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Mining Capex

Downside Risk Emerging

- **Turning Cautious on Mining Capex** — We have been very supportive of mining capex theme in our report *2012 Mining Capex Outlook - China RRR Cut Supportive of Mining Capex* (December 6, 2011). What has changed? We are starting to see notable signs that could impact mining capex prospects in the near-term and beyond.

- **China Could Pose Downside Risks To Mining Capex** — China is important to mining capex, accounting for 40% of global metals output. Data point to a slowdown of activity in China and experts believe significant easing is unlikely. Further, RRR adjustment depends on FX flows, and an interest rate cut is unlikely in the near future. Our economists believe a delay in policy response now may trigger over-reaction later.

- **First Signs of Mining Companies Hesitating** — Last week the Chairman of BHP, Jacques Nasser, said that BHP is re-evaluating its capital spending plans as slowing Chinese growth prompts a more cautious outlook for commodity demands. The risk is if other big mining companies (c70% of total mining customer base) will follow. Junior miners (10-15%) are already struggling to raise funding their 2012 exploration budgets.

- **Downside Risk To Our & Consensus Forecasts If This Trend Materialises** — While our Global Mining Capex model continues to point to solid capex growth this year, the current uncertainty could push/delay mining capex orders into 2H12. The ultimate question is how sustainable capex could prove in 2013, with 2012 capex expected to be almost double the 2008 peak level (in absolute terms). Even if we were to see a normalisation of capex spending in 2013, this could trigger significant downgrades. In our models we now forecast mining equipment to grow by 13% Y/Y in 2012 (previously 15%) and decline by 5% in 2013 (previously estimated growth of 5%).

- **Risk of Chinese Competition** — This report should be read in conjunction with our *Engineering Sector in China - Step-Up in 'Go Global' – Revised Winners & Losers* (published today). We see Metso and FLSmidth as most exposed, whereas Atlas Copco and Sandvik as most protected.

- **Changes To Recommendation** — We downgrade Atlas Copco to Sell (from Neutral) and FLSmidth to Neutral (from Buy). We maintain our Sell on Metso & Weir and Buy on Fenner (high aftermarket exposure) & Sandvik (significant scope for restructuring). Sandvik continues to be one of our 12-month top picks across the sector as we believe the market underestimates its restructuring potential, although we admit if mining capex concerns materialise, this would create near-term pressure on the shares.

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	Rating		Target Price		Current Year Earnings Estimates		Next Year Earnings Estimates	
Ticker	Old	New	Old	New	Old	New	Old	New
ATCOa.ST	2	3	SKr160.00	SKr135.00	SKr10.08	SKr10.10	SKr10.68	SKr9.92
FENR.L	1	1	£5.51	£5.51	p36.1	p36.1	p39.9	p39.9
FLS.CO	1	2	Dkr450.00	Dkr400.00	Dkr30.67	Dkr33.61	Dkr32.62	Dkr31.17
MEO1V.HE	3	3	€24.00	€24.00	€2.39	€2.39	€2.27	€2.27
SAND.ST	1	1	SKr115.00	SKr110.00	SKr8.16	SKr8.15	SKr9.01	SKr8.69
WEIR.L	3	3	£18.30	£16.40	p152.9	p152.9	p152.3	p148.5

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

Contents

Investment Summary

This report should be read in conjunction with our Engineering Sector in China - Step-Up in 'Go Global' – Revised Winners & Losers (published today).

In this report, we are turning more cautious on mining capex and as a result making a number of recommendation, as well as our forecast, changes. We were very supportive of mining capex theme in our report *2012 Mining Capex Outlook - China RRR Cut Supportive of Mining Capex* (December 6, 2011). What has changed? We are starting to see notable signs that could impact mining capex prospects in the near-term and beyond.

Changes to Recommendations

Key Sells: Atlas Copco, Metso and Weir Group; Key Buys: Fenner and Sandvik

We downgrade Atlas Copco to Sell (from Neutral) and FLSmidth to Neutral (from Buy). We maintain our Sell on Metso & Weir. Sandvik continues to be one of our 12-month top picks across the sector as we believe the market underestimates its restructuring potential, although we admit if mining capex concerns materialize, this would create near-term pressure for the shares. In Figure 1, we provide a summary to our ratings and target price changes and in Figure 2 we show our changes to forecasts.

Figure 1. Changes to Ratings and Target Prices

		Rating		Target Price	
Company	**Ticker**	**Old**	**New**	**Old**	**New**
Atlas Copco	ATCOa.ST	Neutral (2)	Sell (3)	SKr160	SKr135
Fenner	FENR.L	Buy (1)	Buy (1)	£5.51	£5.51
FLSmidth	FLS.CO	Buy (1)	Neutral (2)	DKr450	DKr400
Metso	MEO1V.HE	Sell (3)	Sell (3)	€ 24	€ 24
Sandvik	SAND.ST	Buy (1)	Buy (1)	SKr115	SKr110
Weir	WEIR.L	Sell (3)	Sell (3)	£18.30	£16.40

Source: Citi Investment Research and Analysis

Figure 2. Changes to Forecasts

	New		Old		Change	
Atlas Copco (SKr millions)	**2012E**	**2013E**	**2012E**	**2013E**	**2012E**	**2013E**
Net Sales	84,790	86,621	84,570	88,357	0%	-2%
Underlying EBIT	16,985	16,644	16,948	17,882	0%	-7%
Margin	20.0%	19.2%	20.0%	20.2%	0.0	-1.0
PBT	16,385	16,094	16,348	17,332	0%	-7%
CIRA EPS (SKr)	**10.10**	**9.92**	**10.08**	**10.68**	**0%**	**-7%**
	New		**Old**		**Change**	
FLSmidth (DKr millions)	**2012E**	**2013E**	**2012E**	**2013E**	**2012E**	**2013E**
Net Sales	23,801	24,276	23,748	24,595	0%	-1%
Underlying EBIT	2,576	2,382	2,292	2,435	12%	-2%
Margin	10.8%	9.8%	9.7%	9.9%	1.2	-0.1
PBT	2,581	2,396	2,298	2,444	12%	-2%
CIRA EPS (DKr)	**33.20**	**30.79**	**30.38**	**32.31**	**9%**	**-5%**
	New		**Old**		**Change**	
Sandvik (SKr millions)	**2012E**	**2013E**	**2012E**	**2013E**	**2012E**	**2013E**
Net Sales	98,178	100,678	98,339	102,111	0%	-1%
Underlying EBIT	15,114	15,340	15,141	15,871	0%	-3%
Margin	15.4%	15.2%	15.4%	15.5%	0.0	-0.3
PBT	13,110	14,186	13,133	14,708	0%	-4%
CIRA EPS (SKr)	**8.15**	**8.69**	**8.16**	**9.01**	**0%**	**-4%**
	New		**Old**		**Change**	
Weir (GBP millions)	**2012E**	**2013E**	**2012E**	**2013E**	**2012E**	**2013E**
Net Sales	2,683	2,730	2,608	2,726	3%	0%
Underlying EBIT	499	482	497	493	0%	-2%
Margin	18.6%	17.7%	19.1%	18.1%	-0.5	-0.4
PBT	462	449	461	460	0%	-2%
CIRA EPS (p)	**152.9**	**148.5**	**152.9**	**152.3**	**0%**	**-2%**

Source: Citi Investment Research and Analysis

China Could Provide Downside Risk To Mining Capex?

This report should be read in conjunction with our Engineering Sector in China - Step-Up in 'Go Global' – Revised Winners & Losers (published today).

China is important to mining capex. Today it accounts for over 40% of global metals output compared to just 10% in 2000 and represents over 11% of global oil demand, up from around 8.5% in 2006. Combined January-February 2012 data point to a slowdown in activity in China, led by a decline in growth for industrial production, fixed asset investment, consumption and exports, plus a lower-than-average post Chinese New Year (CNY) rally in the manufacturing PMI, . In addition, money and credit growth is still on the weak side. Government-related Research Institutes are not expecting significant loosening of monetary policy as the current pace of economic slowdown does not warrant significant policy easing. Further, RRR adjustment will depend on FX flows, and interest rate cuts are unlikely in the near future. Our economists believe more RRR cuts are needed to boost money and credit growth, and investment appetite. They believe a delay in policy response now may trigger over-reaction later.

How Sustainable is Mining Capex?

We believe mining capex could prove to be at risk relative to current expectations if mining companies start to revised down or delay mining equipment spend due to the slowdown in China and prevailing macro uncertainty. While our Global Mining Capex model continues to point to solid capex growth this year, current uncertainty could push/delay mining capex orders into 2H12. Our model also points to a decline in mining capex for 2013 (although admittedly it is too early to draw conclusions as 2H is typically a better indicator for capex projects into a year ahead); that said, looking at the strong mining capex expansion since early 2000s (except for the downturn in 2009) begs the question of how sustainable such a strong capex increase is, with capex spend projected in 2012 to almost double from the previous peak of 2008 (in absolute terms). Even if we were to see a normalisation of capex spending, this could trigger significant downgrades. In our models for mining equipment providers, we assume mining equipment to grow by 13% Y/Y in 2012 (previously expected growth of 15%) and decline by 5% in 2013 (previously estimated growth of 5%). The risk to our and consensus forecasts lies on the downside.

First Signs of Mining Companies Hesitating

Last week the Chairman of BHP, Jacques Nasser, said that BHP is re-evaluating its capital spending plans as slowing Chinese growth prompts a more cautious outlook for commodity demands (source: Australian Financial Review). The risk is if other big mining companies (c70% of total mining customer base) will follow. Junior miners (10-15%) are already struggling to raise funding for their 2012 exploration budgets.

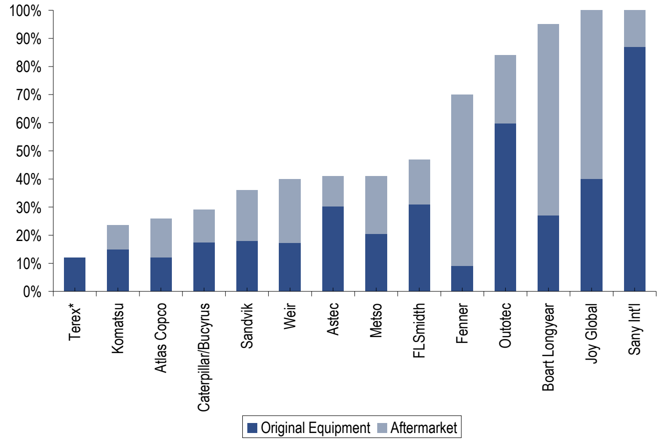
Risk of Chinese Competition

This report should be read in conjunction with our Engineering Sector in China - Step-Up in 'Go Global' – Revised Winners & Losers (published today). We see Metso and FLSmidth as most exposed, whereas Atlas Copco and Sandvik look to be most protected.

Who is Exposed to Mining?

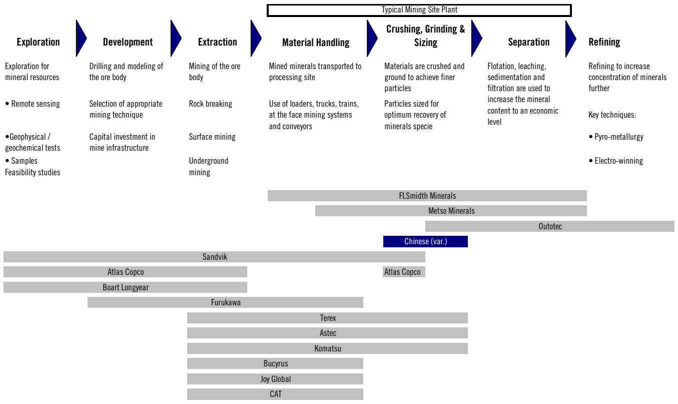
Figure 6 and Figure 7 highlight the exposure to the mining industry of the engineering companies across our global coverage, splitting their revenue mix into mining equipment and mining aftermarket, as well as showing an overview of mining equipment suppliers in terms of where they are in the value chain.

Figure 3. Global Engineering Sector – % of Sales Generated from the Mining Industry



Source: Company reports, Citi Investment Research and Analysis, *For Boart Longyear's Drilling Products business and Terex's Materials Processing no breakdown between OE and aftermarket sales was available

Figure 4. . Mining Equipment Suppliers



Source: Citi Investment Research and Analysis

Global Valuation – Mining Equipment Providers

Figure 5. Global Mining Equipment Manufacturers – Comparable Valuation

Company Name	Ticker	Price (Mar 22)	Rating	EV/Sales 2012E	EV/Sales 2013E	EV/EBIT 2012E	EV/EBIT 2013E	P/E 2012E	P/E 2013E	EBIT Margin 2012E	EBIT Margin 2013E
Europe											
Atlas Copco	ATCOa.SE	159.70	(1)	2.4	2.3	12.0	11.9	15.8	16.1	20.0%	19.2%
Fenner	FENR.GB	4.40	(1)	1.1	1.0	9.4	7.9	12.2	11.0	12.5%	13.0%
FLSmidth	FLS.DK	399.50	(2)	0.8	0.7	7.4	7.6	12.0	13.0	10.8%	9.8%
Metso	MEO1V.FI	33.99	(3)	0.8	0.8	9.9	10.5	14.2	15.0	8.2%	7.6%
Outotec	OTE1V.FI	39.62	NR	0.8	0.7	8.8	7.7	15.1	12.9	9.3%	9.7%
Sandvik	SAND.SE	93.65	(1)	1.3	1.2	8.8	8.2	11.5	10.8	15.4%	15.2%
Weir	WEIR.GB	18.20	(3)	1.7	1.6	9.2	9.3	11.9	12.3	18.6%	17.7%
North America											
Astec	ASTE.US	37.13	NR	0.7	0.7	9.6	9.2	15.2	12.4	7.6%	7.1%
Caterpillar	CAT.US	106.55	(2)	1.0	0.9	7.9	6.4	11.1	9.3	13.2%	14.1%
Joy Global	JOY.US	74.86	NR	1.5	1.1	7.2	5.8	9.8	8.6	20.3%	19.3%
Terex	TEX.US	23.90	NR	0.5	0.4	8.8	6.3	13.1	8.3	5.4%	6.8%
Asia Pacific											
Boart Longyear	BLY.AU	4.22	(1)	1.0	0.9	6.5	5.5	8.3	7.2	15.0%	15.9%
Komatsu	6301.JP	2,389	(2)	1.1	1.0	8.3	7.1	11.1	10.1	14.3%	14.9%
Sany Int'l	0631.CN	5.84	(1)	3.2	2.3	15.0	12.1	18.2	14.8	21.5%	19.4%
Global Mining Equipment Average				**1.3**	**1.1**	**9.2**	**8.2**	**12.8**	**11.6**	**13.7%**	**13.6%**
Pan European Engineering Sector Average				**1.3**	**1.2**	**9.9**	**9.2**	**13.5**	**12.8**	**12.8%**	**12.9%**

Source: Citi Investment Research and Analysis, Powered by DataCentral, *Reuters Consensus

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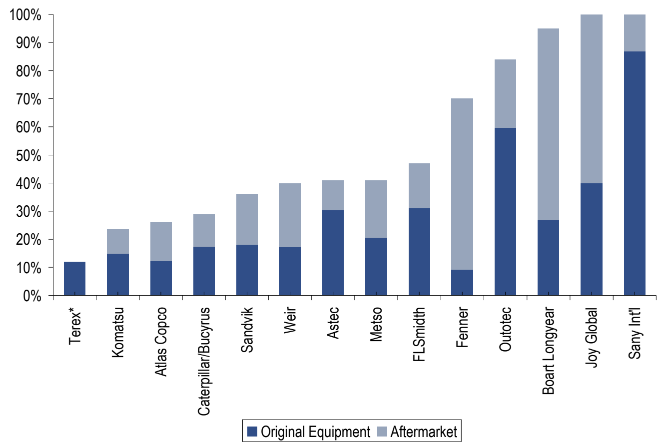

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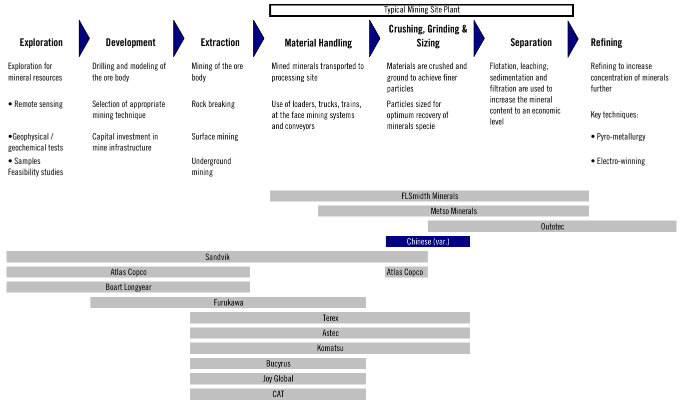
Figure 7. . Mining Equipment Suppliers



Source: Company reports and Citi Investment Research and Analysis

Figure 8 shows the main competitors for Atlas Copco, Caterpillar, Metso, Sandvik, Volvo and Weir Group, ranking the level of their competitive importance from high to low in terms of the level of importance.

Figure 8. Global Mining and Construction Equipment Suppliers – Competitive Overlap

	Level of Competitive Importance		
Company	**High**	**Medium**	**Low**
Atlas Copco	Sandvik	Caterpillar	Boart Longyear, Volvo, Bomag, Furukawa, Wirtgen Group
Caterpillar	Komatsu	Hitachi, John Deere, Terex	Atlas Copco, Bucyrus, Joy Global
Metso	FLSmidth	Outotec, Sandvik, Terex, Wirtgen Group	Atlas Copco, Bucyrus, Ingersoll Rand, Joy Global, Furukawa, Hitachi, Boart Longyear, Weir Group
Sandvik	Atlas Copco	Metso, Ingersoll-Rand, Terex, Joy Global	Caterpillar, Furukawa
Volvo	Caterpillar, John Deere	CNH, JCB, Hitachi, Komatsu, Kobelco, Yanmar	Atlas Copco, Liebherr, Sandvik, Metso, Terex, Hitachi, Joy Global, Wirtgen Group
Weir Group	Metso, KSB	Floorserve, FLSmidth	Atlas Copco, Ingersoll Rand, Sandvik

Source: Company Data, Citi Investment Research and Analysis

Figure 9. Global Mining Equipment Suppliers – Key Products Overlap

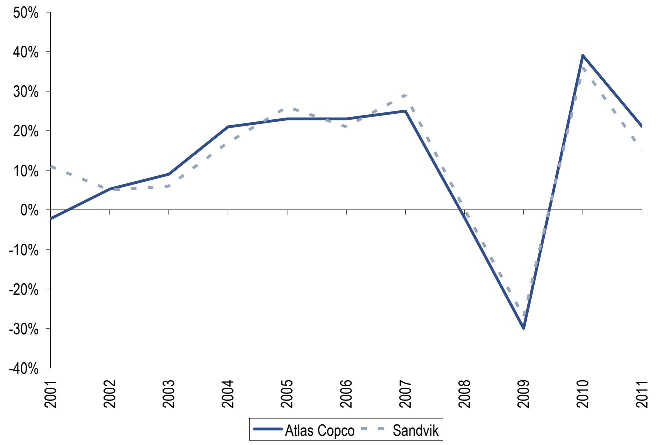
	Atlas Copco	Boart Longyear	Caterpillar/Bucyrus	CNH Global	Doosan Infracore	FLSmidth	Furukawa	HCM	HHI	Ingersoll-Rand	JCB	John Deere	Joy Global	Kobelco	Komatsu	Liebherr	Metso	Outotec	Sandvik	Sany Heavy Industry	Terex	Volvo	Weir Group	Wirtgen	XCMG	Yanmar
Continuous Mining Equipment	x		x										x						x	x						
Crushing Equipment						x	x	x					x		x		x		x		x			x		
Draglines			x										x													
Drilling Equipment	x	x	x				x						x						x	x	x					
Electric Shovel			x										x	x												
Filtration Equipment						x																				
Grinding Equipment						x											x	x								
Haulage Systems			x				x						x				x		x							
Hydraulic Excavators			x	x	x			x	x		x	x		x	x	x				x	x	x			x	x
Hydraulic Shovel			x	x	x				x		x	x				x					x	x				x
Longwall			x										x								x					
Material Handling Equipment			x/x			x							x				x		x							
Underground Mining Loading Equipment	x		x/x																	x						
Mining Tools	x									x									x		x					
Mining Trucks	x		x					x			x				x	x				x	x					
Pyro Processing						x	x										x									
Pumps						x																	x			
Roadheaders	x		x										x						x	x						
Screening Equipment								x									x		x		x			x		
Separation Equipment																	x	x								
Tractors/Dozers			x	x							x	x			x						x					

Source: Company Reports and CIRA

Strong Recovery in Mining Trends

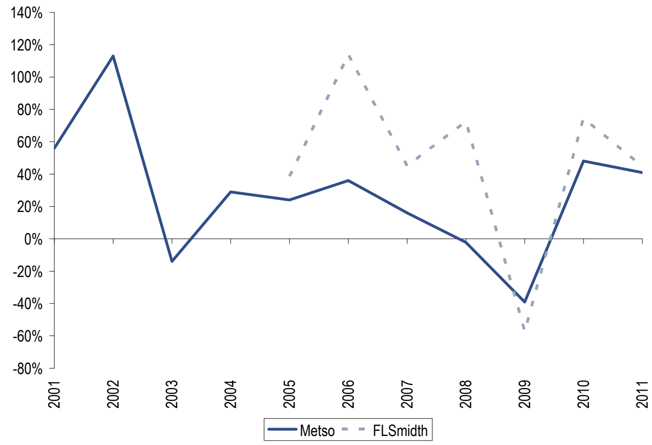
In Figure 10 and Figure 11, we show order development for the key European mining equipment providers. In Figure 12 and Figure 13, we show the cumulative sales growth for the mining and construction-exposed businesses of Atlas Copco (volume growth only), Sandvik (organic), Metso (total) and FLSmidth (total).

Figure 10. Atlas Copco vs. Sandvik - Mining and Construction Organic Order Growth



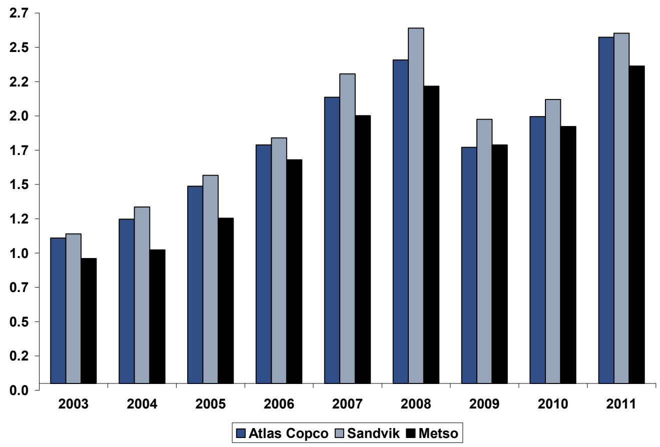
Source: Company reports, Citi Investment Research and Analysis

Figure 11. Metso vs. FLSmidth – Mining and Construction Total Order Growth



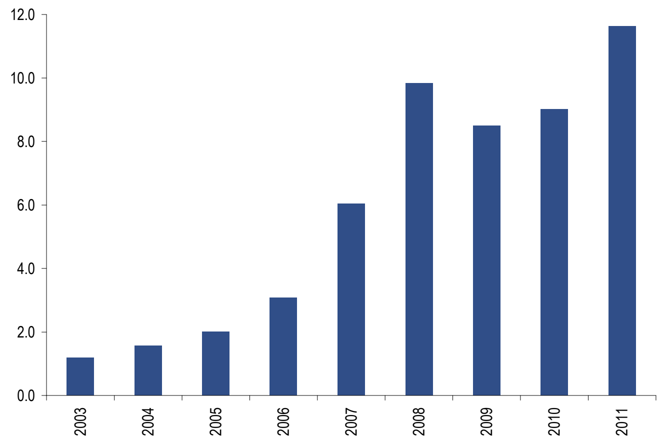
Source: Company reports, Citi Investment Research and Analysis

Figure 12. Atlas Copco (Volume), Sandvik (Organic) and Metso (Total) – Cumulative Sales Growth (Mining and Construction), 2003-2011



Source: Company reports, Citi Investment Research and Analysis

Figure 13. FLSmidth – Total Cumulative Sales Growth (Mining and Construction), 2003-2011



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Is China Slowing?

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Government-related Research Institutes are not expecting significant loosening of monetary policy as the current pace of economic slowdown does not warrant significant policy easing. Further RRR adjustment will depend on FX flows, and an interest rate cut is unlikely in the near future. Our economists believe more RRR cuts are needed to boost money and credit growth and investment appetite. They believe a delay in policy response now may trigger over-reaction later.

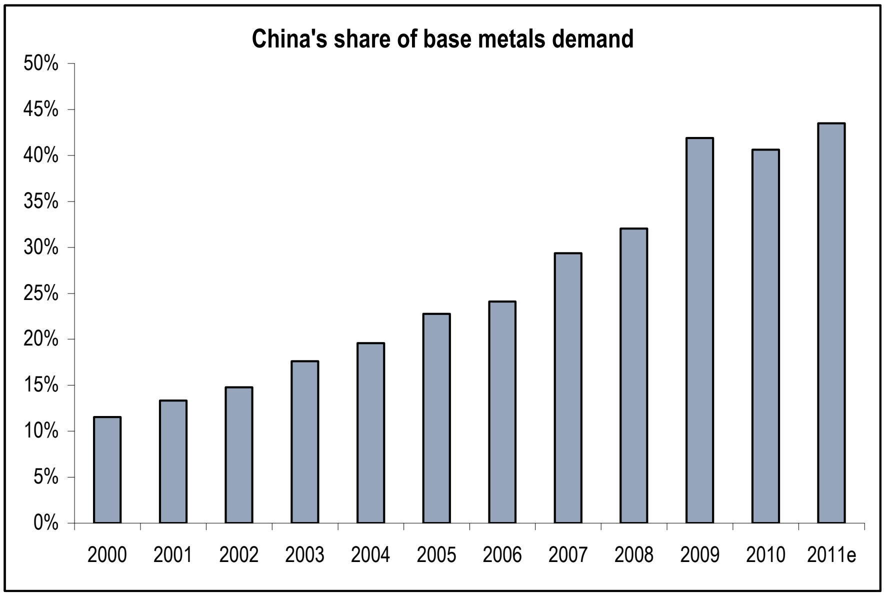
Importance of China to Mining Capex

Today accounts for over 40% of global metals output compared to just 10% in 2000 and represents over 11% of global oil demand, up from around 8.5% in 2006

In our numerous reports on the Engineering sector in China: Winners & Losers, we have talked about China as a key growth driver for our sector, as well as a threat in terms of rising Chinese competition. The US ISM PMI is considered one of the better indicators for share price performance in our sector, as it tends to be the best indicator for a significant demand shift. Share prices in the sector have been following its lead down in recent months. However, it is worth noting that it has been a significantly less accurate indicator at times of moderate growth in recent years. One explanation to this could be the increasing dependence on emerging markets, especially China.

An example of China's increasing contribution is China's claim on global metals output, which has shifted in the last decade (especially in the last two years). China today accounts for over 40% of global metals output compared to just 10% in 2000 (Figure 14).

Figure 14. China's share of base metals demand



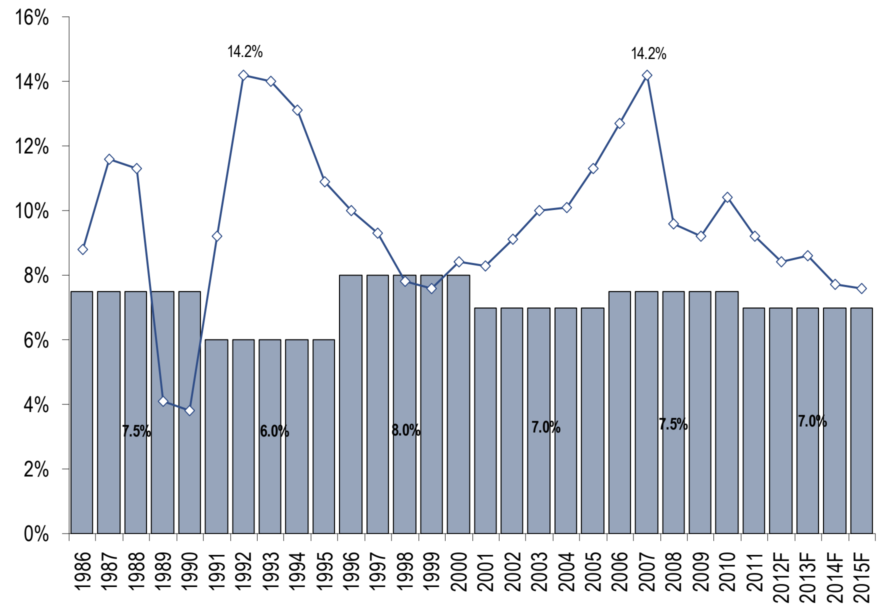
Source: Haver Analytics, Citi Investment Research and Analysis

2012 GDP Growth Target Scaled Down to 7.5%

China scaled down its official real GDP growth target for 2012 to 7.5%. Note that China targets 7% GDP growth p.a. in the 12th FYP

China scaled down its official real GDP growth target for 2012 to 7.5%, which is below 8% for the first time in 8 years, at the annual National People's Congress (NPC). We see rapid weakening of economic activity in 1Q from the Jan-Feb data, and the risk of further slowdown in 2Q would increase if policy continues to fall behind the curve. Worth noting that in the 12th FYP, China targets 7% GDP growth p.a. and China has consistently surpassed the growth target set out in its five-year plans (Figure 15).

Figure 15. China's Real GDP Growth: Targets vs. Reality



Source: Central Government Website, National Bureau of Statistics and Citi Investment Research and Analysis

Government-Related Research Institutes' View

Experts from government-related research institutes shared their views on China's economic prospects and policy path in the year ahead.

In general, experts from government-related research institutes more optimistic than the market about the economy, and believe the government has ample policy room to reduce downside risks. The experts suggest that the Chinese economy will grow by more than 8% (8-8.5% for the full year, 8.5% in 1Q, 8.3% in 2Q, and a stable growth path in Q3 and Q4), and inflation will be about 3% in 2012. The economy should start weak but end strong, with supporting arguments being: (1) government investment (mostly in infrastructure) will increase, supported by proactive fiscal policy; (2) monetary policy may be biased slightly towards the easing end; (3) the pace of property tightening will be managed appropriately: Premier Wen has talked about further property price correction, but this applies to a few cities; and (4) all projects under construction should receive full support of financing. More projects in the 12th Five-Year Plan will be launched.

Citi view

Citi agrees with experts, but sees the risk of further slowdown in 2Q as increasing if policy continues to fall behind the curve.

We think the government is effectively targeting above 8% growth, and Citi agrees with the Government-Related Research Institutes that the target is achievable given the sufficient room for the government to stimulate the economy. Our economists believe the lower target is in order to provide room for economic transformation and are of the view that the government is trying to lower growth expectations, but is de facto targeting above 8% growth this year — Citi expects 2012 growth of 8.4% as noted by our China economists in their report China Macro Flash - 2012 Budget Poses Downside Risks (published March 5th).

However, real and financial data so far in the year point to sharp economic slowdown (more detail below) and growth in 1Q may fall to 8% or below. We continue to think 1Q will be the weakest quarter of the year and monetary, fiscal and property policy easing can generate a mild rebound in 2H. However, if the

government is complacent and fails to be preemptive, the risk for a deferral of economic trough will increase.

Signs of Weakness & 2012 Outlook

Data points released for January – February 2012 confirm a slowdown in growth

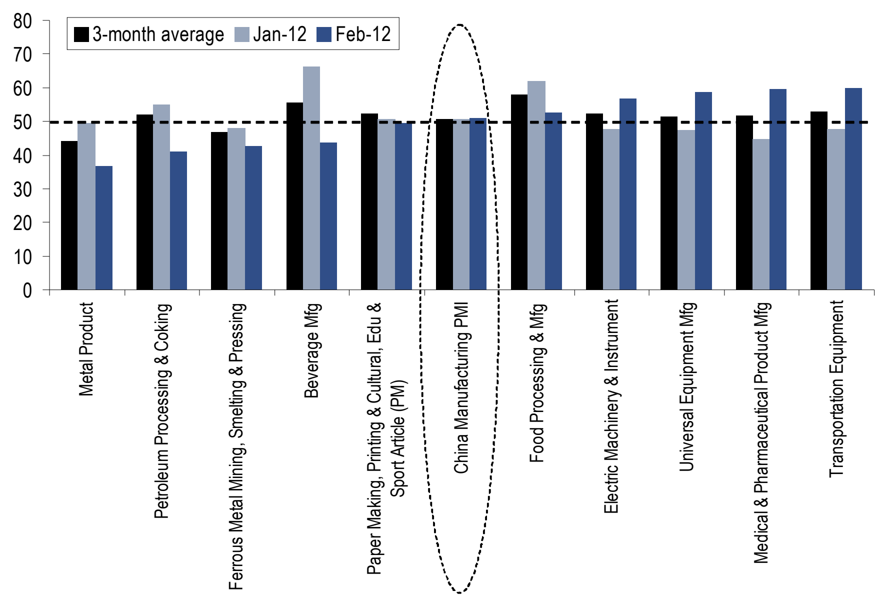
Our China economists, in their recent report, China Macro View - Entering the Year of Long: Threefold Policy Easing to Counter a Soft Patch (February 5th) note that the positive Y/Y GDP growth seen in 4Q11 has hidden an underlying momentum that may herald a sharper slowdown. Data points released for January – February 2012 confirm a slowdown in growth.

Our China PMI Tracker - Slowdown But Not Everywhere

February PMI rise below historic average, bright spots in transportation, medical and food related equipment; weak spots in metal product, petroleum processing and paper equipment

As noted in our recent report Engineering Sector in China - Monthly China PMI Tracker – Implications for the Sector (published March 1st), the February official PMI continued the rebounding thread of December 2011 and rose by 0.5ppt to 51.0 (Figure 17). The post-holiday rally is weaker than the average of 2005-11 (2.8ppts), suggesting continued but slow expansion of manufacturing activity. We note the PMIs for transportation, medical, and food-related equipment, as well as electrical machinery, are showing notable strength. However, the PMIs for metal product, petroleum processing and paper equipment have shown notable weakness (Figure 16).

Figure 16. China Manufacturing PMI by End Market, Feb vs. Jan 2012 and 3 month rolling avg



Source: National sources and Citi Investment Research and Analysis

Below we go through key data points and provide some outlook commentary for this year:

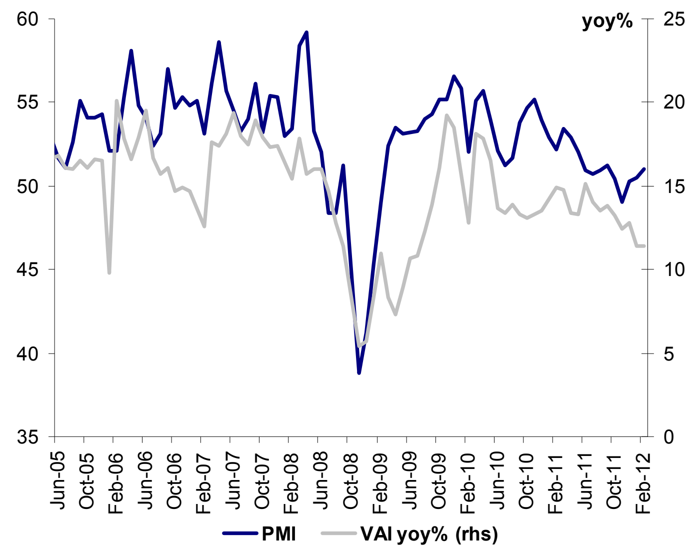
Industrial Production Continues to Decline

Citi forecasts 11.6% Y/Y growth compared to 13.9% Y/Y growth delivered last year

Our economists note in China Macro Flash - Jan-Feb Data — Robust Investment Momentum Offset by Weak Consumption (published March 9th) that industrial production (IP) growth continued to decline in January-February with an 11.4% Y/Y

increase, 1.4ppts below that in December and the lowest since July 2009. Citi forecasts 11.6% Y/Y growth compared to 13.9% Y/Y growth delivered last year.

Figure 17. China – Industrial Production (RHS) vs. Manufacturing PMI, 2005-Present



Source: CEIC and Citi Investment Research and Analysis

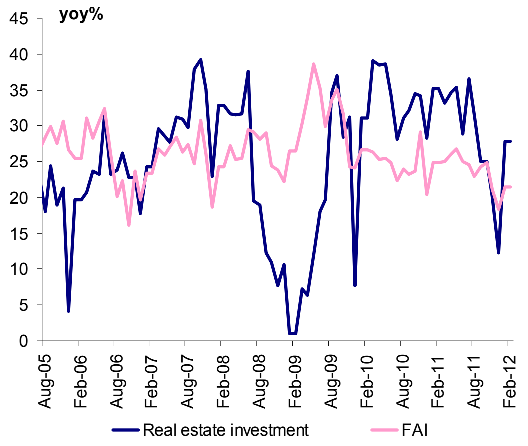
FAI Is Expected to Sharply Slow in 2012

FAI growth may slow to 17 – 18% in 2012 from 24% in 2011, a very sharp slowdown by historical standards

Jan-Feb FAI increased by 21.5% Y/Y, 2.3ppts lower than the full-year growth of 2011 (Figure 18). For 2012, our economists believe FAI investment growth may slow from 24% in 2011 to 17-18%, which would be a very sharp slowdown by historical standards. For comparison, in 2005-11, FAI growth never fell below 23% and averaged 26%. Property investment grew 27.8% Y/Y, only marginally lower than the full-year number for 2011 (Figure 19). In contrast, purchase of areas of land dropped by 0.5% Y/Y; new start areas increased 5.1% Y/Y, 11.1ppts lower than same period last year.

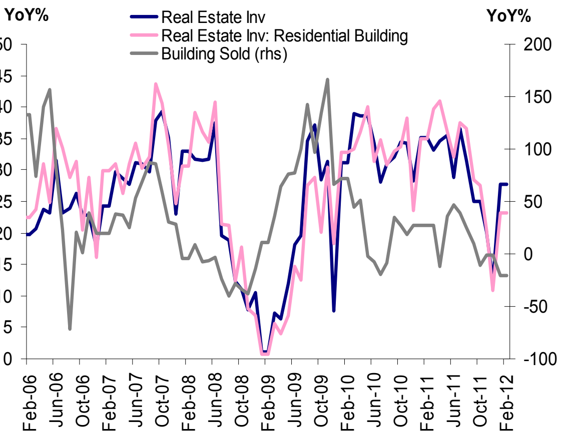
However, experts from the Government-Related Research Institutes are more optimistic, expecting FAI growth to moderate to 20% in 2012, including government-supported infrastructure investment (24%), real estate investment (15%), and manufacturing (22%), as noted in China Macro View - Takeaways from China Policy Day (published March 21st). According to the experts, 1Q investment is not representative since it accounts for a very small portion of annual investment. Consumption growth may be slightly better than last year, and auto consumption will likely grow 20%. Auto and related consumption affect about one-third of retail sales. Exports should grow 10-15% YoY. The experts also expect property investment growth may fall from 28% in 2011 to 18% in 2012.

Figure 18. China – Fixed Asset Investment Growth, 2005-Present



Source: CEIC and Citi Investment Research and Analysis

Figure 19. China – Property Market Investment vs. Sales, 2005-Present



Source: CEIC and Citi Investment Research and Analysis

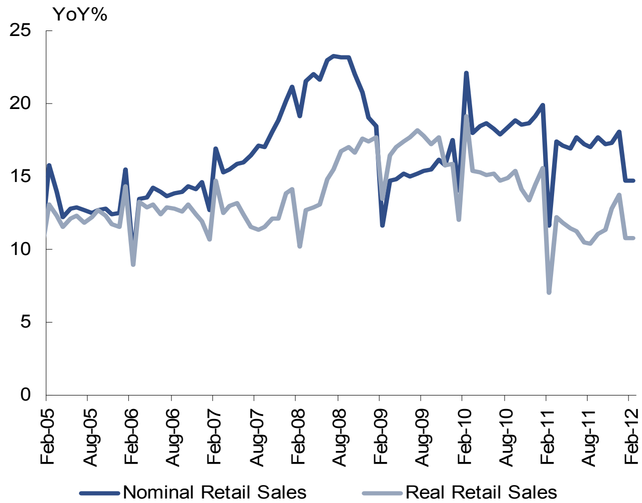
Consumption Growth Dropped Sharply

Consumption growth slowed in January-February, but is expected to become largest contributor to GDP in 2012

Retail sales during January-February grew by 14.7% Y/Y in nominal terms and 10.8% Y/Y in real terms (Figure 20). Sales of petroleum and related products grew by 20.4% Y/Y, while automobile sales increased by 12.7% Y/Y. Home appliance sales shrank by 2.9% Y/Y due to the gradual exit of subsidy policies.

Worth noting, the Government research institute experts expect consumption may grow 12-13% in nominal terms in 2012, becoming the largest contributor to GDP in 2012 and surpassing the contribution of investment for the first time in more than 10 years.

Figure 20. China – Nominal vs. Real Retail Sales Growth, 2005-Present



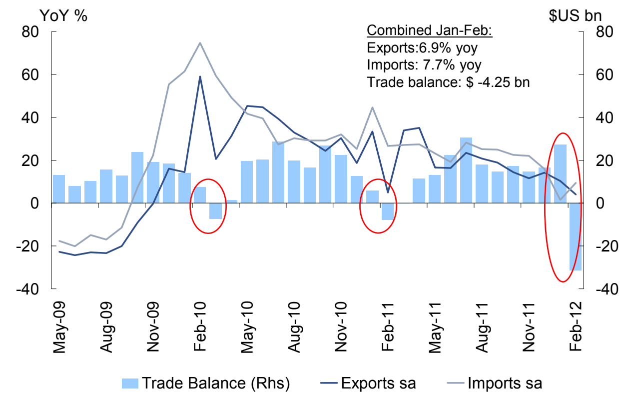
Source: CEIC and Citi Investment Research and Analysis

Exports Are Expected To Stay Weak

Our economists expect exports to remain weak; some positive signals (driven by US economy) that imports improved

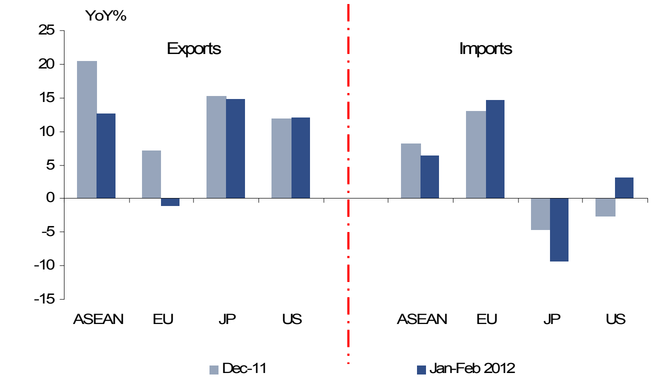
Our economists note in their recent report China Macro Flash - Jan-Feb Trade Data Underscores Slowing Economic Activities (published March 11th) that February trade posted a deficit of US$31.48bn, more than offsetting the January surplus and leading to a total trade deficit of US$ 4.25bn for the first two months (Figure 21). Overall, the data revealed slowing trade activities due to dwindling external and internal demand. Exports grew by 18.4% Y/Y in February but dropped to 4.0% once seasonally adjusted. Our economists expect exports to remain weak, although there are some positive signals from stronger-than-expected US economy (Figure 22). Imports increased significantly by 39.6% Y/Y in February (seasonally adjusted at 9.4%), lifting the combined Jan-Feb import growth rate to 9.6% Y/Y.

Figure 21. China – Trade Balance, 2009 – Present



Source: CEIC and Citi Investment Research and Analysis

Figure 22. China – Divergence Seen for Trade with Major Partners



Source: CEIC and Citi Investment Research and Analysis

Weakening Credit/Money Demand

M2 growth below 2012 target

Our economists note in China Macro Flash - Feb Money and Credit Growth Still on the Weak Side (published March 9th) that M1 growth, which reflects transaction demand in the economy, rose only slightly to 4.3% Y/Y in February from 3.1% in January, close to the slowest pace since 2001. It is reported that bank lending was very slow in the first 20 days of February, but banks accelerated loan extension toward the end of the month, possibly with encouragement from regulators. Even after the boost, M2 growth at 13.0% Y/Y in February still fell short of the 2012 target of 14%. Government research institute experts believe slow money growth in the first two months of 2012 may not reflect weak demand but instead may reflect constraints from LDR (loan-to-deposit ratio), CAR (capital adequacy ratios) and differentiated RRR (reserve requirement ratio).

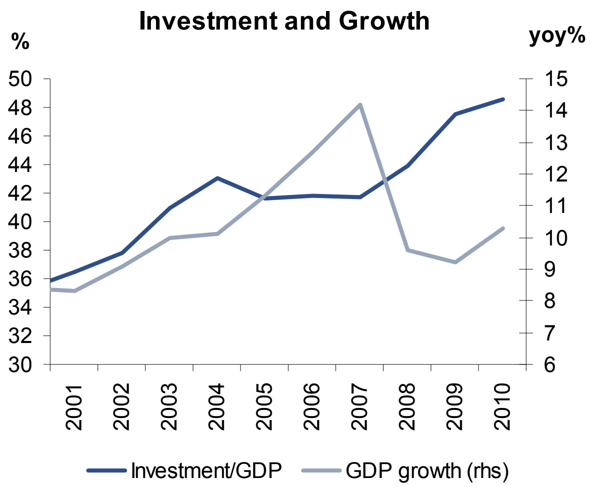
Will There Be A Stimulus Plan & What On?

2012 budget provides room for fiscal policy easing, but significant monetary policy easing is not expected by experts

The ultimate question we believe is whether or not there will be stimulus plan in China to counter weakening demand and if so, how big and what will it be spent on: infrastructure as in the past stimulus plan (2008-2010), consumption (to support transitioning of macro model towards consumption-related growth), investment in equipment or all of the above. Consumption-driven growth provides more sustainable (quality) long-term growth and investment in equipment is considered as a means of acquiring and transmitting technological improvement, thus productivity-enhancing. Structure (infrastructure related) investment, on the other hand, is less effective in promoting long-term growth because of its low technology content, although it helps create jobs and boost short-term demand.

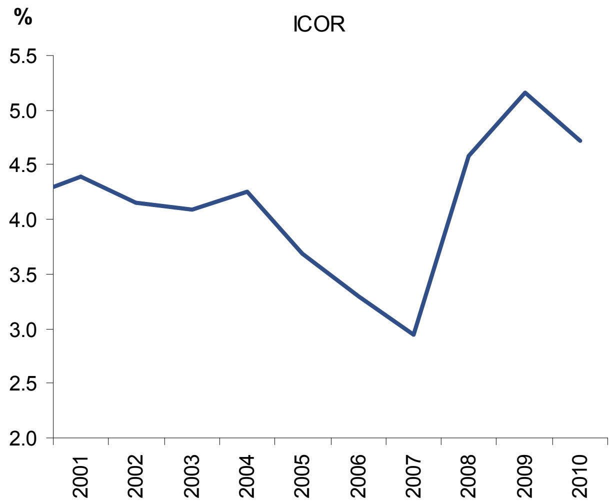
The previous 2-year stimulus plan in China (started in November 2008 and ended at the end of 2010) was a 4 trillion RMB ($600 million) stimulus package, of which c<50% was spent on infrastructure (including rural infrastructure). However, the efficiency of investment appears to be falling, with investment producing a weaker output response (Figure 22). In the absence of a more reliable metric for assessing the productivity of investment, CIRA employs the Incremental Capital Output Ratio (ICOR) as an indicator of marginal product of investment.[1] During 2001-2010, China's average ICOR topped 4. More recently, the ratio rose to around 5, with a big jump in investment/GDP ratio, associated with stimulus measures introduced to tackle the global financial crisis, producing a relatively small output response (Figure 24). The sheer size tends to diminish marginal returns as investable projects are being exhausted. Within the total investment, China appears to have overinvested in structure (construction and installation) relative to machinery and equipment (Figure 25), and infrastructure investment increased rapidly during the global financial crisis (Figure 26). Investment in equipment is considered as a means of acquiring and transmitting technological improvement, thus productivity-enhancing. Structure (infrastructure related) investment, on the other hand, is less effective in promoting long-term growth because of its low technology content, although it helps create jobs and boost short-term demand.

Figure 23. Investment produced weaker output response recently…



Source: National sources and Citi Investment Research and Analysis

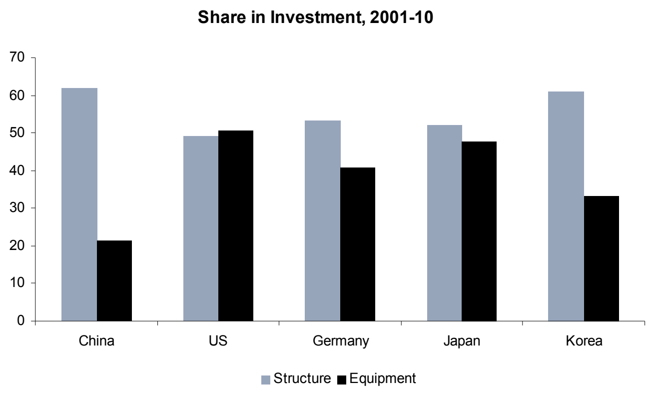
Figure 24. … indicating lower marginal product of investment.



Source: National sources and Citi Investment Research and Analysis

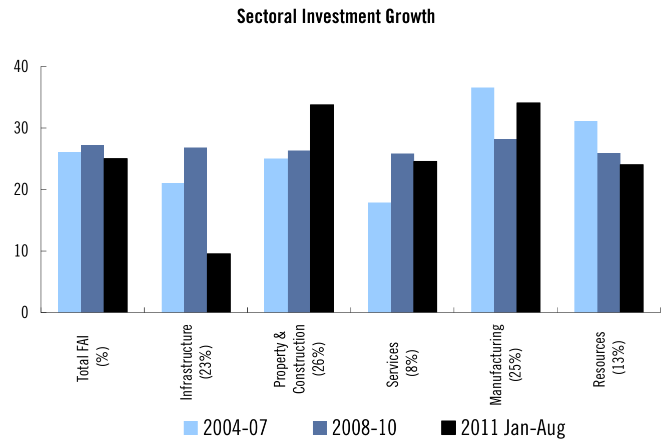
[1] ICOR is obtained by dividing the ratio of investment to GDP with real economic growth. The ratio shows the amount of capital investment incurred per extra unit of output. The higher the ratio, the lower the productivity of capital.

Figure 25. China overinvested in structure relative to equipment



Source: CEIC and Citi Investment Research and Analysis

Figure 26. Infrastructure investment increased rapidly during the global financial crisis.

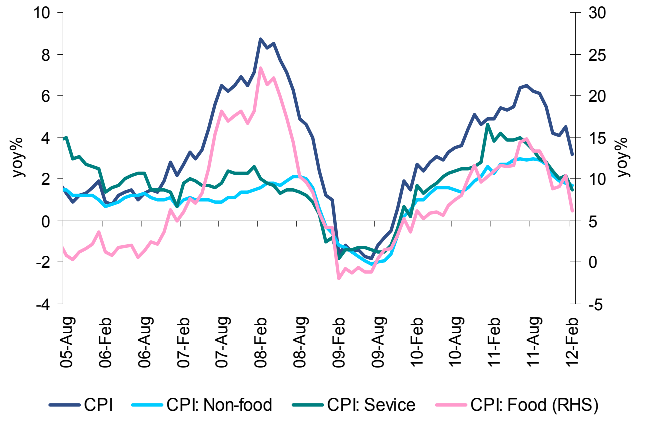


Source: CEIC and Citi Investment Research and Analysis

February inflation below expectations clears the way for further policy easing
CPI

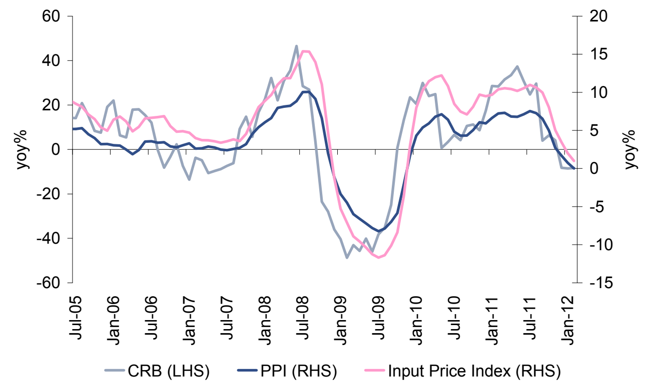
The combination of easing inflation (February inflation below expectations) and weakening growth creates conditions for policy easing. Our economists note in China Macro Flash - Feb Inflation Retreat Clears Way for Policy Easing (published March 9th) that CPI inflation fell sharply to 3.2% Y/Y in February from 4.5% in January, slightly below Citi's and market expectations and the lowest level in one and a half years (Figure 27). For the year as a whole, our economists expect average CPI inflation will most likely undershoot the official target of 4%. PPI inflation fell to 0% Y/Y from 0.7% in January (lowest since end-2009), benefiting from much lower base effect (Figure 28). Our economists believe PPI inflation may remain low Y/Y in the next few months even if M/M price rises, due to a continued favourable base effect.

Figure 27. China – CPI, 2005 - Present



Source: CEIC and Citi Investment Research and Analysis

Figure 28. China – PPI, 2005 - Present



Source: CEIC and Citi Investment Research and Analysis

Further, our economists believe the 2012 budget is expansionary, thus providing sufficient fiscal room to avoid a hard landing. In their recent report China Macro Flash - 2012 Budget More Expansionary than Headline Deficit Indicates (published March 6th), they argued that the 2012 budget is more expansionary than the headline deficit Indicates. The proposed budget envisages a fiscal deficit of 1.5% of GDP. The headline deficit implies inactive fiscal policy, which would pose downside risks to growth. However, detailed budget information indicates that the budget deficit would actually be 2.4% of GDP, based on widely-accepted fiscal accounting methodology, in line with Citi's expectations of 2.5% of GDP. The de facto budget deficit (2.4% of GDP) is therefore significantly larger than the 2011 fiscal outcome (1.3% of GDP). Despite the historical pattern of deficit undershooting, the government has the room to implement the budget fully if needed. Together with prudent monetary policy (with an easing bias) and anticipated relaxation of the property market policies by the middle of the year, the proactive fiscal policy should be supportive of above 8% growth in 2012. In addition, our economists note that government research institute experts estimate the budget deficit at about 2% of GDP, higher than the headline number of 1.5%.

However, experts are not expecting a significant loosening of monetary policy. Government research institute experts think monetary policy has already eased, and the current pace of economic slowdown does not warrant significant policy easing. M2 growth of 14% is a target for reference, not a bottom-line of policy. Further RRR adjustment will depend on FX flows, and an interest rate cut is unlikely in the near future. The room for RMB appreciation is shrinking as the exchange rate is near its equilibrium level. Our economists believe more RRR cuts are needed to boost money and credit growth, and investment appetite. They believe a delay in policy response now may trigger over-reaction later.

How Sustainable is Mining Capex?

We believe mining capex could prove to be at risk relative to the current expectations if mining companies start to revise down or delay mining equipment spend due to the slowdown in China and prevailing macro uncertainty. While our Global Mining Capex model continues to point to solid capex growth this year, current uncertainty could push/delay mining capex orders into 2H12. Our model also points to a decline in mining capex for 2013 (although admitted it is too early to draw conclusions as 2H is typically a better indicator for capex projects into the year ahead), that said looking at a strong mining capex expansion since early 2000s (except the downturn in 2009) begs the question of how sustainable is such a strong capex increase, with capex spend projected in 2012 to almost double from the previous peak of 2008 (in absolute terms). Even if we were to see a normalisation of capex spending, this could trigger significant downgrades. In our models for mining equipment providers, we assume mining equipment grows by 13% Y/Y in 2012 (previously expected growth of 15%) and declines by 5% in 2013 (previously estimated growth of 5%). This risk to our and consensus forecasts lies on the downside.

Early Signs of Customer Hesitation?

Last week BHP Billiton is re-evaluating the company's capex plans

Most recently (March 19) the Australian Financial Review reported that BHP Billiton Chairman Jacques Nasser has said that BHP Billiton is re-evaluating the company's capex plans "as slowing Chinese growth prompts a more cautious outlook for commodity demand". The article further notes that "BHP is looking more closely at where Chinese demand for iron ore is likely to peak before committing to a US$20 billion-plus investment in mine and port infrastructure in Western Australia state's Pilbara region."

Figure 29. Click here to add title

Company	Comment
BHP	Jacques Nasser, said last week that BHP is re-evaluating its capital spending plans as slowing Chinese growth prompts a more cautious outlook for commodity demands
Junior Miners	Junior miners struggling to fund their exploration budgets are being reined in this year as companies struggle to raise capital to fund the search for new reserves (for copper and iron ore). Big miners need new deposits to offset falling output at mines that were discovered in the previous boom of late 1970s and early 1980s. But these companies have tended in recent years to leave exploration largely to small companies, known as “juniors”, which are now struggling to raise equity funding to drill

Source: Australian Financial Review; Financial Times, Citi Investment Research and Analysis

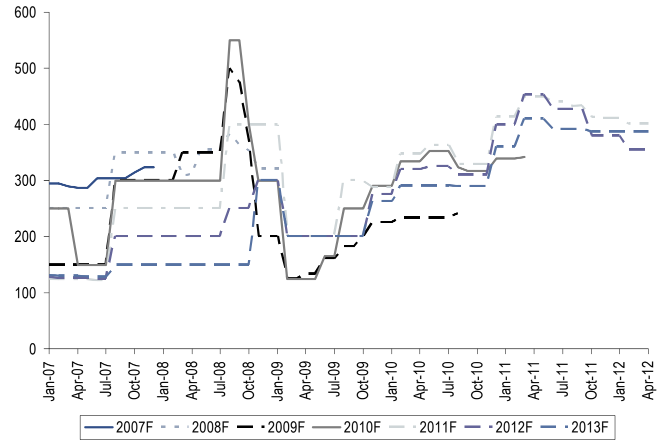
Strong Correlation With Copper Price

The copper price has seen a 16% rebound recently to $3.85/lb after falling to $3.33/lb in October (Figure 30). The current price is 14% below the historical peak of c.$4.48/lb reached in February 2011. In January 2012, Citi commodities analysts lowered their 2012 copper price forecast to $3.55/lb from $3.80/lb previously, but kept their 2013 forecast stable at $3.87/lb.(Figure 31).

Figure 30. Copper Price (USD cents/lb), 1978-Present

Source: Metal Bulletin, dataCentral

Figure 31. Cit Forecasts - Copper Price (USD cents/lb)

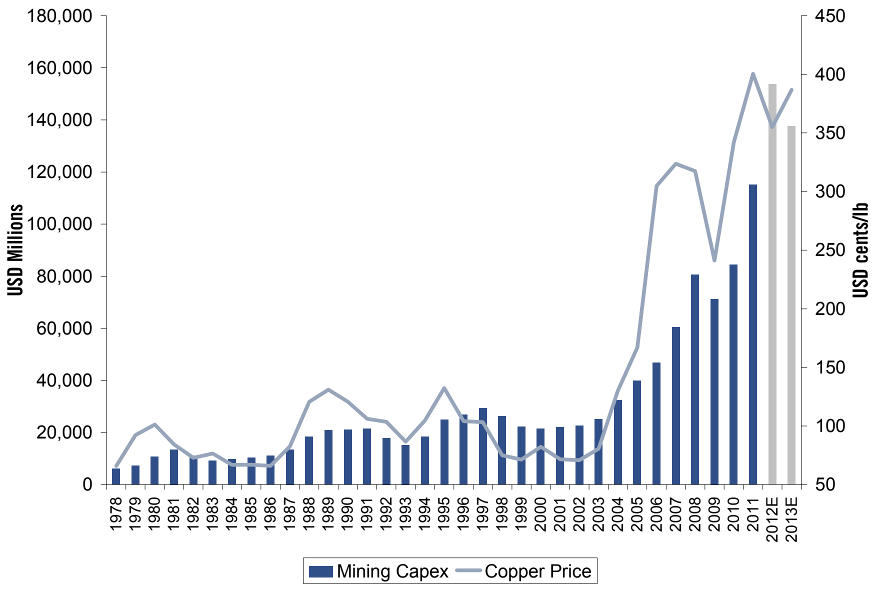


Source: Citi Investment Research and Analysis

Strong correlation between copper price and mining capex, which points to a step-up in mining capex in 2012

There is a strong correlation between global mining capex and metal prices, in particular copper prices (Figure 32). In the Appendix – A we show the detailed outlook for commodity prices. We note that 2012E capex is almost double (1.9x) the 2008 peak level and is c>30% above 2011 and 2013E capex is 1.7x above the 2008 peak and 20% above 2011.

Figure 32. World Mining Capex (USD millions) vs. Copper Price (USD cents/lb), 1978-2013E



Source: Company Reports and Citi Investment Research and Analysis

Updated Mining Capex Model

Our Mining Capex model points to capex growth in 2012E of 34% Y/Y followed by a decline of 11% in 2013E

Our proprietary Mining Capex model shows solid capex growth in 2012E followed by a decline in 2013E. The model, which is based on CIRA forecasts for over 40 companies world-wide, points to capex growth of c34% Y/Y in 2012E, followed by a c11% decline in 2013E as shown in Figure 33.

Figure 33. CIRA Mining Capex Model*

	2004	2005	2006	2007	2008	2009	2010	2011	2012E	2013E
Capex	-21,140	-26,052	-30,504	-39,455	-52,581	-46,530	-55,147	-75,115	-100,379	-89,784
Growth		23.2%	17.1%	29.3%	33.3%	-11.5%	18.5%	36.2%	33.6%	-10.6%
Sales	135,247	171,412	206,158	262,517	317,823	251,349	339,733	414,143	428,339	470,656
Growth		26.7%	20.3%	27.3%	21.1%	-20.9%	35.2%	21.9%	3.4%	9.9%
Depreciation	-12,095	-13,105	-12,708	-16,417	-20,711	-19,784	-22,748	-25,984	-30,283	-35,238
Growth		8.4%	-3.0%	29.2%	26.2%	-4.5%	15.0%	14.2%	16.5%	16.4%
Capex/Depreciation	1.75	1.99	2.40	2.40	2.54	2.35	2.42	2.89	3.31	2.55
Capex % of Sales	15.6%	15.2%	14.8%	15.0%	16.5%	18.5%	16.2%	18.1%	23.4%	19.1%

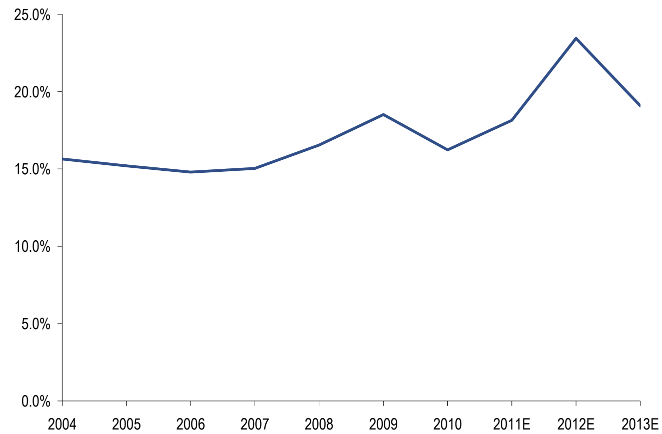
* based on CIRA forecasts for over 40 companies world-wide

Source: Company Reports, Citi Investment Research and Analysis

Both capex/sales and capex/depreciation ratios show above-average investment in 2012E, more normalised level in 2013E

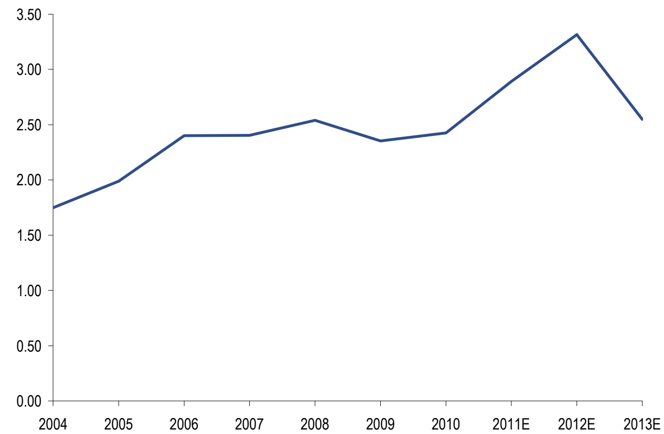
Both capex/sales and capex/depreciation ratios show well above-average investment by global mining companies in 2012E, but point to a sharp return to a more normalised level in 2013E (Figure 34 and Figure 35).

Figure 34. Global Metals and Mining Sector – Capex/Sales (2004-13E)



Source: Company Reports, Citi Investment Research and Analysis

Figure 35. Global Metals and Mining Sector – Capex/Depreciation (2004-13E)



Source: Company Reports, Citi Investment Research and Analysis

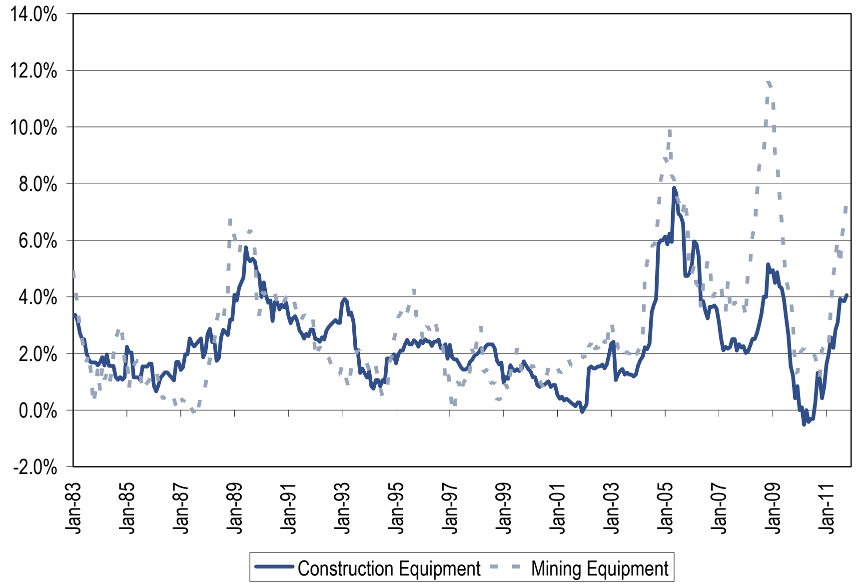
While our Global Mining Capex model continues to point to solid capex growth this year, the current uncertainty could push/delay mining capex orders into 2H12. The ultimate question is how sustainable capex could prove in 2013, with 2012 capex forecast to almost double the 2008 peak level (in absolute terms). Even if we were to see a normalisation of capex spending in 2013, this could trigger significant downgrades. In our models, we now forecast mining equipment to grow by 13% Y/Y in 2012 (previously 15%) and decline by 5% in 2013 (previously estimated growth of 5%).

Pricing Recovered but Still Well Below Peak

Pricing for mining equipment continues to recover from 2010 lows but is not yet back to peak levels.

Pricing for mining equipment continues to recover from 2010 lows but is not yet back to peak levels. For example, in the US, PPI for mining equipment is at 7.5% today, up from the trough of 1.2% (October 2010), but is still below the prior peak of 11.6% — in contrast, construction equipment PPI today is at 4.1%, up from -0.5% (March-2010) vs. previous peak of 7.8% (Figure 36). However, while we find this pricing data to be useful from a directional standpoint, our conversations with industry participants suggests BLS data fail to fully capture "true" price trends, as cheaper financing or payment options may be used as enticements to sell equipment in a weak demand environment.

Figure 36. PPI Changes – Construction Equipment and Mining Equipment, 1983–Present



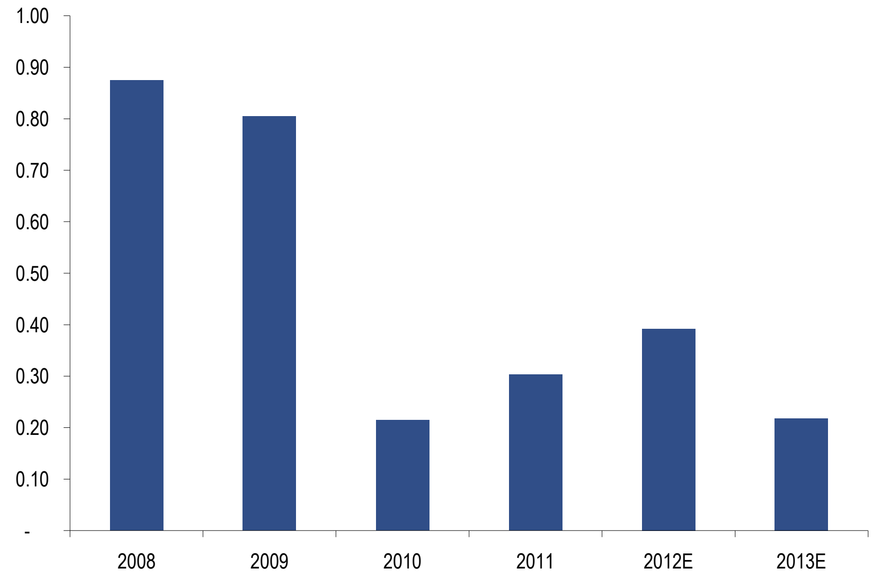
Source: DataStream, US BLS

Miners Have Strong Balance Sheets

Mining companies have strong balance sheets and large mining companies account for a greater majority of demand today than they did in 2008.

The sharp fall in commodity prices in 4Q08/early 09 and tough credit conditions saw many mining companies rein in capital expenditure budgets for 2009/10. Cash preservation took priority and many longer-term expansion projects were delayed or cancelled, with highly geared mining companies most affected. Worth noting, this time around miners have a strong balance sheet position, with the net debt/EBITDA for the mining industry having improved from >1x in 2008 to c0.3x in 2011 (Figure 37).

Figure 37. Pan European Mining Companies – Net Debt/EBITDA



Source: Company reports, Citi Investment Research and Analysis

Risk of Chinese Competition

With regards to mining equipment, we see Metso and FLSmidth as most exposed, whereas Atlas Copco and Sandvik as most protected.

This report should we read in conjunction with our Engineering Sector in China – Step-Up in 'Go Global' – Revised Winners & Losers (published today), where we argue that the risk of Chinese competition in surface mining is increasing.

Mining (especially coal) equipment industry continues to be a key focus in 12th FYP. Chinese competitors are present in crushing and underground coal mining, where we believe the competition will intensify in the medium-term. A wide technological gap still prevails in the underground mining (ex coal). With regards to mining equipment, we see Metso and FLSmidth as most exposed, whereas we see Atlas Copco and Sandvik as most protected.

Chinese Competitors Are Present In…

Chinese competitors are present in crushing and underground coal mining – mostly negative for Metso and FLSmidth (to a lesser extend) in the medium-term, in our view

Chinese competitors are predominantly present in underground coal mining and surfacing mining such as crushing, where we believe competitive risk will increase in the medium-term. Companies mostly exposed are Metso and FLSmidth, although, in our view FLSmidth has a unique advantage in the sector owing to its experience in successfully dealing with Chinese competitor Sinoma in the cement industry — witness a solid progression of EBIT margins at the time of market share erosion due to the rise of Sinoma. We believe this also explains FLSmidth's more conservative approach when it comes to China. The company is not complacent and while not currently seeing major risk from Chinese competitors in the mining equipment industry, FLSmidth is planning to implement its knowledge of the Cement business into its Minerals division. In underground mining (ex coal), which is the core competence of Atlas Copco and Sandvik, there is limited presence of Chinese competition. For example, the major Chinese mining equipment companies lack a competitive offering in the area of drill rigs (exploration, blast hole, etc.) and the market is fairly fragmented.

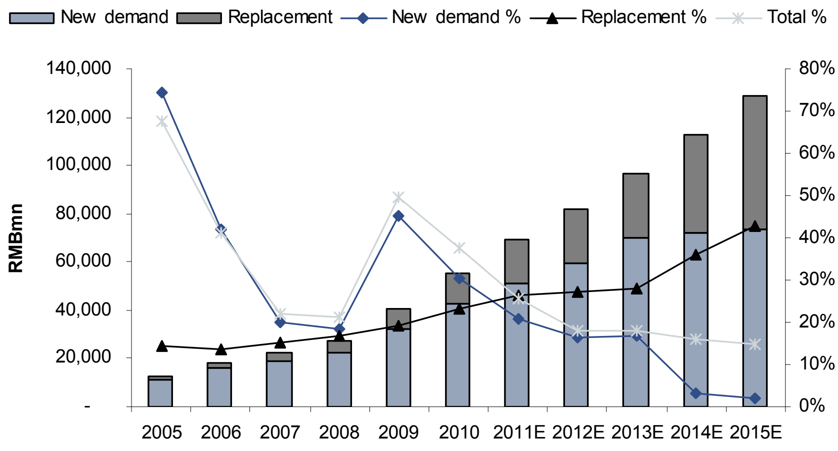
1. Coal Mining (Including Underground Coal Mining)

Coal mines in China use domestically-produced coal mining machinery

As a result of the relative price competitiveness, continuous improvements in quality and technological standards, and also due to advantages in the provision of after-sales services in China, domestically-produced coal mining machinery is mainly used in coal mines in China. According to a report by the China National Coal Mining Machinery Industry Association in July 2009, imported coal mining machinery accounted for only approximately 3.0% of the total quantity of domestic coal mining machinery sold in China during 2008. Wide distribution networks, quality aftermarket services and a deep understanding of the needs of domestic coal mining customers have also contributed to the success of domestic manufacturers in the domestic market.

Over the next 5 years, replacement-driven demand (replacement cycle of coal mine machinery is only about five years) is expected to outpace demand for new coal mining machinery. The latter is expected to fall below 15% in the next five years and by 2015E, CIRA expects new demand for coal mining machinery to reach RMB73bn from RMB42bn noted in 2010, and replacement demand to grow to RMB55bn from RMB13bn seen in 2010 (Figure 38). Given the secular growth of the coal mining machinery industry, domestic players are expanding capacity through construction or M&A, and foreign dominant players are seeking acquisition targets in China (for example a recent acquisition of IMM by Joy Global, which currently has 18% of the stake in IMM with intention to buy an initial stake of 41%).

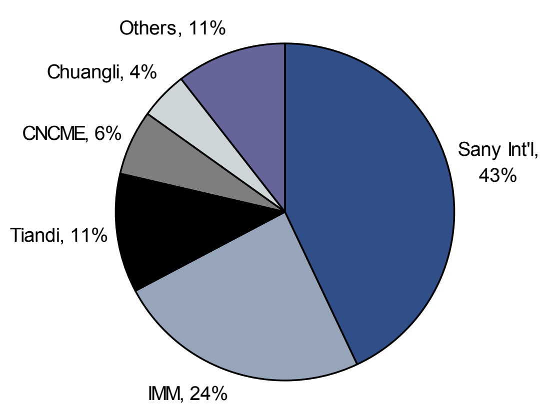
Figure 38. China Major Coal Machinery – New vs. Replacement and Growth (2005 – 2015E)



Source: CMIA, Citi Investment Research and Analysis estimates

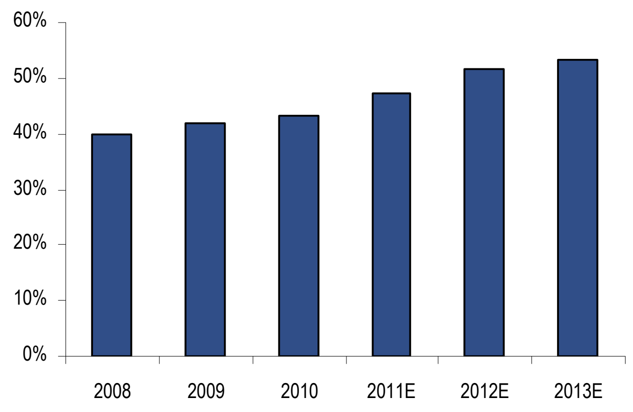
Competition is high in the roadheaders industry, with the combined domestic market share of the two largest manufacturers (Sany Heavy Equipment International and IMM) accounting for 67% in 2010 and with the top four accounting for 84% of the market in 2010, resembling the characteristics of an oligopoly (Figure 39). Worth noting, the largest coal-related equipment provider, Sany Heavy Equipment, emerged in 2004 with zero market share and is reaching towards 43% market share today, and our Chinese Machinery analyst, Jenny Zhen, expects the company to gain further market share (Figure 40).

Figure 39. China – Roadheaders Market Share by Sales Value, 2010



Source: CMIA, Company Reports and CIRA estimates

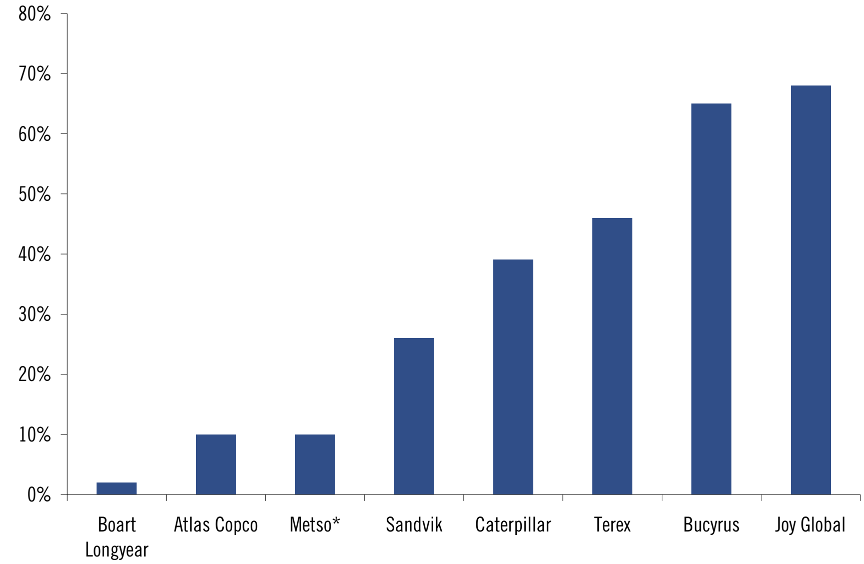
Figure 40. Sany Heavy Equipment International - Roadheader Market Share



Source: Company Reports and CIRA estimates

In Figure 41 we show global mining companies' exposure to coal mining equipment.

Figure 41. Global Mining Equipment Companies – Coal as a % of Mining Equipment Sales



Source: Company reports, Citi Investment Research and Analysis, *Estimate

2. Surface Mining (Crushing)

We expect competition to intensify in surface mining (crushing). Metso is most exposed, in our view.

We expect competition to intensify in surface mining (crushing). Metso notes in its annual report that in mining technology, Chinese suppliers have expanded their operations also to global markets, particularly to the countries that represent targets of investments by Chinese mining companies (e.g. Australia/Africa). Indeed, this can be also seen by looking at the major orders received by Chinese companies outside of China, with mining-related orders (more specifically ball mills) appearing frequently (Figure 42).

Figure 42. Major Announced Overseas Orders by Chinese Companies, 2007-Present

Date	Company	Industry	Customer	Country	Comments	Amount
02/06/2011	CITIC Heavy Industries	Mining	London Mining Company	Sierra Leone	1x Ball Mill	NA
29/04/2011	CITIC Heavy Industries	Mining	SAMARCO	Brazil	4x Ball Mills	NA
07/04/2011	CITIC Heavy Industries	Mining	Fortescue Metals Group Ltd	Australia	2x High pressure grinding rolls	NA
05/04/2011	CITIC Heavy Industries	Mining	USIMINAS	Brazil	1x Ball Mill	NA
01/02/2011	Zhengzhou Coal Mining Machinery	Mining	Magnitogorsk Iron & Steel Works	Russia	Production and delivery of face equipment	NA
27/05/2010	CITIC Heavy Industries	Mining	Bariq Mining Limited	Saudi Arabia	1x SAG Mill, 1x Ball Mill, 1x Regrind Mill	NA
25/09/2009	CITIC Heavy Industries	Mining	Sino Iron Project	Australia	World's largest 6x AG Mills and 6x Ball Mills	NA
25/06/2009	CITIC Heavy Industries	Mining	Vedanta Group	India	2x Air Swept AG Mills	NA
11/05/2009	CITIC Heavy Industries	Mining	Vale	Brazil	7 x Ball Mills, 1x Primary Gyratory Crusher	NA
19/02/2009	Northern Heavy Industries	Mining	Vale	Oman	20 belt conveyors and a sampling system	$48.7m
30/06/1905	Northern Heavy Industries	Mining	Vale	Various	Projects in Brazil and Mozambique	$32.5m
29/08/2008	CITIC Heavy Industries	Mining	HZL	India	1x SAG Mill, 1x Ball Mill	NA
27/08/2008	CITIC Heavy Industries	Mining	Copper Mines of Tasmania	Tasmania	1x SAG Mill	NA
31/07/2008	CITIC Heavy Industries	Mining	Phu Bia Mining	Laos	1x Ball Mill	NA
14/07/2008	CITIC Heavy Industries	Mining	Phu Bia Mining	Laos	1x Ball Mill	NA
15/04/2008	CITIC Heavy Industries	Mining	Essar	India	6x Ball Mills	NA
15/11/2007	CITIC Heavy Industries	Mining	NA	Russia	7x SAG Mills into two mining projects in Russia	NA
01/08/2007	CITIC Heavy Industries	Mining	Sino Iron Project	Australia	6 x AG Mills, 6 x Ball Mills	NA

Source: Company Reports, Citi Investment Research and Analysis

For more details see *2012 Mining Capex Outlook - China RRR Cut Supportive of Mining Capex* (December 6, 2011).

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Company-Specific Section

Company Focus

- Company Update
- Rating Change
- Target Price Change
- Estimate Change

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Sell	**3**
from Neutral	
Price (22 Mar 12)	SKr159.70
Target price	SKr135.00
from SKr160.00	
Expected share price return	-15.5%
Expected dividend yield	3.2%
Expected total return	**-12.3%**
Market Cap	SKr189,345M
	US$28,173M

Price Performance
(RIC: ATCOa.ST, BB: ATCOA SS)

Atlas Copco AB (ATCOa.ST)

Downgrade to Sell – Priced For Perfection

- **Downgrade to Sell** — In this report we downgrade Atlas Copco to Sell from Neutral, having lowered the rating from Buy to Neutral at the end of January. We continue to see long-term fundamentals as attractive, but believe in the near-term, the macro uncertainty (especially renewed concerns about China) will continue to weigh down on the shares. We view Atlas Copco as the highest-quality company in our sector and relatively more defensive (witness its margins decline of 390bps to c15% with sales volume decline of 23% from peak to trough in the recent downturn), but we think the stock is priced for perfection.
- **TP Lowered to SKr135, EPS Lowered** — Our 2013E EPS forecast is lowered by 7% (2012E is largely unchanged) to account for lower than previously anticipated growth forecasts in mining equipment, while our aftermarket growth forecast remains unchanged at 5%: all in all for the Mining business of Atlas Copco, we estimate volume growth of 9% (previously 15%) and flat in 2013E (previously +5%). Our DCF-based target price is lowered to SKr135 from SKr160, also reflecting higher WACC due to increased uncertainty.
- **Downside Risk to Mining Capex** — We believe mining capex could prove to be at risk relative to the current expectations if mining companies start to revise down or delay mining equipment spend due to slowdown in China and prevailing macro uncertainty, especially if it weighs down on copper prices. The current projections for 2012E mining capex are almost double from the previous peak of 2008 (in absolute terms). Even if we were to see a normalisation of capex spending, this could trigger significant downgrades.
- **Highest Quality…**— We believe Atlas Copco is the highest-quality company across our wider European Engineering universe, as defined by high EBIT margins and high ROCE. Over the past decade (2000-2010), EBIT margins were on average at 16% (peak/trough range was at 19%/15%; 3Q11 margins were at 23.1%) and ROCE at 26%.
- …**But Priced for Perfection** — Atlas Copco is a victim of its own success. On our revised 2012E forecasts, Atlas Copco is trading on 2012E P/E of 15.8x, EV/EBIT of 12.0x, EV/Sales of 2.4x, dividend yield of 3.2% and free cash flow yield of 5.8%.
- **The Upside Risk** — If we see no delays or cuts in mining capex and improvement in the demand environment of China, as well as continuation of the US recovery, our expectations could prove to be conservative.

Atlas Copco AB (SEK)

Year to 31 Dec	2010A	2011A	2012E	2013E	2014E
Sales (SKrM)	69,875.0	81,203.0	84,790.1	86,620.6	89,358.7
Net Income (SKrM)	9,921.0	12,963.0	12,263.5	12,045.7	11,779.8
Diluted EPS (SKr)	8.19	10.68	10.10	9.92	9.70
Diluted EPS (Old) (SKr)	8.19	10.68	10.08	10.68	10.19
PE (x)	19.5	15.0	15.8	16.1	16.5
EV/EBITDA (x)	12.0	9.9	10.2	10.1	10.0
DPS (SKr)	9.00	5.00	5.05	4.96	4.85
Net Div Yield (%)	5.6	3.1	3.2	3.1	3.0

Company Focus

■ Company Update

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Buy	**1**
Price (22 Mar 12)	£4.40
Target price	£5.51
Expected share price return	25.2%
Expected dividend yield	2.1%
Expected total return	**27.3%**
Market Cap	£851M
	US$1,351M

Price Performance
(RIC: FENR.L, BB: FENR LN)

Fenner (FENR.L)

Strong Aftermarket Positions

- **Strong Niche Positions** — Fenner has two reporting divisions — Engineered Conveyor Solutions (ECS, 70% Sales / 65% EBITA) and Advanced Engineering Products (AEP, c.30% sales / c.35% EBITA). Fenner's mining exposure is mainly in ECS, where its conveyor belting is a consumable product. 60% of ECS sales go to thermal coal, c.20% into Copper / Iron Ore, 10% into construction and 10% other Industrial. Fenner is a market leader with c. 17-20% global share, with the main competitors being Continental and Goodyear.
- **Aftermarket Bias** — Within ECS, c.90% of sales are in Service / Aftermarket. We think this is a key differentiating factor and demand is less volatile than for pure capex plays. Service can be inherently higher-margin than belt sales to original or aftermarkets, and as Service grows, we expect to see positive mix effects. AEP is focused on extremely niche markets in the Medical, IT, Aerospace, Energy and Industrial markets. These have generated 15% sales CAGR over the last 5 years, with margins now approaching 20%.
- **Upgrade Cycle** — EPS momentum has been very strong in the last 2 years and we are not making any changes to forecasts today given the heavy aftermarket bias noted above. Indeed, we have upgraded forecasts by a cumulative 17% in 2012 thus far and since October 2010 FY 2012 expectations have nearly doubled. This is on a combination of positive operational gearing (AEP building scale) and ECS capacity built in 2007-2009 being utilised. Market share gains are also benefitting. While remaining vigilant for signs of slowing demand (North American thermal coal constitutes c.18-20% group sales), we think positive consensus EPS momentum can continue.
- **Order Book Remains Normal** — Fenner operates with a c.5-month order book, and the 8 March IMS stated that there are no changes to the anticipated pattern at this stage of the year. ECS is a play on total extraction volumes and targets the largest, lowest-cost producers in its markets.
- **Buying Opportunity** — The shares have pulled back from highs in the last week or so and we view this as a buying opportunity. The stock remains in our midcap key buys list and we think 2012 can continue deliver both re-rating and further consensus EPS momentum. With the stock trading on only 11.8x PER / 6.7x EV/EBITDA and 1.1x EV/Sales (Dec 2012E), we see good value in the shares. Our DCF based price is 551p.

Fenner (GBP)

Year to 31 Aug	2010A	2011A	2012E	2013E	2014E
Sales (£M)	552.5	718.3	830.2	894.2	956.8
Profit Before Tax (£M)	44.9	78.5	99.9	112.1	122.1
Diluted EPS (p)	17.5	27.7	36.1	39.9	43.1
Diluted EPS (Old) (p)	17.5	27.7	36.1	39.9	43.1
PE (x)	25.2	15.9	12.2	11.0	10.2
EV/EBITDA (x)	14.0	9.4	7.6	6.7	6.0
DPS (p)	7.3	8.0	9.2	10.6	11.6
Net Div Yield (%)	1.6	1.8	2.1	2.4	2.6

Company Focus

- Company Update
- Rating Change
- Target Price Change
- Estimate Change

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Neutral	**2**
from Buy	
Price (22 Mar 12)	Dkr399.50
Target price	Dkr400.00
from Dkr450.00	
Expected share price return	0.1%
Expected dividend yield	2.4%
Expected total return	**2.6%**
Market Cap	Dkr21,253M
	US$3,776M

Price Performance
(RIC: FLS.CO, BB: FLS DC)

FLSmidth (FLS.CO)

Downgrade to Neutral on Mining Capex Concerns

- **Downgrade to Neutral** — In this report, we downgrade FLSmidth to Neutral from Buy. We continue to see long-term fundamentals as attractive, but believe in the near-term the macro uncertainty (especially renewed concerns about China,) as well as the change in the management team, could weigh down on the shares. We would advise to hold the shares rather than sell at this stage despite our concerns regarding mining capex, as we believe cement capex is at the bottom of its cycle, as well as it having a relatively cheap valuation (FLSmidth is trading on 2012E P/E of 12.0x, EV/EBIT of 7.4x and EV/Sales of 0.8x), which could provide some cushion to the share price.

- **TP Lowered to DKr400, EPS Changed** — We raise our 2012E EPS forecast by 9% to reflect better-than-expected company guidance, driven by a solid backlog. Our 2013E EPS forecast is lowered by 5% to account for lower than previously anticipated growth forecasts in mining equipment, while our aftermarket growth forecast remains unchanged at 5%; all in all for the Mining business of FLSmidth, we estimate growth of c11% (previously 15%) and a decline of 2% in 2013E (previously +5%). We set our target price of DKr140 at a 10% discount to our DCF valuation.

- **Downside Risk to Mining Capex** — We believe mining capex could prove to be at risk relative to the current expectations if mining companies start to revise down or delay mining equipment spend due to the slowdown in China and prevailing macro uncertainty, especially if it weighs on copper prices. The current projections for 2012E mining capex are almost double from the previous peak of 2008 (in absolute terms). Even if we were to see a normalisation of capex spending, this could trigger significant downgrades.

- **Management Change Could Create Near-Term Uncertainty** —FLSmidth is seeing two notable changes to its management team: (1) CFO, Poul Erik Tofte, is leaving at the end of this month and (2) Group Executive Vice President and CEO of Minerals of Christian Jepsen will leave at the end of July this year for a position at one of the company's customers.

- **Upside Risk** — If we see no delays or cuts in mining capex, finalisation of the Ludowici acquisition (if successful, Ludowici will be consolidated in June with immediate accretion, not currently reflected in our forecasts), and a step-up in cement-related orders, our expectations could prove to be conservative.

FLSmidth (DKK)

Year to 31 Dec	2010A	2011A	2012E	2013E	2014E
Sales (DkrM)	20,186.0	21,998.0	23,801.0	24,276.1	25,010.5
Net Income (DkrM)	1,339.0	1,576.0	1,766.1	1,638.1	1,818.1
Diluted EPS (Dkr)	25.41	29.99	33.61	31.17	34.60
Diluted EPS (Old) (Dkr)	25.41	27.48	30.67	32.62	na
PE (x)	15.7	13.3	11.9	12.8	11.5
EV/EBITDA (x)	8.4	7.5	6.6	6.4	5.5
DPS (Dkr)	9.00	9.00	9.76	10.34	11.47
Net Div Yield (%)	2.3	2.3	2.4	2.6	2.9

Company Focus

■ Company Update

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Sell	**3**
Price (22 Mar 12)	€33.99
Target price	€24.00
Expected share price return	-29.4%
Expected dividend yield	4.0%
Expected total return	**-25.4%**
Market Cap	€5,110M
	US$6,752M

Price Performance
(RIC: MEO1V.HE, BB: MEO1V FH)

Metso Oyj (MEO1V.HE)

Sell – On Mining & Paper Capex Concerns

- **Reiterate Sell Rating, TP €24** — Metso continues to be one of our top sell ideas across our wider European Engineering coverage universe, as well as one of the top sell ideas in Citi Euro SMID. 4Q11 results followed by a conference call highlighted more negatives than positives. Since the European Engineering sector troughed on October 4th, 2011 Metso has outperformed the market (DJSTOXX) by c41% and vs. average sector outperformance of the market of c13%.

- **Downside Risk to Mining Capex** — We believe mining capex could prove to be at risk relative to the current expectations if mining companies start to revise down or delay mining equipment spend due to the slowdown in China and prevailing macro uncertainty, especially if it weighs on copper prices. The current projections for 2012E mining capex are almost double from the previous peak of 2008 (in absolute terms). Even if we were to see a normalisation of capex spending, this could trigger significant downgrades.

- **Downside Risk Paper Capex** — Metso generates c.40% of group sales from paper and pulp-related end markets (with paper being the majority). In 4Q11, Metso has seen a deceleration in Pulp, Paper and Power (PPP) division orders (-34% Y/Y) due to a lack of availability of financing in China, with no improvement evident YTD. China has been a key contributor to strong order growth (PPP orders are 54% of group backlog) on the back of China's stimulus plan and significant capacity additions in the pulp and paper industry. Our pulp and paper capex model points to a 22% cumulative decline from 2011, with a slowdown in Asia being the biggest driver — for more details, see our recent report entitled Metso Oyj (MEO1V.HE) - Reiterate Sell - Focus on Deteriorating Paper Outlook.

- **Increasing Risk from Chinese Competition** — We expect competition to intensify in surface mining (crushing in particular), with Chinese companies (most notably CITIC Heavy Industries) receiving major orders outside of China (e.g. Australia/Africa/Brazil).

- **Valuation** — On 2012E forecasts (below the current consensus), Metso is trading on P/E of 14.2x (sector on 13.5x), EV/EBIT of 9.9x and EV/Sales of 0.8x vs. our through-cycle EBIT margin of 6.7% (vs. a 10-year av. EBIT margin of 6%) vs. Metso's guidance of c9% (based on mid point of divisional EBIT margin guided ranges 7%/11%; note: prior peak was 10%). If Metso were to achieve the target, we would see fair value of €34/share, suggesting to us no upside.

Metso Oyj (EUR)

Year to 31 Dec	2010A	2011A	2012E	2013E	2014E
Sales (€M)	5,552.0	6,646.0	7,189.9	7,384.3	6,932.1
Net Income (€M)	257.0	356.0	357.7	339.0	294.3
Diluted EPS (€)	1.72	2.38	2.39	2.27	1.97
Diluted EPS (Old) (€)	1.72	2.38	2.39	2.27	1.97
PE (x)	19.8	14.3	14.2	15.0	17.3
EV/EBITDA (x)	9.4	7.9	7.6	7.9	8.8
DPS (€)	1.55	1.70	1.37	1.31	1.16
Net Div Yield (%)	4.6	5.0	4.0	3.8	3.4

Company Focus

- Company Update
- Target Price Change
- Estimate Change

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Buy	**1**
Price (22 Mar 12)	SKr93.65
Target price	SKr110.00
from SKr115.00	
Expected share price return	17.5%
Expected dividend yield	3.9%
Expected total return	**21.3%**
Market Cap	SKr117,473M
	US$17,479M

Price Performance
(RIC: SAND.ST, BB: SAND SS)

Sandvik AB (SAND.ST)

Buy – Restructuring Story Outweighs Mining Capex Concerns

- **Remains One of Our 12month- Top Picks, But We Admit Near-Term is Uncertain** — Despite our concerns regarding mining capex, which we admit if materialise will create near-term pressure on the shares, we continue to favour Sandvik as we believe that the market under-estimates Sandvik's restructuring potential, which is just at the early stages. In addition, a potential resumption of nuclear projects in China (expected next month) could provide support to the shares.
- **TP Lowered to SKr110, EPS Lowered** — Our 2013E EPS forecast is lowered by 4% in 2013E (2012E is largely unchanged) to account for lower than previously anticipated growth forecasts in mining equipment, while our aftermarket growth forecast remains unchanged at 5%; all in all for the Mining business of Sandvik we estimate LFL growth of c10% (previously 11%) and flat in 2013E (previously +3%). We lower our target price to DKr110 from DKr115 to reflect reduced estimates and higher macro risks.
- **Downside Risk to Mining Capex** — We believe mining capex could prove to be at risk relative to the current expectations if mining companies start to revised down or delay mining equipment spend due to slowdown in China and prevailing macro uncertainty especially if it weighs on copper prices. The current projections for 2012E mining capex are c2x the previous 2008 peak level (in absolute terms) and if normalised, this could trigger significant downgrades.
- **Restructuring on Track** — The CEO of Sandvik, Olof Faxander, has recently hosted a conference call where he noted that restructuring remains on track, with the focus in 2012 on execution. 2H11 was focused on setting up the organisation and uncertainties related to the changes that impacted underlying performance in 4Q11 are now largely over, with the CEO saying "the most difficult part is behind". Sandvik noted that savings related to headcount reductions (900 people group-wide, of which 400 in Mining and Construction) would already have some effect in 1Q12 and would gradually ramp up, with full planned effect by end of 2012.
- **Nuclear Revival in China** — As noted in our recent report *Sandvik AB - New China Nuclear Construction to Commence in 2012* (6 March), China is set to resume approval of new nuclear projects in April. As a reminder, between 2009 and prior to the March 2011 Japan disaster, Sandvik had booked more than SKr13bn of nuclear-related orders (14% of group sales). We note we could see upside to our SMT peak EBIT margin forecast of 9% (vs. Sandvik's guidance of 10-12%) if nuclear-related orders were to return.

Sandvik AB (SEK)

Year to 31 Dec	2010A	2011A	2012E	2013E	2014E
Sales (SKrM)	82,654.0	94,084.0	98,177.8	100,678.0	104,149.3
Net Income (SKrM)	6,712.2	8,026.9	9,666.0	10,307.4	11,208.4
Diluted EPS (SKr)	5.66	6.77	8.15	8.69	9.45
Diluted EPS (Old) (SKr)	5.66	6.77	8.16	9.01	9.79
PE (x)	16.6	13.8	11.5	10.8	9.9
EV/EBITDA (x)	9.7	7.5	6.9	6.6	6.1
DPS (SKr)	3.00	3.25	3.61	3.91	4.25
Net Div Yield (%)	3.2	3.5	3.9	4.2	4.5

Company Focus

- Company Update
- Target Price Change
- Estimate Change

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Sell	**3**
Price (22 Mar 12)	£18.03
Target price	£16.40
from £18.30	
Expected share price return	-9.0%
Expected dividend yield	1.4%
Expected total return	**-7.6%**
Market Cap	£3,810M
	US$6,048M

Price Performance
(RIC: WEIR.L, BB: WEIR LN)

Weir Group PLC (WEIR.L)

Mining Risks Add to Oil & Gas Issues

- **Sell** — We downgraded our Rating to Sell from Neutral on 5 March. Our sell case is based on our view that (1) there will be limited growth in the Oil & Gas business in 2012E and 2013E and (2) that margins are likely to reduce back in line with the peer group in this segment. We would also note that visibility at Weir is significantly reduced at only c4 months' backlog today.

- **Margin Pressures in Shale Oil & Gas** — A flat outlook for US horizontal rig count is a lead indicator for Weir's new OE sales and even though there should be growth in aftermarket and replacement demand, we see the net effect as being no growth in 2012E and 2013E (with the impact of lower rig count having a lagged impact on pressure pumping). In a bear case scenario, Weir's shale oil & gas sales could fall 19% if on an annualised basis if there were no new additions to capacity. We also have concerns about the sustainability of margins in Weir's shale oil & gas business. Current 27% plus margins may prove unsustainable as competitor capacity catches up and OE growth slows in the next few years. We forecast margins falling to 23.5% in 2013E in this segment.

- **Mining Risks** — Mining is forecast to represent 45% of profits in 2012E. Weir is the global leader in slurry pumps. Aftermarket at 60% of sales provides some protection, but our revised expectation of OE weakness means growth should be minimal in 2013.

- **2013E EPS 13% Below Consensus** — Weir suggested on its recent results call that 2012 should be in line with consensus. Given a strong order backlog in the shale oil & gas business, we are only slightly below consensus in 2012E. However, we see the larger risk in 2013. Our 2013/14E EPS have been reduced by another 2-3% on the back of our lower Mining related assumptions. We believe we are now at least 13% below 2013E consensus.

- **Revised £16.40 Target Price** — Our previous Target Price of £18.30 was based on a P/E of 12x2013E. However, this did not allow for the larger liabilities at Weir (2012E net debt / EBITDA 1.3x). Weir is currently on an EV/EBITDA of 8.2x13E. This is a premium to the Oil Services peers on c7x, a premium to our sector on 6.6x, and a premium to the Mining peers on 7.5x. Our new Target price of £16.40 is based on an EV/EBITDA multiple of 7.5x13E.

Weir Group PLC (GBP)

Year to 31 Dec	2010A	2011A	2012E	2013E	2014E
Sales (£M)	1,635.0	2,292.0	2,682.7	2,730.0	2,895.7
Profit Before Tax (£M)	294.7	395.6	462.0	448.8	469.5
Diluted EPS (p)	99.2	132.2	151.3	147.0	153.8
Diluted EPS (Old) (p)	99.2	132.2	151.3	150.8	158.2
PE (x)	18.2	13.6	11.9	12.3	11.7
EV/EBITDA (x)	11.4	9.4	8.0	8.0	7.5
DPS (p)	27.0	33.0	37.0	40.0	40.0
Net Div Yield (%)	1.5	1.8	2.1	2.2	2.2

Atlas Copco AB

Company description

Atlas Copco is an industrial company that develops electric and pneumatic tools, assembly systems, compressed air, construction and mining equipment and related services. Atlas Copco has four divisions: Compressor Technique, Industrial Technique, Mining and Rock Excavation Technique and Construction Technique.

Investment strategy

We rate Atlas Copco as Sell. We continue to see long-term fundamentals as attractive, but believe in the near-term, the macro uncertainty (especially renewed concerns about China) will continue to weigh on the shares. We view Atlas Copco as the highest-quality company in our sector and relatively more defensive (witness its margins decline of 390bps to c15% with sales volume decline of 23% from peak to trough in the recent downturn) but we think the stock is priced for perfection.

Valuation

Our DCF valuation is SKr135, which we set as our target price. Our DCF valuation is based on a number of assumptions:

Through-cycle top-line growth of 3%.

Through-cycle EBIT margins of 18% (vs. 14% 2000-09 average).

Terminal growth of 2.5% and a WACC of 8.5%.

For the net debt in our DCF, we adjust for "other cash provisions" (including unfunded pension liabilities).

Risks

Stock-specific risks include the volatility and unpredictability of industrial, construction and mining capital equipment demand. While the demand environment is showing signs of stabilisation, the risk remains on the downside particularly if the equipment demand recovery proves to be less dramatic than the shares are pricing in or prove to be far off. Atlas Copco also has a notable currency risk. If the impact of these risk factors is less negative than we anticipate, then the share price might exceed our target price.

Fenner

Company description

Fenner has two reporting divisions – Engineered Conveyor Solutions (ECS) and Advanced Engineering Products (AEP). The company is a long established (1861), global leader in industrial conveyor belting (main competitors are Continental, Goodyear, Semperit and Bridgestone), with the thermal coal market the main exposure. Importantly, demand in this segment is much more stable than metallurgical coal (only fell 1% globally during the recession) and belting is a key consumable input. AEP is focused on extremely niche markets in the Medical, IT, Aerospace and Industrial markets and has generated 15% CAGR in revenues over the last 5 years.

Investment strategy

Our Buy rating on Fenner is based on 4 main strands: 1) Fenner's strong market position: its share of the global belting market stands at around 17%, which has likely edged up over the last couple of years; 2) its ability to re-invest for growth and leverage the existing platforms; 3) its strong cash-generating potential; the much improved balance sheet should facilitate future investment, and 4) improving returns and valuation; we expect the fade in high levels of historic internal investment to play through to significant improvements in post-tax RoE, with significant bolt-on M&A potential in the future. While investors would need to back management to deliver on this, we think the track record is strong and further value can be created.

Valuation

We base our 551p target price for Fenner on our DCF model, which we cross-reference against the industrials sector, the industry peer group and finally the FCF yield of the company as an absolute measure. Our DCF model is based on a 10.0% WACC and a 2% perpetuity growth rate, which we believe is relatively conservative given the strong balance sheet and market positions.

Risks

We see the risks on Fenner as follows: With M&A forming part of the strategy and AEP dependent on new product launches, we believe this is an apt risk assessment. We note the following potential risks to our target price:

As with all industrial stocks, a double dip in economic activity would be negative for the stock.

The recent strong run in the share price, coupled with the re-rating have added valuation risks and, in a less benign macro environment, the shares would be vulnerable to a de-rating.

The recently announced management change needs to be smoothly transitioned. If it were not done so, this could prove a negative to reaching our target price.

A more aggressive competitive response could impact margins, particularly if Chinese competition targets overseas markets and gains traction with major western mining companies.

Rising raw material input costs (specifically rubber) could also impact margins should management be unable to pass the impact onto customers.

Similarly, rising energy costs could impact on manufacturing margins as it remains a 10-15% element within cost of sales.

AEP has a c.115 products under development and, as such, there is a risk that commercial applications fail to materialise for a significant proportion of these.

FLSmidth

Company description

FLSmidth, a global engineering company based in Denmark, was founded in 1882. Since the late 1990s, the company has undergone a portfolio realignment. FLSmidth has three divisions (Cement, Minerals and Cembrit) and is active in emerging markets which account for 66% of group sales.

Investment strategy

We rate FLSmidth Neutral. We continue to see long-term fundamentals as attractive, but believe in the near-term macro uncertainty (especially renewed concerns about China) as well as the change in the management team could weigh on the shares. We would advise to hold the shares rather than sell at this stage despite our concerns regarding mining capex as we believe cement capex is at the bottom of its cycle, as well as considering its relatively cheap valuation.

Valuation

We set our TP of DKr400 at a c10% discount to our DCF fair value of DKr441/share. Our DCF valuation is based on: (i) through-cycle growth of 3% (in line with our sector average); (ii) WACC of 8.5% (in our Mechanicals coverage our WACC assumptions range between 8-9% depending on the risk profile of the company); (iii) terminal growth rate of 2.5% (in line with our sector average); and (iv) through-cycle EBIT margins of 8.5%, conservatively assuming no improvement from average EBIT margins of 8.5% during 2006-09.

Risks

The main factor that could impede FLSmidth from reaching our target price would be a significant weakening or strengthening of global cement and mining equipment demand, as this would potentially have a more negative or more positive effect on our earnings estimates than we currently assume.

There is also acquisition risk: FLSmidth could potentially make expensive acquisitions that could alter the risk and debt profile of the group. Other risks include currency, raw material and interest risk risks. On the positive side, if we see no delays or cuts in mining capex; finalization of Ludowici acquisition; a step up in cement related orders, our expectations could prove to be conservative.

Metso Oyj

Company description

Metso Corporation is a global supplier of process industry machinery, systems and aftermarket services. Divisions include Mining and Construction; Automation; Pulp; Paper and Power, Recycling; and Valmet Automotive.

Investment strategy

We rate Metso Sell. We believe order and earnings growth will be under pressure in 2012-2014 due to downside risk in pulp & paper capex and large mining orders, which we believe is not reflected in the current share price.

Valuation

Our TP is €24, set at our DCF value of €24. We assume the following key parameters within our DCF valuation: a terminal growth rate of 2.5%, a through-cycle margin of 6.7% (vs. 5.6% average margin over 1996-2009) and a WACC of 9%.

Risks

At the industry level, the uncertain outlook for the world economy implies material earnings risk over the next 12 months. Stock-specific risks include the fact that the high level of demand cyclicality in supplying capital equipment to the paper, mining and aggregates industries has historically made for volatile sales, earnings and cash flows from Metso's two main businesses. Better cost management and efforts to grow the aftermarket over the past two years have probably mitigated the impact of demand fluctuations, although this will only be tested once demand turns down. F/X rates are a risk as Metso trades across different currency zones as well as translates profits of overseas entities. If the impact on the company from any of these factors proves to be more negative than we anticipate, the stock will likely have difficulty achieving our financial targets. However, if any of these factors proves to have less of an effect than we anticipate, the stock could materially outperform our target price.

Sandvik AB

Company description

Sandvik AB is a high-technology engineering group with advanced products and business activities that are conducted through representation in 130 countries. Divisions include: Mining, Machining Solutions, Materials Technology, Construction and Venture.

Investment strategy

We rate Sandvik Buy. Despite our concerns regarding mining capex, which we admit if they were to materialise would create near-term pressure on the shares, we continue to favour Sandvik as we believe that the market underestimates Sandvik’s restructuring potential, which is just at the early stages. In addition, potential resumption of nuclear projects in China (expected next month) could provide support for the shares.

Valuation

Our target price is SKr110, based on our DCF fair valuation of SKr110. We assume the following key parameters within our DCF valuation: through-cycle growth rate of 3% and a terminal growth rate of 2.5%, a through-cycle margin of 13.6% and WACC of 8.7%.

Risks

We see a number of industry- and company-specific risks in the case of Sandvik where fluctuations could cause significant changes to our earnings forecasts and valuation and cause the shares to deviate significantly from our target price. Most notably, Sandvik is economically sensitive. High leverage, however, works both ways; when recovery eventually comes, the profit bounce-back should be equally strong. Sandvik's financial leverage could amplify the recovery. Sandvik also has notable currency risk and its Materials Technology business is exposed to metals price fluctuations.

Weir Group PLC

Company description

Weir Group is a UK engineering company with its head office in Glasgow. The business is focused primarily on the markets for pumps and valves (new equipment and aftermarket/service). The company reports results for three key divisions: Minerals; Power & Industrial and Oil & Gas.

Investment strategy

We rate Weir as Sell with a Target Price of £16.40. Our sell case is based on our view that (1) there will be limited growth in the Oil & Gas business in 2012E AND 2013E; (2) that margins are likely to reduce back in line with the peer group in this segment; and (3) that mining capex growth is set to slow. This translates to EPS c10% below consensus and a valuation premium to the global oil services peers.

Valuation

Our target price for Weir of £16.40 is based on a target EV/EBITDA of 7.5x 2013E. This is in line with mining capex-related peers and at a slight premium to the global Oil Services sector.

Risks

On our assessment of industry- and company-specific risk factors, there are a number of risks that could impact our earnings forecasts and as such could cause the share price to deviate significantly from our target price. Our EPS assumptions assume limited new additions to US shale oil & gas pressure pumping capacity. As such if there were an increase this would see upside to forecasts and our valuation. Other risks to consider include input costs and currency.

Notes

Appendix A-1

Analyst Certification

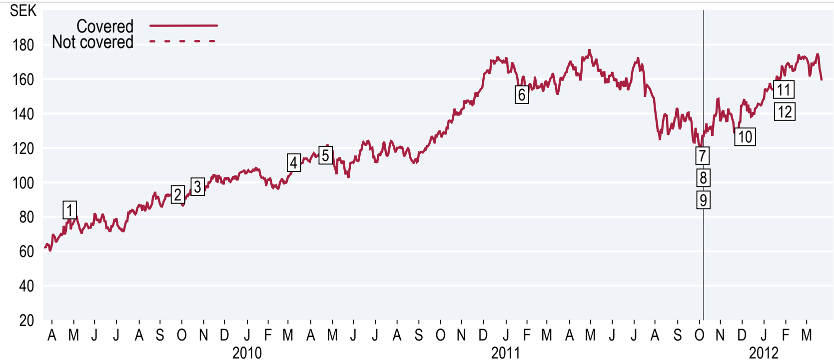
The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

IMPORTANT DISCLOSURES

Atlas Copco AB (ATCOa.ST)

Ratings and Target Price History
Fundamental Research

Analyst: Natalia Mamaeva



	Date	Rating	Target Price	Closing Price
1	27-Apr-09	3H	*58.00	84.00
2	25-Sep-09	3H	*70.00	89.50
3	23-Oct-09	3H	*75.00	95.20
4	9-Mar-10	3H	*80.00	109.00
5	22-Apr-10	*2H	*120.00	117.20
6	25-Jan-11	2H	*140.00	159.00
7	6-Oct-11	2H	*125.00	127.60
8	7-Oct-11	Stock rating system changed		
9	7-Oct-11	*2	125.00	126.40
10	6-Dec-11	*1	*165.00	144.80
11	30-Jan-12	*2	165.00	164.80
12	31-Jan-12	2	*160.00	161.70

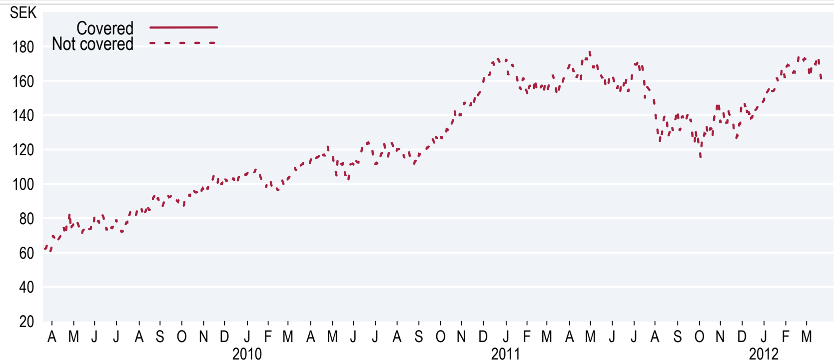
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Atlas Copco AB (ATCOa.ST)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Natalia Mamaeva



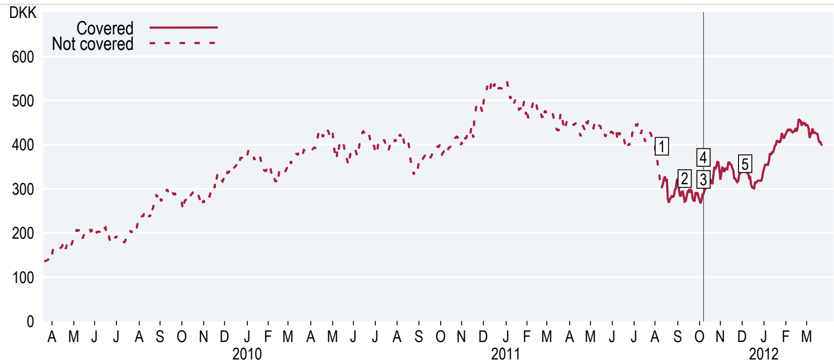
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

FLSmidth (FLS.CO)

Ratings and Target Price History
Fundamental Research

Analyst: Natalia Mamaeva
Covered since August 10 2011



	Date	Rating	Target Price	Closing Price
1	10-Aug-11	*1H	*500.00	303.20
2	12-Sep-11	1H	*400.00	271.00
3	7-Oct-11	Stock rating system changed		
4	7-Oct-11	*1	400.00	288.50
5	6-Dec-11	1	*450.00	351.70

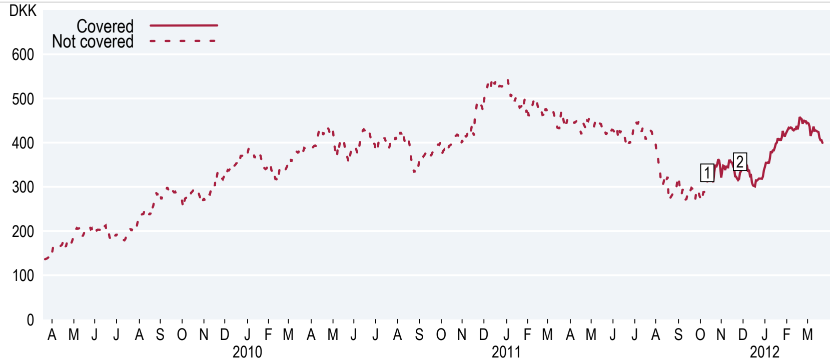
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

FLSmidth (FLS.CO)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Natalia Mamaeva
Covered since August 10 2011



	Date	Rating	Target Price	Closing Price
1	12-Oct-11	*ADD MP	-	312.50
2	27-Nov-11	*REM MP	-	318.00

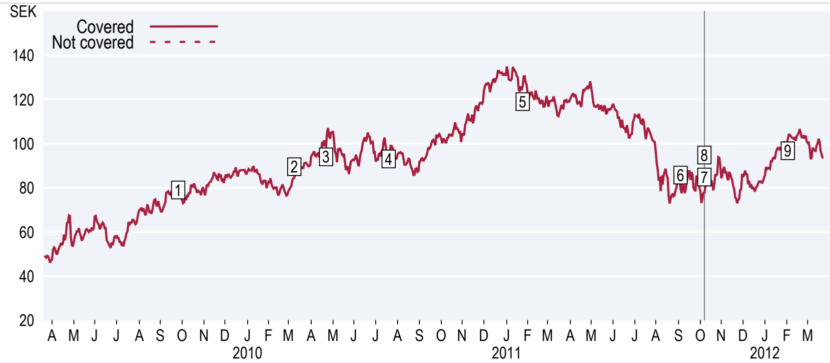
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Sandvik AB (SAND.ST)

Ratings and Target Price History
Fundamental Research

Analyst: Natalia Mamaeva
Covered since July 9 2009



	Date	Rating	Target Price	Closing Price
1	25-Sep-09	2H	*78.00	76.40
2	9-Mar-10	*1H	*100.00	84.50
3	22-Apr-10	1H	*120.00	98.85
4	20-Jul-10	1H	*125.00	94.75
5	25-Jan-11	1H	*175.00	126.00
6	5-Sep-11	1H	*110.00	79.55
7	7-Oct-11	Stock rating system changed		
8	7-Oct-11	*1	110.00	77.40
9	2-Feb-12	1	*115.00	102.00

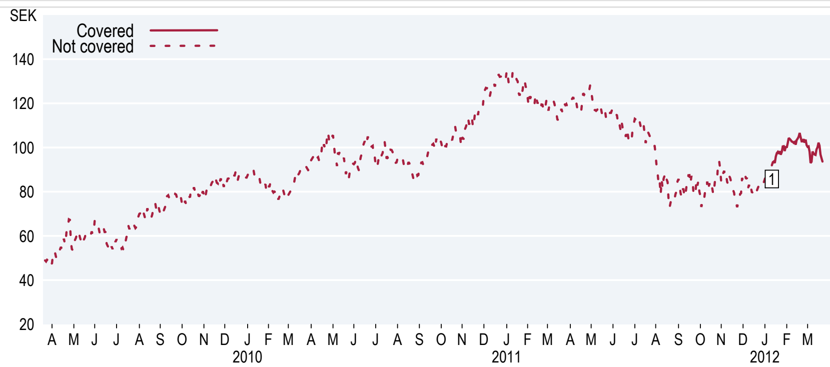
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Sandvik AB (SAND.ST)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Natalia Mamaeva
Covered since July 9 2009



	Date	Rating	Target Price	Closing Price
1	11-Jan-12	*ADD MP	-	91.95

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Weir Group PLC (WEIR.L)

Ratings and Target Price History
Fundamental Research

Analyst: Mark Fielding

	Date	Rating	Target Price	Closing Price
1	13-May-09	3H	*4.35	4.65
2	25-Sep-09	3H	*6.20	6.76
3	12-Jan-10	3H	*7.50	7.95
4	27-Jan-10	*2H	7.50	7.55
5	27-Apr-10	*1H	*12.30	10.04
6	14-Jun-10	1H	*12.80	10.66
7	3-Aug-10	1H	*14.50	12.26
8	14-Feb-11	*2M	*18.70	17.63
9	4-May-11	2M	*21.00	18.60
10	12-Sep-11	2M	*20.00	17.54
11	6-Oct-11	2M	*16.00	15.31
12	7-Oct-11	Stock rating system changed		
13	7-Oct-11	*2	16.00	15.77
14	24-Nov-11	2	*17.00	17.77
15	21-Dec-11	2	*19.50	19.62
16	5-Mar-12	*3	*18.30	19.39

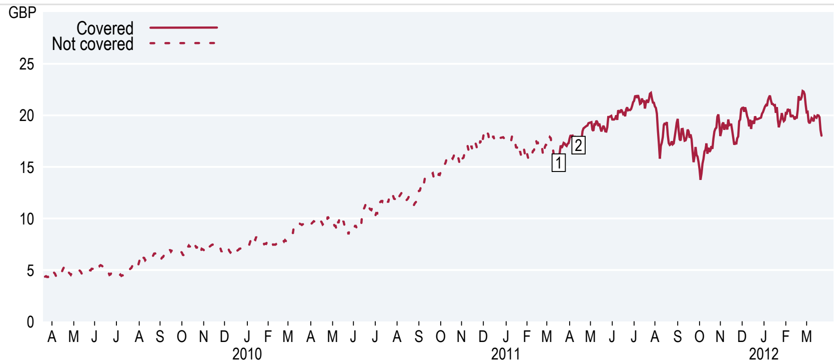
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Weir Group PLC (WEIR.L)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Mark Fielding



	Date	Rating	Target Price	Closing Price
1	17-Mar-11	*ADD MP	-	16.06
2	14-Apr-11	*REM MP	-	17.40

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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	12 Month Rating			*Relative Rating*		
Data current as of 31 Dec 2011	**Buy**	**Hold**	**Sell**	**Buy**	**Hold**	**Sell**
Citi Investment Research & Analysis Global Fundamental Coverage	57%	34%	9%	10%	79%	10%
% of companies in each rating category that are investment banking clients	45%	41%	40%	49%	43%	41%

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Relative three-month ratings: CIRA may also assign a three-month relative call (or rating) to a stock to highlight expected out-performance (most preferred) or under-performance (least preferred) versus the geographic and industry sector over a 3 month period. The relative call may highlight a specific near-term catalyst or event impacting the company or the market that is anticipated to have a short-term price impact on the equity securities of the company. Absent any specific catalyst the analyst(s) will indicate the most and least preferred stocks in the universe of stocks under consideration, explaining the basis for this short-term view. This three-month view may be different from and does not affect a stock's fundamental equity rating, which reflects a longer-term total absolute return expectation. For purposes of NASD/NYSE ratings-distribution-disclosure rules, most preferred calls correspond to a buy recommendation and least preferred calls correspond to a sell recommendation. Any stock not assigned to a most preferred or least preferred call is considered non-relative-rated (NRR). For purposes of NASD/NYSE ratings-distribution-disclosure rules we correspond NRR to Hold in our ratings distribution table for our 3-month relative rating system. However, we reiterate that we do not consider NRR to be a recommendation.

Prior to October 8, 2011, the firm's stock recommendation system included a risk rating and an investment rating. **Risk ratings,** which took into account both price volatility and fundamental criteria, were: Low (L), Medium (M), High (H), and Speculative (S). **Investment Ratings** of Buy, Hold and Sell were a function of CIRA's expectation of total return (forecast price appreciation and dividend yield within the next 12 months) and risk rating. Additionally, analysts could have placed covered stocks "Under Review" in response to exceptional circumstances (e.g. lack of information critical to the analyst's thesis) affecting the company and/or trading in the company's securities (e.g. trading suspension). Stocks placed "Under Review" were monitored daily by management and as practically possible, the analyst published a note re-establishing a rating and investment thesis. For securities in developed markets (US, UK, Europe, Japan, and Australia/New Zealand), investment ratings were:Buy (1) (expected total return of 10% or more for Low-Risk stocks, 15% or more for Medium-Risk stocks, 20% or more for High-Risk stocks, and 35% or more for Speculative stocks); Hold (2) (0%-10% for Low-Risk stocks, 0%-15% for Medium-Risk stocks, 0%-20% for High-Risk stocks, and 0%-35% for Speculative stocks); and Sell (3) (negative total return). For securities in emerging markets (Asia Pacific, Emerging Europe/Middle East/Africa, and Latin America), investment ratings were:Buy (1) (expected total return of 15% or more for Low-Risk stocks, 20% or more for Medium-Risk stocks, 30% or more for High-Risk stocks, and 40% or more for Speculative stocks); Hold (2) (5%-15% for Low-Risk stocks, 10%-20% for Medium-Risk stocks, 15%-30% for High-Risk stocks, and 20%-40% for Speculative stocks); and Sell (3) (5% or less for Low-Risk stocks, 10% or less for Medium-Risk stocks, 15% or less for High-Risk stocks, and 20% or less for Speculative stocks).

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