survey (see our European and Global reports), investors switched back to a +3% overweight positioning on European industrials MoM from a net -17% underweight in January. However, investors allocation to Global industrials have maintained overweight to a net 9%, vs net 6% overweight in January, while investors swung to be c11% underweight in the US. This would seem to reflect the relative appeal of European industrials over their US peers given similar exposures but a c2x turn discount on valuation (2025E EV/EBITA).

Exhibit 25: European industrial goods & services
Net 3% of European participants say they are overweight the sector



Source: BofA European Fund Manager Survey

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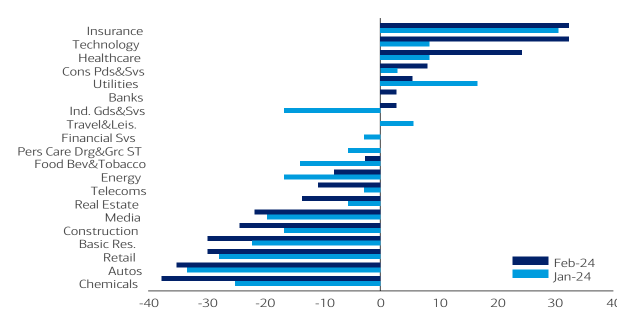
Exhibit 26: Current EUROPEAN sector snapshot (% saying overweight-% saying underweight)
Investors move to overweight positioning in European Industrials in February



Source: BofA Regional Fund Manager Survey

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5. Fundamental outlook: slowdown continues, but positive guides

Our takeaways from Q4 results (see note) have so far been that fundamentals are slowing, but guidance has been more robust than consensus expectations and company commentary remains constructive due to backlog visibility, underlying trends such as energy transition and energy efficiency and the support of government stimulus (primarily in the US). Our summary points have been:

1) Q4 results are broadly in line with expectations. Orders ex Energia(ENR)/Volvo have beaten expectations by c1.5%, with revenue/OpProfit in line. Volvo beat on pricing and Siemens Energy on grid.

2) Guidance has been slightly stronger than expected. ABB guided 5% org (cons 4%), with Wartsila guiding for a better 2024 market environment. US peers such as Eaton and Emerson have also guided to FY24 growth above prevailing consensus expectations.

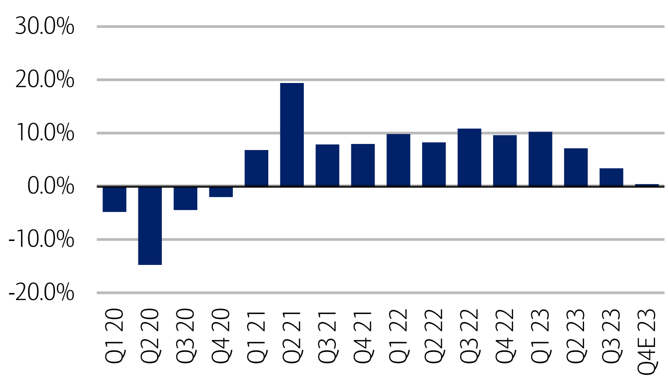
3) Revenue growth is slowing. Now c3% (vs Q2/Q3: 9/4%) as backlogs normalise,

4) Cash conversion is picking up. Now 140% of EBIT (vs Q4'22/Q3'23: 120%/107%).

5) Margins are also falling. 60bps QoQ as tailwinds around price/cost and strong volumes fade.

Exhibit 27: Organic sales growth, y/y

Organic growth has continued to slow in Q4 as pricing and backlogs fade



Source: BofA Global Research estimates, company report

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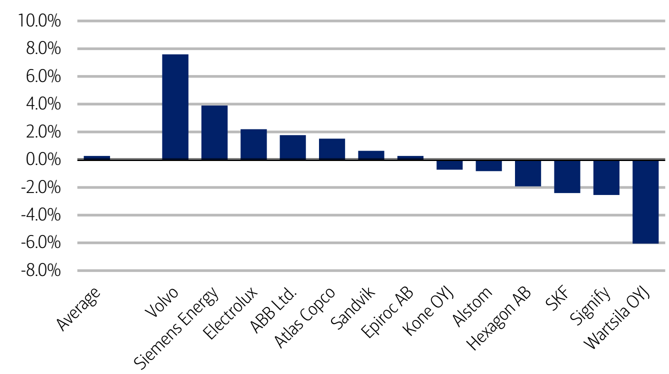
Exhibit 28: Absolute revenue beats vs consensus expectations

Q4 actual revenues have fallen roughly in line with consensus expectations (taken from our Q4 so far report)



Source: BofA Global Research estimates, company reports, Visible Alpha (as of 19/01/2024)

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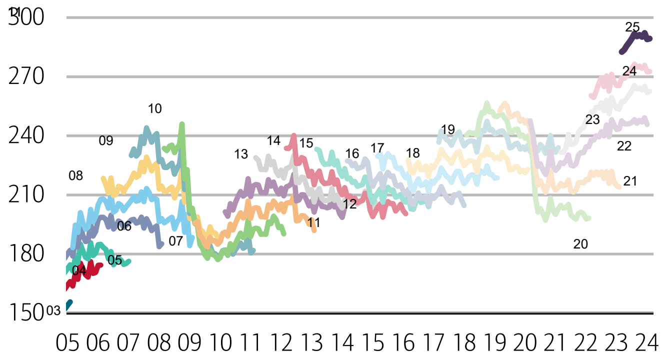
6. Consensus expectations: profit expectations troughing, but consensus still "buy" weighted

Sales and earnings revisions in the Capital Goods sector have had two periods of clear negative revisions: the great financial crisis and the COVID-19 crisis. Following the 2008-2009 crisis, EPS growth expectations dropped below the double-digit mark but recovered and stabilised higher after 2011.

2024 estimates have increased following a 2023 that held up better and delivered more than people expected back in January. However, growth and profitability assumptions have stagnated. Expectations for 2025 reflect a return to more 'normal' levels of growth and profitability.

In the LTM 2024/2025 MSCI Cap Goods sales revisions have been revised upwards by c1.5/2.7%. LTM 2024/2025 EPS revisions have also revised upwards c2.6/5.0%. Month on month 2024-2025 Sales and EPS revisions have rose by 0.3-0.5%.

Exhibit 29: MSCI Cap Goods – Cons. sales development FY
2023 sales expectations have continued to revise higher



Source: BofA Global Research estimates, Refinitiv

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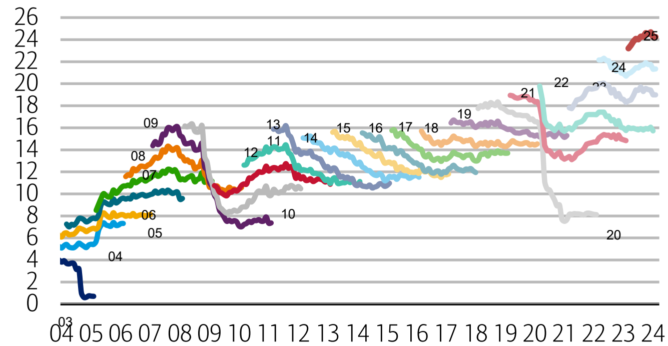
Exhibit 30: MSCI Cap Goods – Cons. EPS evolution by Financial Year
With EPS moving up in line, indicating stable margins



Source: BofA Global Research estimates, Refinitiv

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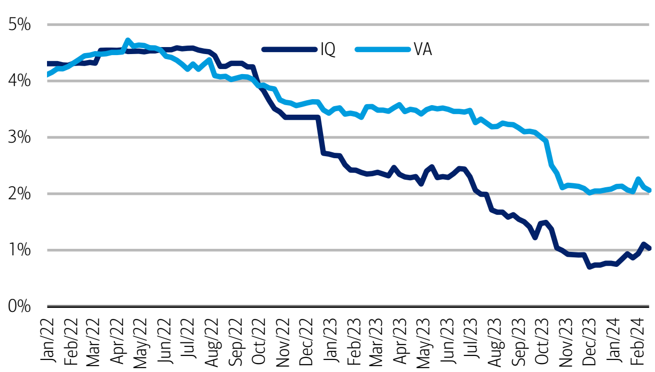
Using Visible Alpha, YTD organic growth estimates for 2024 have gradually declined over the LTM (now c1%), with the increase in total forecast revenue above driven from growth in 2023 (e.g. pricing) that has pushed the opening base for 2024 higher. 2025 growth however continues to be resilient at c5%

Exhibit 31: 2024 Revenue organic growth – BofA vs VA
BofA 2024 organic growth estimates have fallen since Jan'22, now c1%



Source: BofA Global Research estimates, Visible Alpha

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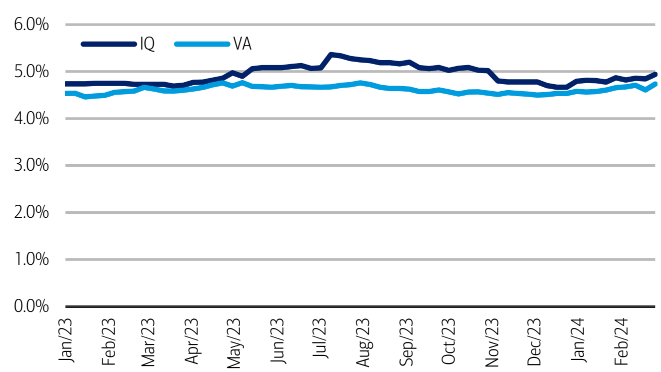
Exhibit 32: 2025 Revenue organic growth – BofA vs VA
BofA 2025 organic growth estimates have remained stable at c5%



Source: BofA Global Research estimates, Visible Alpha

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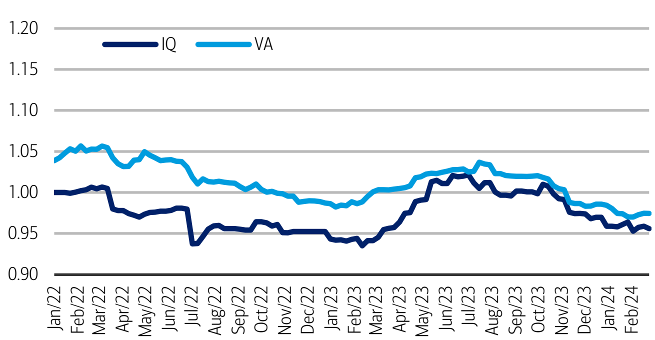
Meanwhile, YTD expectations for operating profit in 2024 have declined by c1.5% as margin and growth estimates have fallen marginally, while YTD 2025 operating profit has gained expectation by c+0.2% and appears to have troughed.

Exhibit 33: 2024 Operating profit – BofA vs VA, indexed
BofA estimates for 2024 op. profit have fallen 5% vs Jan'22



Source: BofA Global Research estimates, Visible Alpha

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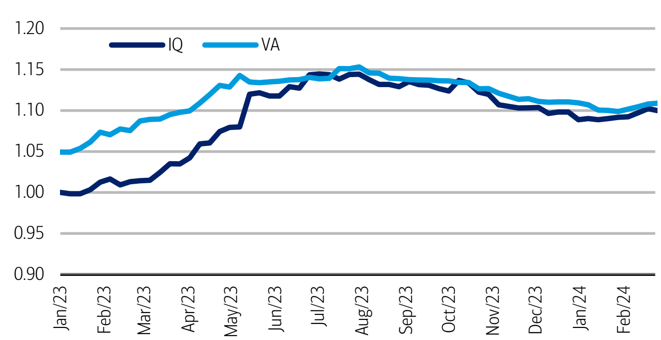
Exhibit 34: 2025 Operating profit – BofA vs VA, indexed
BofA estimates for 2025 op. profit have increased by c10% since Jan'23



Source: BofA Global Research estimates, Visible Alpha

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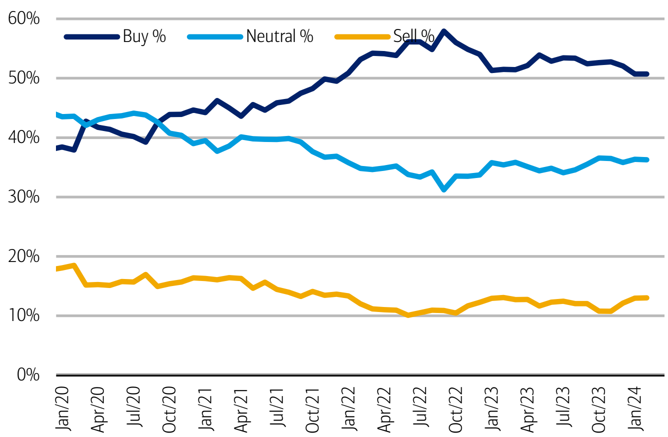
Since September 2022 the percentage of Buy rating on Cap Goods names has fallen, peaking at c58% in September 2022 to c51% now.

Exhibit 35: Consensus sell side ratings for our coverage universe (January 2020 - February 2024)

MoM the % of Ratings has remain flat in February



Source: BofA Global Research, Bloomberg

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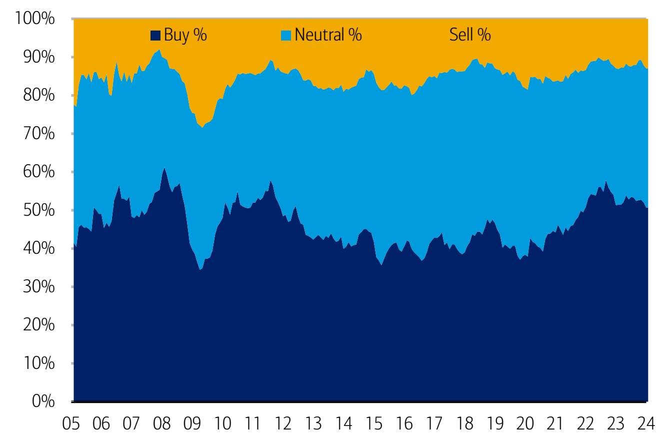
Exhibit 36: Consensus sell side ratings for our coverage universe (January 2005 - February 2024)

Sell side sector average '05-'24 for Buy-46%, neutral -38%, Sell-15%



Source: BofA Global Research, Bloomberg

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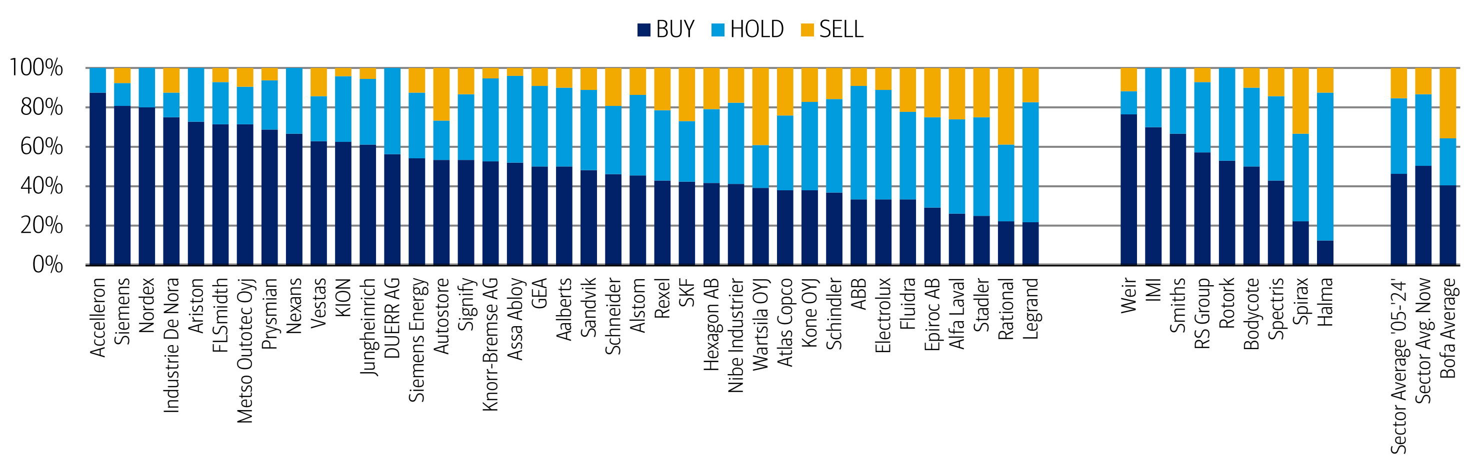
The sell side is notably negative on a few names such as Legrand and Rational but continues to be constructive more broadly on Cap Goods, with c50% of analysts having Buy ratings, vs BofA 40% Buy ratings. This is higher than the historical average of c46% buys across 2005-2024.

Exhibit 37: Consensus sell side and BofA ratings for our coverage universe (March 2024)

The sell side is notably negative on Legrand, Rational and Stadler, while positive on Accelleron, Siemens and Nordex



Source: BofA Global Research, Bloomberg

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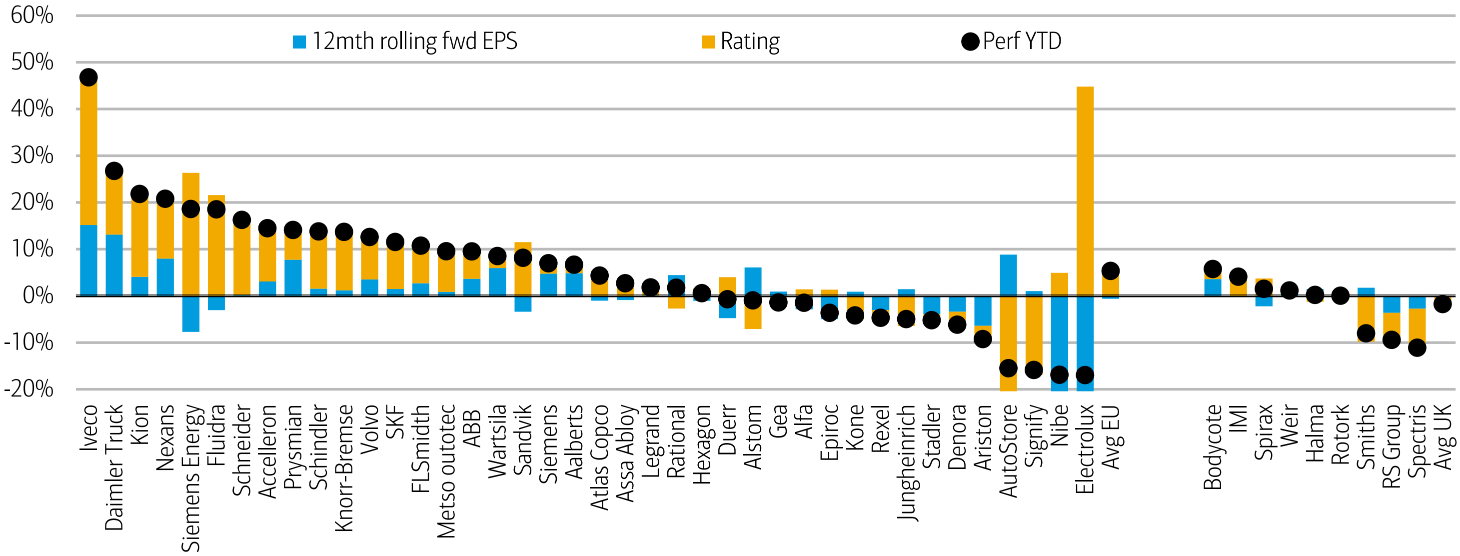
Europe: Multiples and EPS revisions

Exhibit 39: Rolling 12m fwd. EPS/PE changes

On average, Europe non-UK cap goods stocks are up YTD



Source: BofA Global Research estimates, Refinitiv

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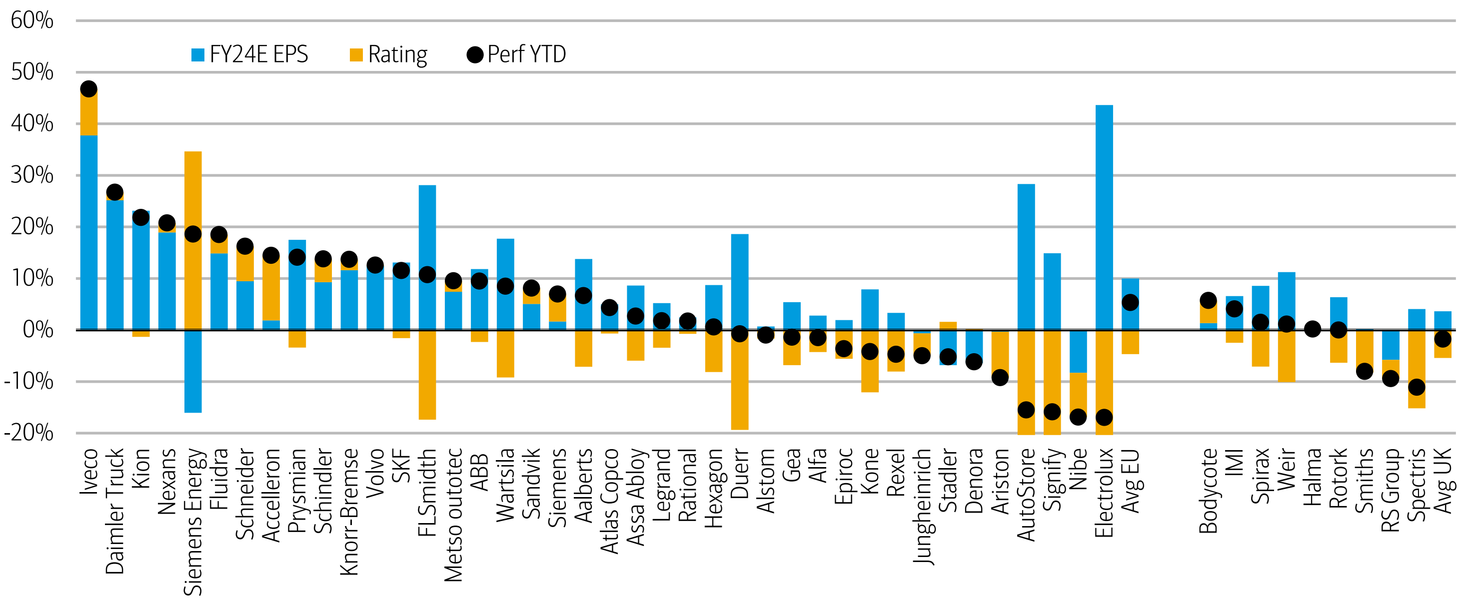
Exhibit 40: Changes in 2024E EPS and PE

The average company has seen positive revisions to 2024 EPS expectations (blue column)



Source: BofA Global Research estimates, Refinitiv

Note: For Alstom, Halma, Siemens and Smiths, forward EPS estimates are for F22-23

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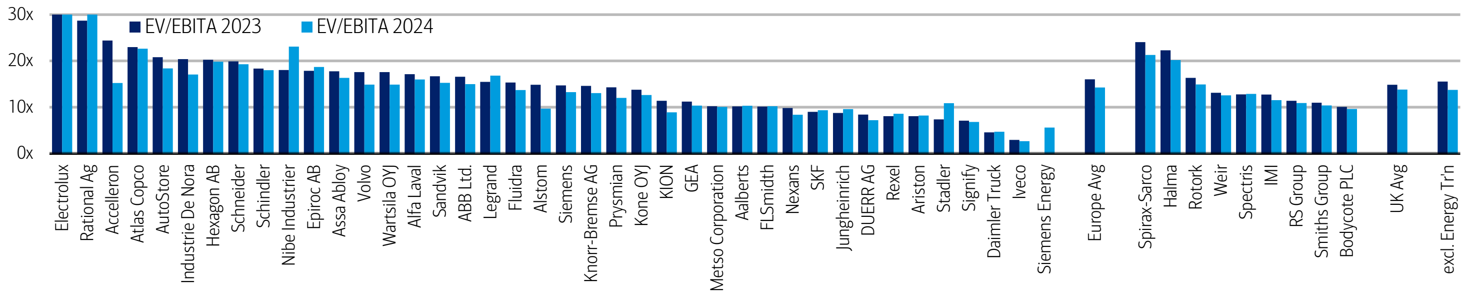
Europe: Valuations and PE ranges

Exhibit 40: EV/EBITA ratios for 2023E and 2024E for Europe and UK stock clusters

Average EV/EBITA is c15.5x for 2023E and c13.7x for 2024E (excluding Energy Transition stocks)



Source: BofA Global Research estimates, Refinitiv. Note: Companies displayed most expensive to least, Euro and UK)

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Exhibit 41: 2023E Free Cash Yield and Dividend Yield for Europe and UK stock clusters

Free cash flow yields average c4% while dividend yields average c2.5% (excluding Energy Transition stocks)

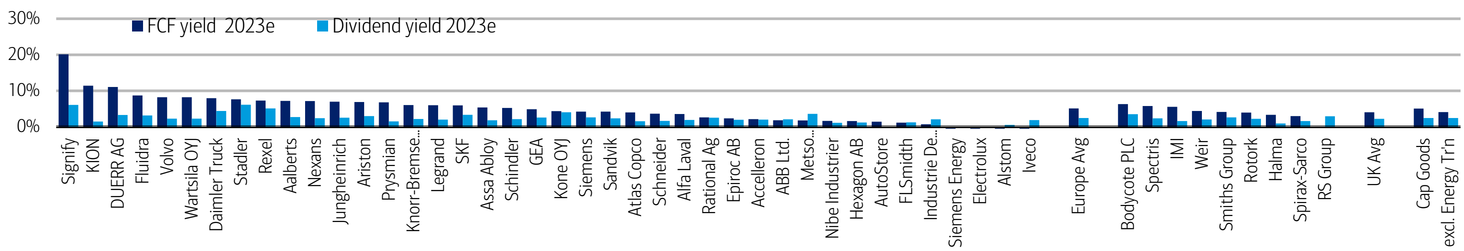

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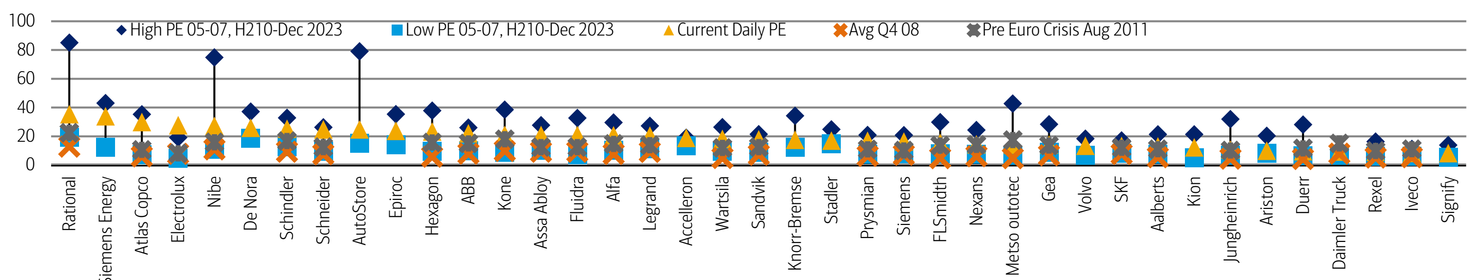
Exhibit 43: European stocks trade within historical ranges (on a 12 month forward view)

Stocks trade within historical ranges



Source: BofA Global Research estimates, Refinitiv

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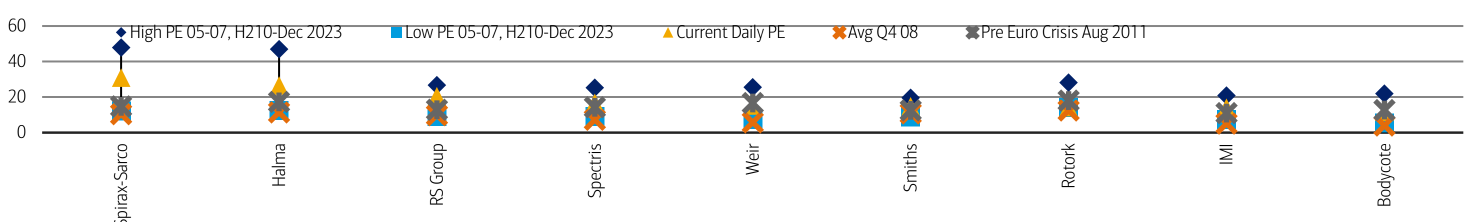
Exhibit 44: UK capital goods stocks trade within historical range (on a 12 month forward view)

UK capital goods stocks trade within historical ranges



Source: BofA Global Research estimates, Refinitiv

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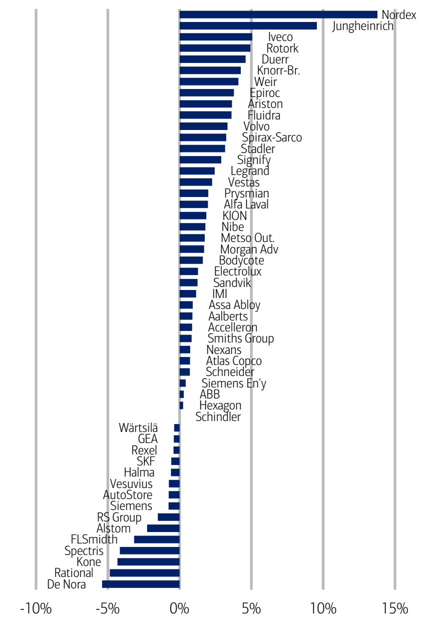
Stock performance charts

Exhibit 45: 1W Absolute Performance
Best performer Nordex; worst performer De Nora



Source: BofA Global Research, Bloomberg

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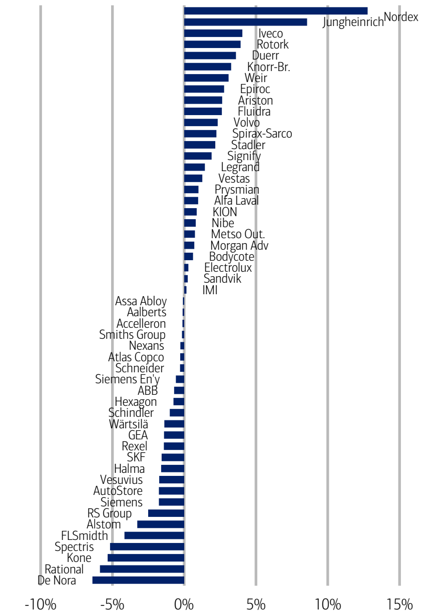
Exhibit 46: 1W Relative Performance
Best performer Nordex; worst performer De Nora



Source: BofA Global Research, Bloomberg

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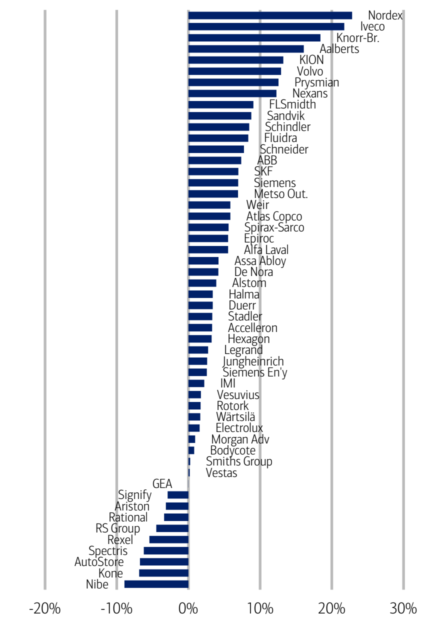
Exhibit 47: 1M Absolute Performance
Best performer Nordex; worst performer Nibe



Source: BofA Global Research, Bloomberg

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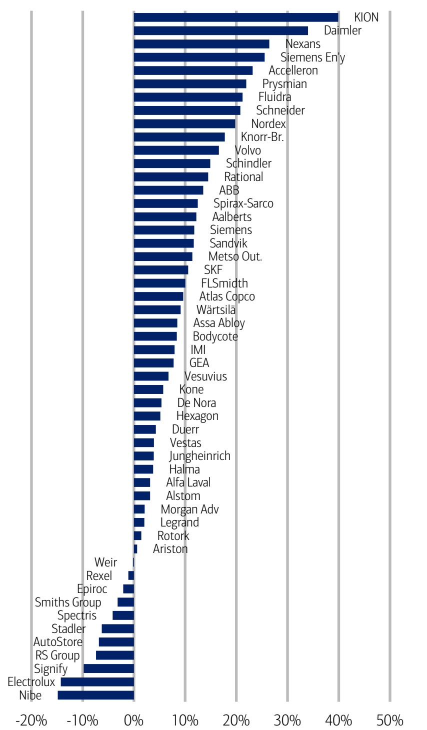
Exhibit 47: 3M Absolute Performance
Best performer KION; worst performer Nibe



Source: BofA Global Research, Bloomberg

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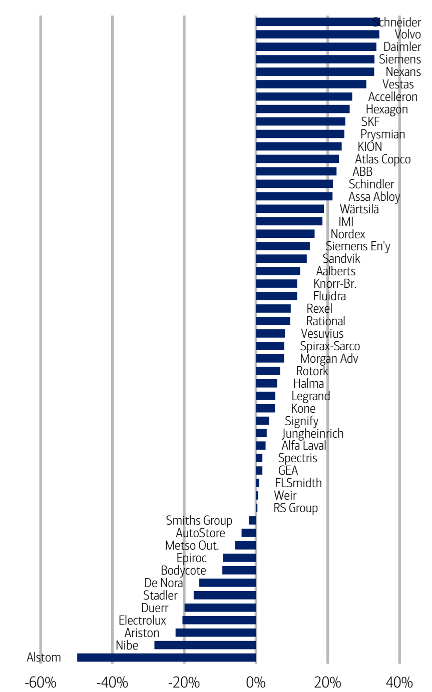
Exhibit 49: 6M Absolute Performance
Best performer Schneider; worst performer Alstom



Source: BofA Global Research, Bloomberg

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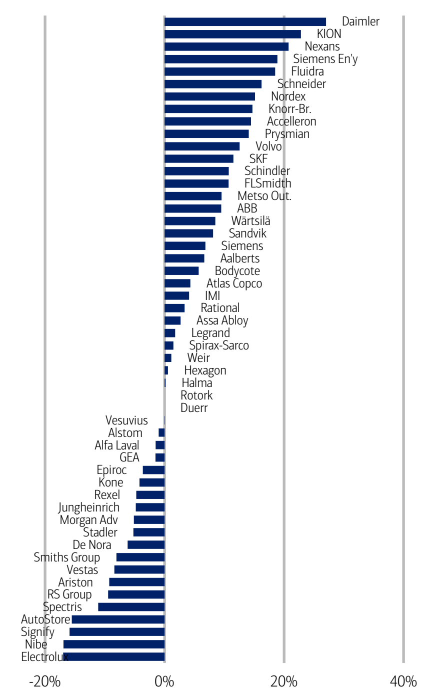
Exhibit 50: YTD Absolute Performance
Best performer Daimler; worst performer Electrolux



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Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

[R1] Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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