STANDARD
&POOR'S

Global Credit Portal
RatingsDirect®

April 8, 2010

As U.S. Manufacturers Increase Capital Investment, Highly Leveraged Firms May Have More Ground To Make Up

Primary Credit Analysts:
Gregg Lemos Stein, New York (1) 212-438-1730; gregg_lemos-stein@standardandpoors.com
Thomas R Kelly, New York (1) 212-438-7699; tom_kelly@standardandpoors.com

Table Of Contents

As U.S. Manufacturers Increase Capital Investment, Highly Leveraged Firms May Have More Ground To Make Up

U.S. nonfinancial corporate issuers are starting to recover from the severe credit erosion of 2008 and 2009. Defaults have moderated and a more benign economic outlook has contributed to an increase in positive rating actions. Still, Standard & Poor's Ratings Services believes that the recovery may drag out in many sectors--even if the U.S. economy continues to expand and avoids a double-dip recession.

For the broad range of capital-intensive manufacturing sectors and industries that depend heavily on these sectors, one potential complicating factor is the low capital spending that persisted during the downturn. This trend was most pronounced among speculative-grade rated companies (rated 'BB+' or lower). In our view, the ability to cut spending dramatically--in some cases nearly to minimal levels necessary to keep operations running--was positive for many companies' liquidity and cash flow during the worst periods of late 2008 and much of 2009.

However, we believe companies will eventually need to increase spending to make up for past underinvestment. This may be difficult for those with highly leveraged or aggressive financial risk profiles. Conversely, we believe some firms' ability to preserve a higher level of reinvestment through the downturn underscores their superior financial flexibility. This in turn supports--and in some cases even enhances--their long-term competitive positions, in part because they will have invested in new facilities or equipment that might give them an edge over peers.

Spending May Increase Gradually

Even though capital spending has increased during the past 12 months (see chart 1), we do not think firms will rush to return to predownturn spending levels. This is especially true because the U.S. manufacturing sector is still at very low levels of capacity utilization, according to Federal Reserve data (see chart 2). Although it has improved steadily from the depths of mid-2009, utilization remains well below the low point of the 2001 recession.

Chart 1

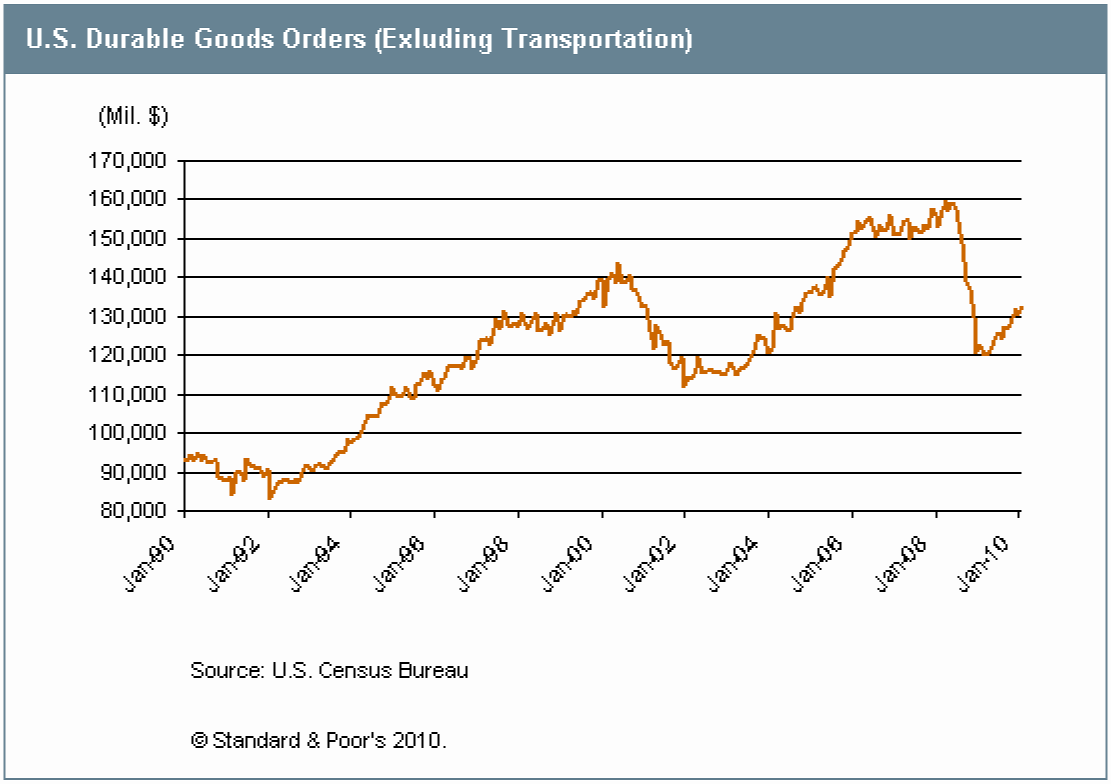
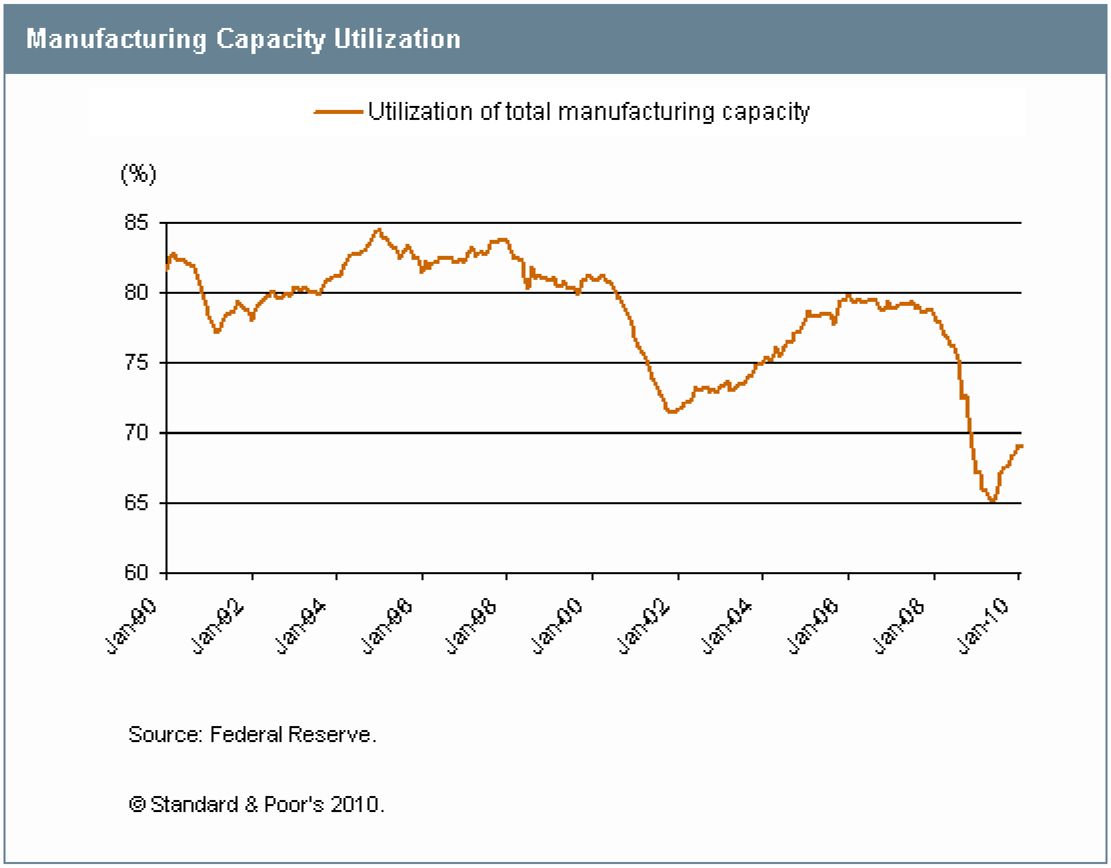

U.S. Durable Goods Orders (Exluding Transportation)
(Mil. $)
170,000
160,000
150,000
140,000
130,000
120,000
110,000
100,000
90,000
80,000
Jan-90
Jan-92
Jan-94
Jan-96
Jan-98
Jan-00
Jan-02
Jan-04
Jan-06
Jan-08
Jan-10
Source: U.S. Census Bureau
© Standard & Poor's 2010.

Chart 2



In our view, the timing of capital spending increases will depend on a range of macroeconomic, competitive, and company-specific factors. However, absent evidence to the contrary, we would expect companies eventually to bring their capital spending closer to historical norms, relative to sales or some other metric such as depreciation. Although we recognize that some companies may have found ways to reduce permanently the capital intensity of their business through innovation, greater productivity, joint ventures, or outsourcing of production (or some combination of these), we do not believe this will lead to a step-down in long-term investment needs for most companies.

Hard-Hit Industries Will Take Longer To Bounce Back

Individual company data from selected heavy manufacturing industries shows the dramatic decline in capital expenditures in 2009 compared with 2008. For example, auto suppliers rated by Standard & Poor's that report financial results publicly cut capital spending by an aggregate 32% year over year in 2009 (see table 1), as U.S. auto sales and production plummeted to their lowest levels in decades and General Motors Corp. and Chrysler LLC entered bankruptcy. Although the declines varied greatly by supplier, as a group the speculative-grade rated suppliers saw a somewhat bigger decline of 36%. Meanwhile, two of only three investment-grade rated suppliers in North America-- Johnson Controls Inc. and BorgWarner Inc.--cut spending to a comparatively lesser degree (20% and 15%, respectively).

Table 1

Auto Suppliers

		--2009--			--2008--			
(Mil. $)	Rating as of April 7, 2010	Capex	D&A*	Capex/D&A (%)	Capex	D&A*	Capex/D&A (%)	Capex change 2009 vs. 2008 (%)
BorgWarner Inc.	BBB/Stable/--	172	235	73	370	260	142	(53)
Johnson Controls Inc.	BBB/Positive/A-2	647	707	92	807	745	108	(20)
Magna International Inc.	BBB/Stable/--	629	737	85	739	873	85	(15)
IG subtotal		1,448	1,679	86	1,916	1,878	102	(24)
Affinia Group Inc.	B/Stable/--	31	38	82	25	36	69	24
American Axle & Manufacturing Inc.	B-/Stable/--	142	135	105	140	200	70	1
American Tire Distributors Inc.	B/Stable/--	13	32	40	13	26	53	(5)
ArvinMeritor Inc.	CCC+/Positive/--	111	81	137	138	120	115	(20)
Commercial Vehicle Group Inc.	CCC+/Developing/--	6	17	37	13	19	66	(51)
Cooper Tire & Rubber Co.	B/Watch Pos/--	79	124	64	129	143	90	(38)
Dana Holding Corp.	B/Stable/--	99	311	32	250	292	86	(60)
Exide Technologies	B/Stable/--	109	96	114	57	101	56	92
Federal-Mogul Corp.	B+/Stable/--	176	327	54	320	349	92	(45)
Goodyear Tire & Rubber Co.	BB-/Negative/--	746	636	117	1,049	660	159	(29)
Harman International Industries Inc.	B+/Positive/--	80	147	54	139	152	91	(43)
KAR Auction Services Inc.	B/Stable/--	66	172	38	130	183	71	(49)
Lear Corp.	B/Positive/--	119	264	45	168	299	56	(29)
LKQ Corp.	BB-/Stable/--	56	38	147	67	33	200	(16)
Shiloh Industries Inc.	B/Negative/--	7	29	25	9	33	27	(16)
Stoneridge Inc.	B+/Negative/--	12	20	60	25	26	93	(52)
Tenneco Inc.	B/Positive/--	120	221	54	233	222	105	(48)
TRW Automotive Inc.	B+/Stable/--	201	495	41	482	576	84	(58)
United Components Inc.	B-/Negative/--	15	37	41	32	37	86	(52)
SG subtotal		2,187	3,220	68	3,417	3,507	97	(36)
Total		3,635	4,899	74	5,333	5,385	99	(32)

*D&A excludes amortization in cases where amortization is reported separately in the consolidated cash-flow statement. Data are as reported by the companies and do not include Standard & Poor's adjustments for operating leases, etc.

A similar downturn in demand in late 2008 and much of 2009 buffeted the highway trucking sector (see table 2), and freight tonnage remains much lower than it was just a few years ago. With little need to add new trucks, the four trucking firms we rate that report financial results publicly reduced capital spending by an aggregate 35%, including a 74% drop by the two speculative-grade rated firms.

Table 2

Trucking Companies

		--2009--			--2008--			
(Mil. $)	**Rating as of April 7, 2010**	**Capex**	**D&A***	**Capex/D&A (%)**	**Capex**	**D&A***	**Capex/D&A (%)**	**Capex change 2009 vs. 2008 (%)**
Con-way Inc.	BBB-/Negative/--	68	185	37	234	202	116	(71)
Hunt (J.B.) Transport Services Inc.	BBB/Stable/A-2	353	189	187	303	202	150	16
IG subtotal		421	374	113	538	405	133	(22)
Quality Distribution Inc.	B-/Stable/--	8	20	41	15	21	70	(44)
YRC Worldwide Inc.	CCC-/Developing/--	37	255	15	162	264	61	(77)
SG subtotal		46	275	17	177	285	62	(74)
Total		467	650	72	715	690	104	(35)

*D&A excludes amortization in cases where amortization is reported separately in the consolidated cash-flow statement. Data are as reported by the companies and do not include Standard & Poor's adjustments for operating leases, etc.

By contrast, the predominantly investment-grade rated railroad industry (see table 3), which faced a smaller drop-off in revenues during the downturn, had an aggregate 14% decline in capital spending. Even in this sector, though, the two speculative-grade rated railroads cut spending more than their larger investment-grade rated competitors did. Speculative-grade companies registered a combined 33% decline, compared with a 13% decline for investment-grade companies.

Table 3

Railroads

		--2009--			--2008--			
(Mil. $)	**Rating as of April 7, 2010**	**Capex**	**D&A***	**Capex/D&A (%)**	**Capex**	**D&A***	**Capex/D&A (%)**	**Capex change 2009 vs. 2008 (%)**
Burlington Northern Santa Fe LLC	BBB+/Stable/A-2	2,356	1,537	153	2,768	1,397	198	(15)
Canadian National Railway Co.	A-/Stable/A-2	1,402	790	177	1,424	725	196	(2)
Canadian Pacific Railway Co.	BBB/Negative/--	724	497	146	836	437	191	(13)
CSX Corp.	BBB-/Stable/--	1,447	908	159	1,740	918	190	(17)
Norfolk Southern Corp.	BBB+/Stable/A-2	1,299	845	154	1,558	815	191	(17)
Union Pacific Corp.	BBB/Stable/--	2,384	1,444	165	2,780	1,387	200	(14)
IG subtotal		9,612	6,021	160	11,106	5,679	196	(13)
Kansas City Southern	B/Stable/--	349	183	191	534	169	317	(35)
RailAmerica Inc.	B+/Stable/--	48	52	91	61	49	125	(22)
SG subtotal		397	235	169	595	218	273	(33)
Total		10,009	6,256	160	11,701	5,897	198	(14)

*D&A excludes amortization in cases where amortization is reported separately in the consolidated cash-flow statement. Data are as reported by the companies and do not include Standard & Poor's adjustments for operating leases, etc.

Capital-goods companies, which span a diverse range of sectors from long-cycle construction and farm equipment to short-cycle industrial components, showed an aggregate decline of 33%. Capital spending among speculative-grade rated issuers dropped a significantly higher 53%. Some investment-grade companies posted large declines as well, but in aggregate the drop was considerably smaller at 26%. The speculative-grade list of capital goods companies includes equipment rental companies, which traditionally cut back sharply on new equipment purchases during downturns and sell off used equipment to improve free cash flow (see table 4).

Table 4

Capital Goods

		--2009--			--2008--			
(Mil. $)	Rating as of April 7, 2010	Capex	D&A*	Capex/D&A (%)	Capex	D&A*	Capex/D&A (%)	Capex change 2009 vs. 2008 (%)
Acuity Brands Inc.	BBB-/Stable/--	21	36	59	27	34	80	(22)
AGCO Corp.	BBB-/Stable/--	215	130	166	251	127	197	(14)
AMETEK Inc.	BBB/Stable/--	33	66	50	44	63	70	(25)
Carlisle Cos. Inc.	BBB/Stable/--	48	57	85	68	59	114	(29)
Caterpillar Inc.¶	A/Negative/A-1	790	945	84	1,429	691	207	(45)
Cooper Industries PLC	A/Stable/A-1	127	146	87	137	143	96	(8)
Crane Co.	BBB/Stable/--	28	58	49	45	57	79	(37)
Cummins Inc.	BBB/Stable/--	310	326	95	543	314	173	(43)
Danaher Corp.	A+/Stable/A-1	189	185	102	194	146	133	(3)
Deere & Co.¶	A/Stable/A-1	797	516	154	788	484	163	1
Dover Corp.	A/Stable/A-1	120	258	46	176	261	67	(32)
Eaton Corp.	A-/Stable/A-2	195	573	34	448	571	78	(56)
Emerson Electric Co.	A/Stable/A-1	531	727	73	714	707	101	(26)
General Electric Co.¶	AA+/Stable/A-1+	2,429	2,311	105	2,996	2,162	139	(19)
Grainger (W.W.) Inc.	AA+/Stable/A-1+	142	148	97	195	140	140	(27)
Harsco Corp.	A-/Stable/A-2	165	312	53	458	338	135	(64)
Honeywell International Inc.	A/Stable/A-1	609	957	64	884	903	98	(31)
Hubbell Inc.	A/Negative/A-1	29	71	42	49	63	78	(40)
IDEX Corp.	BBB/Stable/--	25	32	79	28	31	90	(10)
Illinois Tool Works Inc.	A+/Stable/A-1	247	309	80	362	324	112	(32)
Ingersoll-Rand PLC	BBB+/Negative/A-2	204	425	48	306	453	68	(33)
ITT Corp.	BBB+/Stable/A-2	272	293	93	249	278	89	9
Joy Global Inc.	BBB-/Stable/--	94	59	160	84	71	118	12
Kennametal Inc.	BBB/Negative/--	105	83	126	163	81	202	(36)
Leggett & Platt Inc.	A-/Negative/A-2	83	110	76	118	116	102	(30)
Mettler-Toledo International Inc.	BBB/Stable/--	60	30	203	61	29	210	(2)
Pall Corp.	BBB/Stable/A-2	133	89	149	124	93	133	7
Parker-Hannifin Corp.	A/Stable/A-1	271	253	107	280	258	109	(3)
Pentair Inc.	BBB-/Stable/--	54	65	84	53	60	89	2
Rockwell Automation Inc.	A/Negative/A-1	98	102	96	151	101	149	(35)
Roper Industries Inc.	BBB-/Stable/--	26	34	76	30	34	89	(14)
Snap-On Inc.	A-/Negative/A-2	64	50	129	74	48	154	(13)

Table 4

Capital Goods (cont.)								
Thomas & Betts Corp.	BBB/Stable/--	41	75	55	42	80	52	(2)
Timken Co.	BBB-/Stable/--	114	201	57	258	201	129	(56)
Tyco International Ltd.	BBB+/Watch Pos/A-2	709	1,133	63	734	1,154	64	(3)
United Technologies Corp.	A/Stable/A-1	826	1,258	66	1,216	1,321	92	(32)
IG subtotal		10,206	12,418	82	13,781	11,998	115	(26)
Actuant Corp.	BB/Stable/--	21	52	41	44	45	99	(52)
Ahern Rentals Inc.	B/Negative/--	42	102	41	151	100	151	(72)
Altra Industrial Motion Inc.	B+/Stable/--	9	22	42	19	21	92	(52)
American Railcar Industries Inc.	BB-/Negative/--	15	23	64	52	20	260	(71)
Baldor Electric Co.	BB-/Stable/--	44	50	88	43	58	74	3
Blount Inc.	BB-/Stable/--	17	20	85	26	21	123	(34)
Bucyrus International Inc.	BB/Positive/--	59	42	143	112	37	304	(47)
CNH Global N.V.	BB+/Negative/--	218	398	55	493	374	132	(56)
Columbus McKinnon Corp.	BB-/Stable/--	12	11	116	12	8	150	(2)
EnerSys	BB/Stable/--	57	49	116	45	49	92	27
Flowserve Corp.	BB+/Positive/--	108	86	127	127	72	177	(15)
Gardner Denver Inc.	BB/Stable/--	43	69	62	41	61	67	4
Greenbrier Cos. Inc. (The)	B-/Negative/--	39	38	103	78	35	221	(50)
Greif Inc.	BB+/Stable/--	125	103	121	143	106	134	(13)
H&E Equipment Services Inc.	BB-/Stable/--	35	99	35	150	115	130	(77)
Hawk Corp.	B/Negative/--	8	8	93	15	8	196	(51)
Itron Inc.	B+/Stable/--	53	57	92	63	53	119	(17)
Manitowoc Co. Inc.	BB-/Negative/--	73	92	79	150	80	187	(52)
MasTec Inc.	BB-/Stable/--	22	50	44	35	28	123	(38)
Mueller Water Products Inc.	B/Stable/--	40	60	67	88	64	139	(55)
Oshkosh Corp.	B+/Positive/--	46	76	61	76	73	103	(39)
Park-Ohio Industries Inc.	B/Negative/--	6	19	30	17	21	84	(68)
Poindexter (J.B.) & Co. Inc.	B/Negative/--	11	17	67	15	18	83	(23)
Polypore International Inc.	B/Stable/--	16	35	47	48	36	132	(66)
Rexnord LLC	B/Negative/--	39	61	64	55	54	101	(29)
RSC Equipment Rental Inc.	B+/Stable/--	51	330	16	274	367	75	(81)
Sensata Technologies B.V.	B/Positive/--	15	48	31	41	51	80	(63)
Sensus USA Inc.	B+/Negative/--	27	26	101	23	27	84	17
SPX Corp.	BB+/Stable/--	93	106	88	116	105	111	(20)
Terex Corp.	BB-/Stable/--	51	74	70	106	67	159	(52)

Table 4

Capital Goods (cont.)								
Thermadyne Holdings Corp.	B-/Stable/--	8	13	59	13	12	103	(40)
Titan International Inc.	B+/Negative/--	40	34	115	80	30	263	(51)
TriMas Corp.	B+/Negative/--	14	29	48	29	28	103	(52)
Trinity Industries Inc.	BB+/Stable/--	429	161	267	1,244	140	886	(65)
United Rentals Inc.	B/Negative/--	311	474	66	704	513	137	(56)
WESCO International Inc.	BB-/Stable/--	13	26	50	35	27	132	(63)
Westinghouse Air Brake Technologies Corp.	BB/Stable/--	18	36	51	20	30	66	(7)
SG subtotal		2,228	2,992	74	4,785	2,957	162	(53)
Total		12,434	15,410	81	18,566	14,955	124	(33)

*D&A excludes amoritization in cases where amortization is reported separately in the consolidated cash-flow statement. ¶Manufacturing/industrial operations only. Excludes financial services. Data are as reported by the companies and do not include Standard & Poor's adjustments for operating leases, etc. The amounts shown are gross capital expenditures, excluding proceeds from sales of used equipment.

Cash Flow And Liquidity Remain Concerns During Upturns Too

In any downturn, we view companies' ability to defer noncritical capital expenditures and otherwise control costs as a key factor in avoiding or minimizing deterioration in their financial risk profiles. The recent downturn was so severe that most companies cut their spending dramatically. But some highly leveraged firms were forced to cut back more extensively. We are building into our assumptions for ratings on these companies a gradual increase of capital investment closer to, if not precisely at, historical levels. The key question is whether the companies can boost and still maintain appropriate cash-flow generation and liquidity. Depending on the competitive landscape, this could become a factor in our assessment of their financial risk profiles and, to some degree, their longer-term competitive positions. Of course, one company's orders are another company's revenues, so a slow recovery in capital spending would also mean a slower recovery in revenues for some manufacturers. Nevertheless, we believe that those in a position to increase spending face markedly better long-term prospects.

Special Report

Click on the links below to see other articles in "Special Report: U.S. Corporate Issuers: Some Deleverage While Others Releverage."

Click on this link to go to the Special Report Archive.

As Some U.S. Corporate Issuers Move To Unload Debt, Others Load Up To Pursue Growth

A Pickup in M&A May Be Just The Beginning As U.S. Borrowers Seek Strategic Growth

U.S. Nonfinancial Corporate Defaults: A Q4 2009 Decline Signals A Moderating Trend

U.S. Homebuilders And Retailers Exemplify What Separates The Winners From The Losers In The Corporate Sector