Capital Goods

Slow recovery in China weighs on earnings outlook

This report does not constitute a rating action.

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What do we expect over the next 12 months?

A slow recovery in China and some end-markets continues to weigh on the earnings outlook in Asia-Pacific.

Key risks include persistently high interest rates and uncertainty around a soft global economic landing. The factors may hurt corporate customer sentiment in terms of capital spending, in turn impeding the recovery of key leverage measures.

The demand outlook and degree of margin protection, as well as cash flow management, will be key drivers of credit quality.

What are the key risks around the baseline?

Slower recovery in China and some end-markets. The weak property sector as well as slow consumption and investment in China will continue to weigh on demand within the Chinese corporate sector for capital goods, despite stimulus by the government. Stagnant demand recovery in some end-markets, such as factory automations for manufacturing, means slower capital expenditure by corporate customers.

Global economic slowdown. Although the demand outlook in the U.S. still looks solid, it continues to be curbed among European economies. Persistently high interest rates should cool capital spending by corporate customers and the construction sector. Some Asia-Pacific capital goods companies--especially Japanese ones--have exposure to the European market. A weaker macroeconomy will erode EBITDA and cash flow, potentially hurting credit metrics.

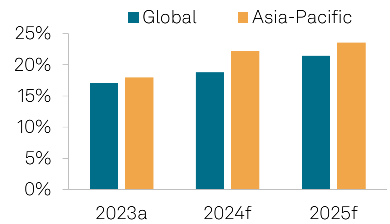
What do they mean for the sector?

Margin pressure. Weaker demand and soft sales, together with a tough competition, would prevent Asia-Pacific companies from achieving a meaningful improvement in EBITDA and margins.

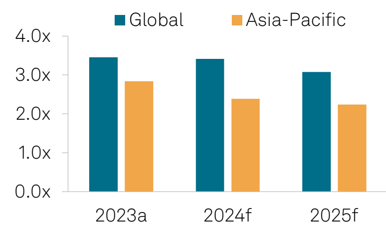
Delayed improvement in cash flow metrics. Given our continued expectation for cautious economic conditions, we assume capital goods companies will carefully manage growth investment and shareholder returns. However, if the economic outlook weakens further, cash flow ratios could deteriorate.

Rating Metrics

FFO to debt (median, adjusted)



Debt to EBITDA (median, adjusted)



Source: S&P Global Ratings.

All figures are converted into U.S. dollars using historical exchange rates. Forecasts are converted at the last financial year-end spot rate. FFO--Funds from operations. a--Actual. f--Forecast.