

A photograph of a rowing team in a boat, with several oars visible. The image is slightly blurred and has a dark overlay.

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**Inside**<sup>The</sup>  
**BUY-SIDE**<sup>®</sup>

**3Q17 Earnings Primer**  
**Industrial Sentiment Survey**

October 19, 2017

For over a decade, we have surveyed global investors and analysts on the equity markets, world economies and business climate. We share our research broadly with corporate executives, investor relations (IR) professionals and the financial community.

**Survey scope:** 30 investors and analysts globally; buy-side firms manage \$287B in assets and have \$35B invested in Industrials

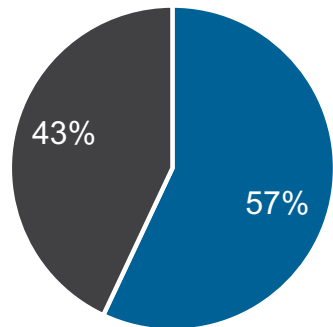
**Survey timeframe:** Sep. 14 to Oct. 11, 2017

**Market Performance**

	<u>3Q17</u>	<u>YTD</u> <sup>1</sup>
<b>S&amp;P 500</b>	3.9%	14.0%
<b>S&amp;P Industrial</b>	3.7%	14.9%

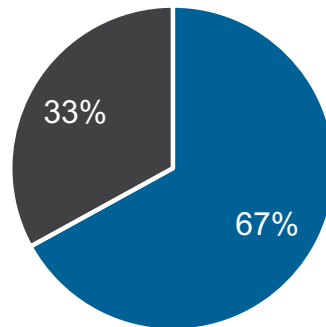
<sup>1</sup> As of 10'13'17

**Role**



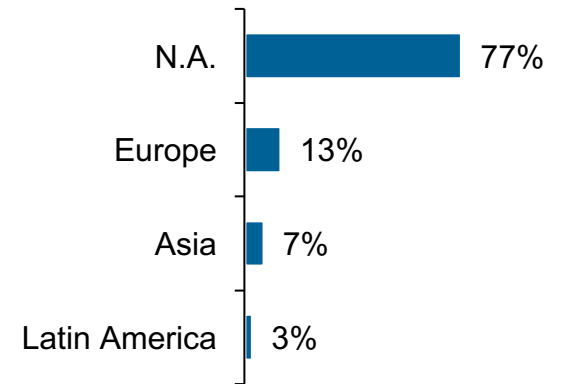
■ Buy Side ■ Sell Side

**Sector Focus**



■ Industrials ■ Generalist

**Region**





## #1 Investors Expect Strong 3Q17 Industrial Performance, Marking the Fourth Consecutive Quarter of Upbeat Sector Sentiment; Hurricane Impact/Recovery Seen as “Wildcard” Heading into Year-end

- Nearly 90% expect earnings to *meet* or *exceed* consensus with over half expecting beats; 66% predict sequential improvement
- Management tone remains positive with those classifying executive language as *Neutral to Bullish* or *Bullish* over 80% and outright *Bullish* see an uptick
- Over 60% remain *Neutral to Bullish* or *Bullish* toward Industrials, a slight sequential increase and the most upbeat tone recorded since survey inception<sup>1</sup>
- Most expect Hurricanes Harvey & Irma recovery efforts will be positive for 2018 U.S. GDP though nearly 60% expect impact to have negative implications on 4Q17 results

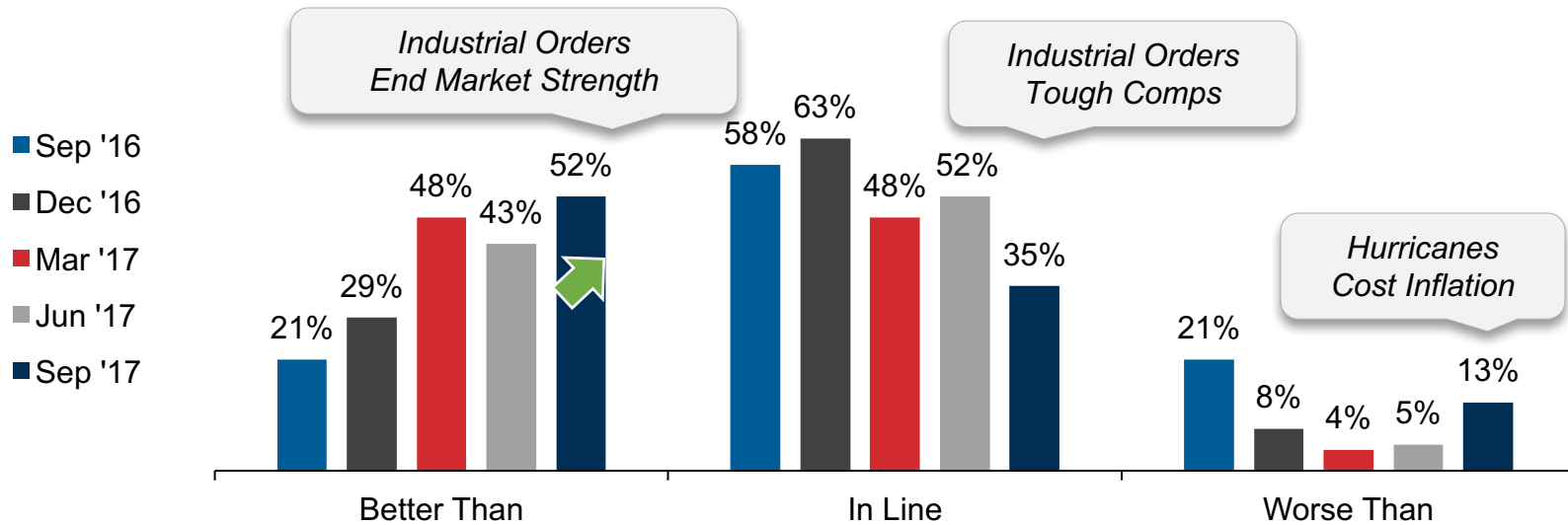
## #2 Growth Expected to Continue into 2018 and Majority Now Consider Industrial Stocks Fairly Valued

- 41% believe we are in *Mid-to-Late* innings in the cycle, an increase from 29% last quarter though nearly 40% anticipate industrial organic growth of 4.0% in 2018, an improvement from expectations of 3.0% to 4.0% for 2017
- 71% expect U.S. GDP to improve over the next six months, nearly doubling from last quarter
- Nearly 75% anticipate revenue growth to improve year-over-year with global capex expected to increase over the next six months; Brazil sees massive spike in positive sentiment after posting second consecutive quarter of GDP growth
- More than half classify Industrial equities as *Fairly Valued* and those classifying stocks as *Overvalued* sharply declined to 35% from 54% QoQ

## #3 D.C. Dysfunction, Geopolitics Remain Top of Mind; Defense Sector Flying High

- Primary concerns include: 1) government ineptitude; 2) geopolitical concerns, with emphasis on escalating N. Korea tensions; 3) interest rate hikes
- 95% expect geopolitical volatility to *Stay the Same* or *Worsen*, while only 35% expect the Washington D.C. political scene to *Improve*
- Over 80% expect Defense to *Grow Faster* than GDP, the second highest sentiment ever recorded for any sub-sector, trailing only Resi. Construction in Dec. 2015

## Expectations Regarding 3Q17 Earnings Performance Relative to Consensus

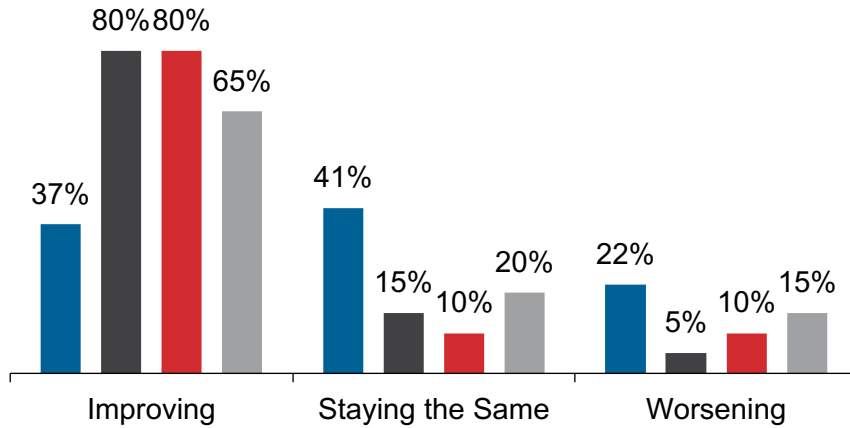


**87%** Expect *In Line* to *Better Than* Consensus Results

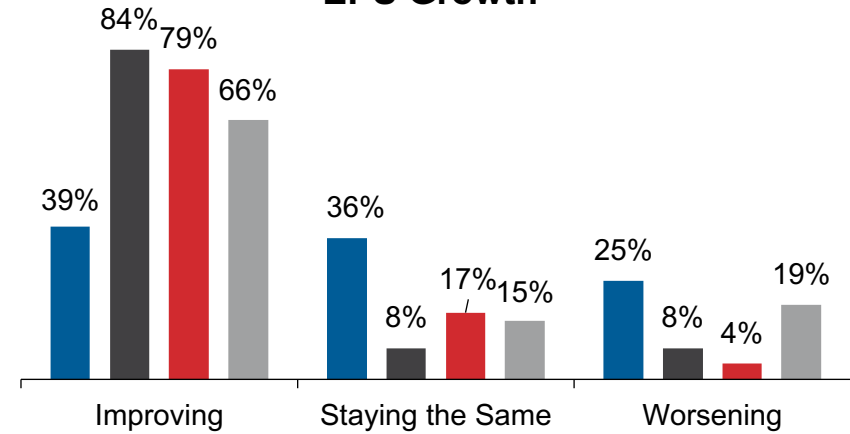
**66%** Expect Sequential Improvement

## Key Performance Indicators

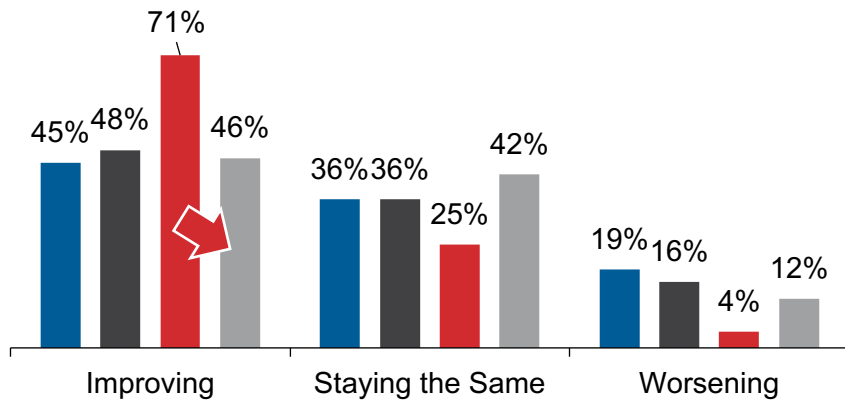
### Revenue



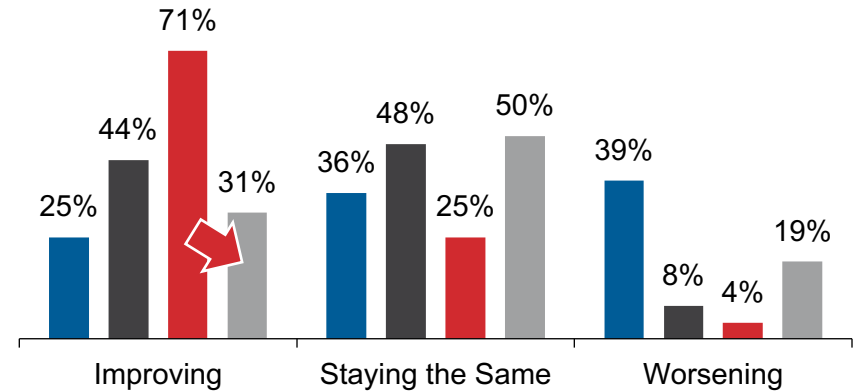
### EPS Growth



### Cash Flow



### Operating Margins



■ Dec '16 ■ Mar '17 ■ Jun '17 ■ Sep '17

## Better Than

*“Jobs creation.”* **Buy Side, Industrials, N. America**

*“Inflection in end markets (e.g., Fluids, Oil & Gas capex, Aerospace, Non-Resi Construction, Machinery).”* **Buy Side, Industrials, N. America**

*“There is still strong industrial order momentum, currency swinging to a tailwind offset by some further raw materials cost increases (mostly taken care of by price increases) and hurricane headwind.”* **Buy Side, Industrials, N. America**

*“The wild card is the storm's impact. Outside of that, they will come in above but that is the wild card.”* **Buy Side, Generalist, N. America**

*“Industrial economy seems to be improving slightly.”* **Sell Side, Industrials, N. America**

*“Calendar effect holding back growth in Q2 while this swings back in Q3 and underlying growth has accelerated.”* **Sell Side, Industrials, Europe**

## In Line

*“Seeing improvement but 3Q may lack the upside of previous quarters.”* **Buy Side, Industrials, N. America**

*“Expectations have been reduced to more realistic levels.”* **Buy Side, Generalist, N. America**

*“Improving manufacturing PMI series.”* **Sell Side, Industrials, Europe**

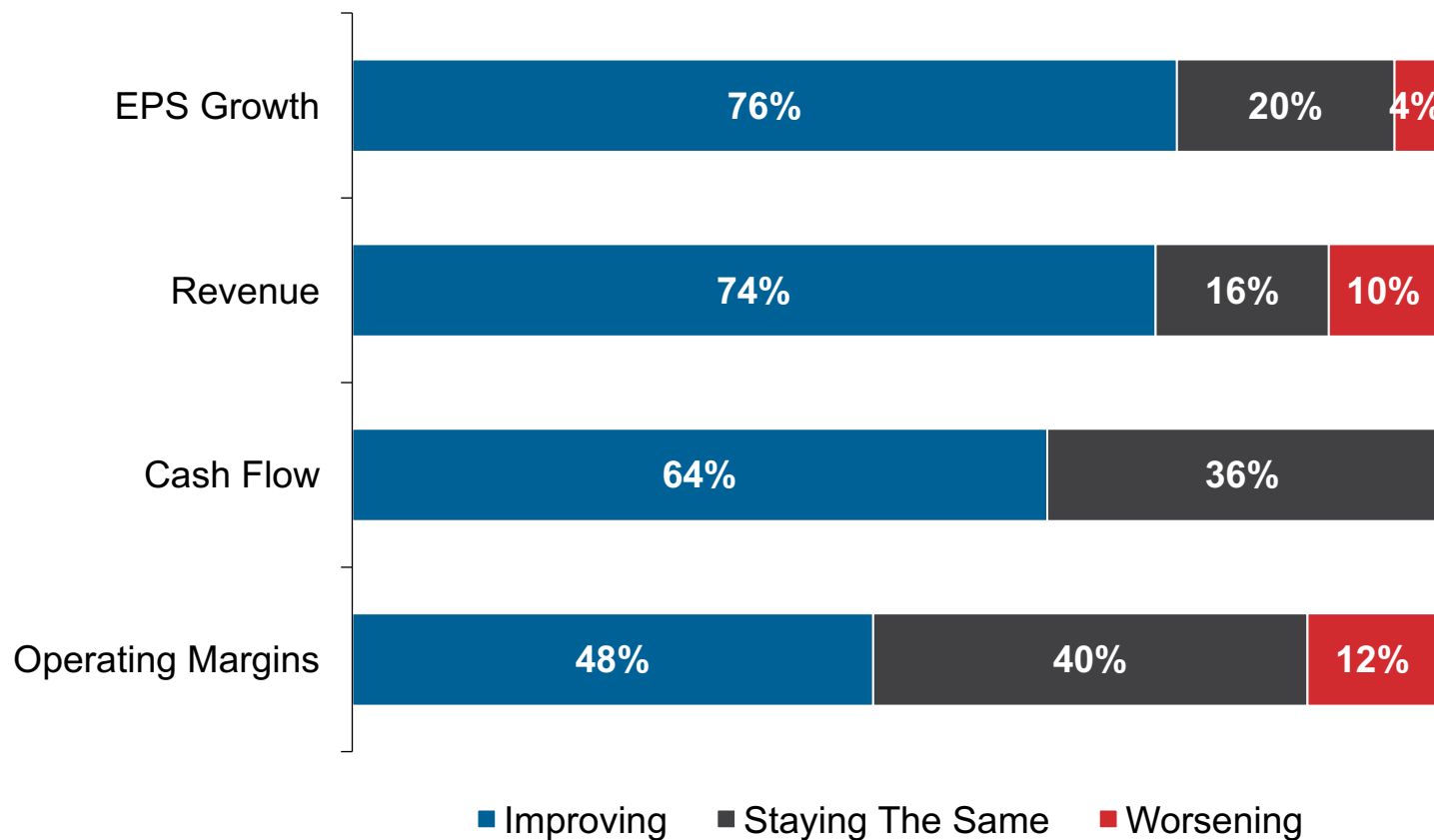
## Worse Than

*“Cost inflation, weak pricing, hurricane impact.”* **Buy Side, Industrials, N. America**

*“Hurricane disruptions, price/cost headwinds.”* **Buy Side, Industrials, N. America**

*“The impact from hurricanes.”* **Sell Side, Generalist, N. America**

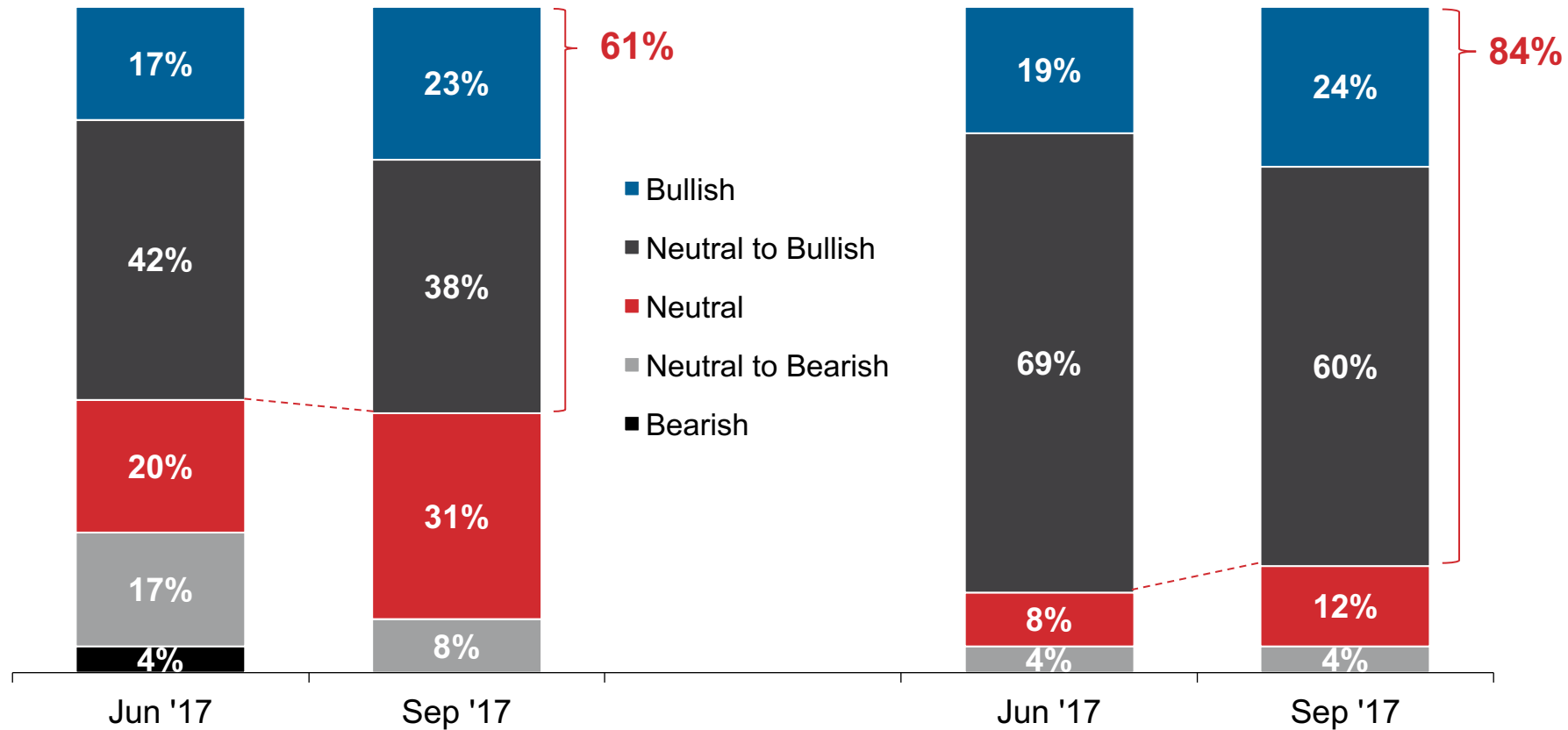
### Expectations for 2018 Versus 2017





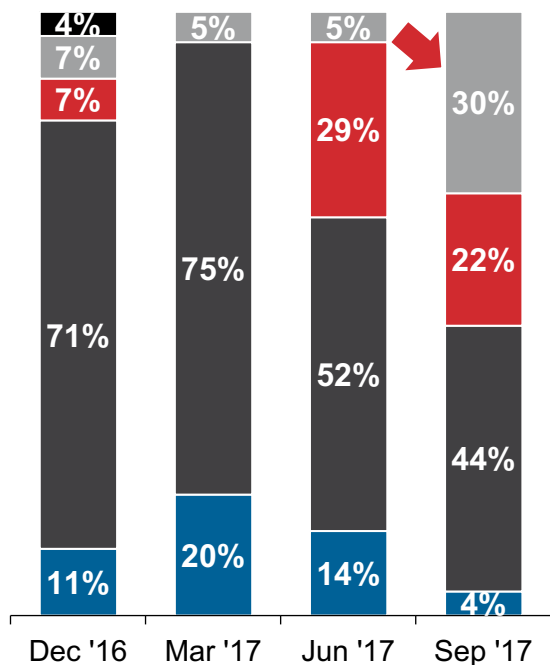
### Investor Sentiment

### Management Tone

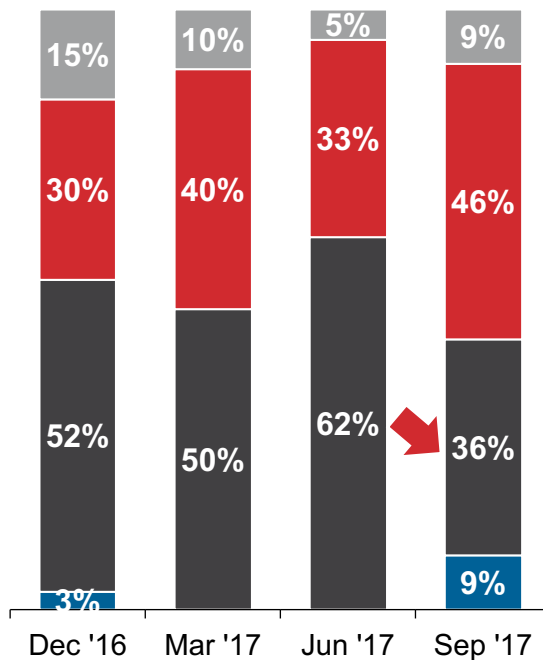


# Short- and Long-cycle Products See Slight Pullbacks, While Services Expected to Accelerate

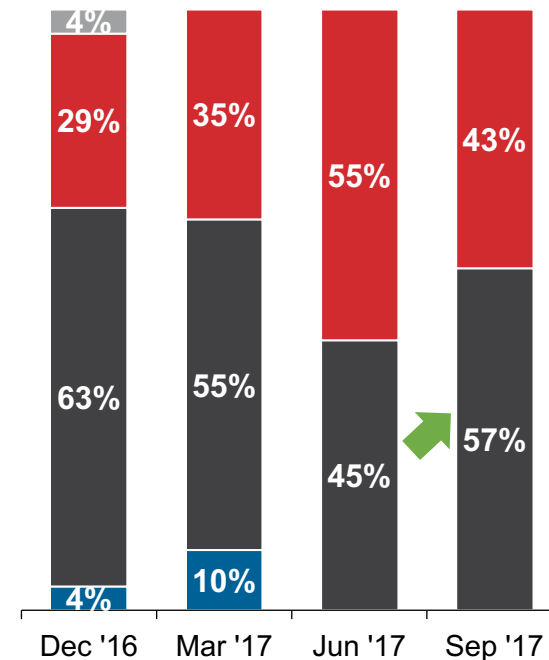
## Short-cycle Products



## Long-cycle Products

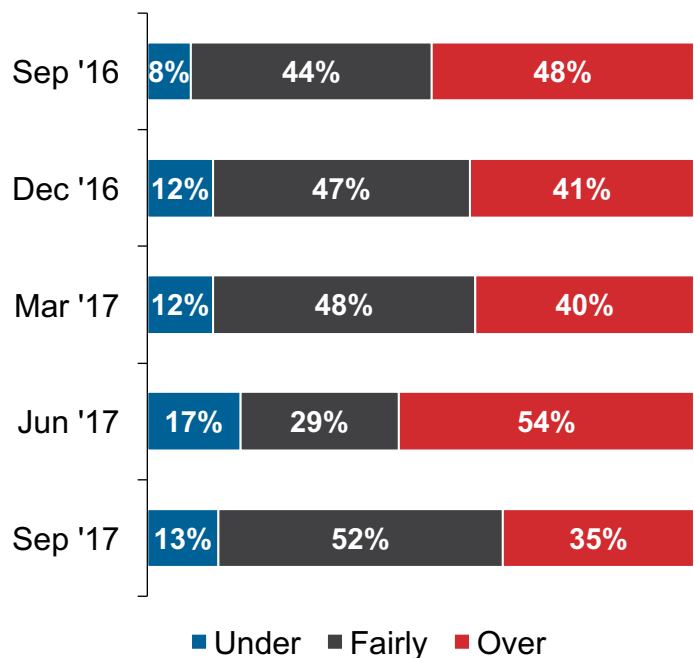


## Services

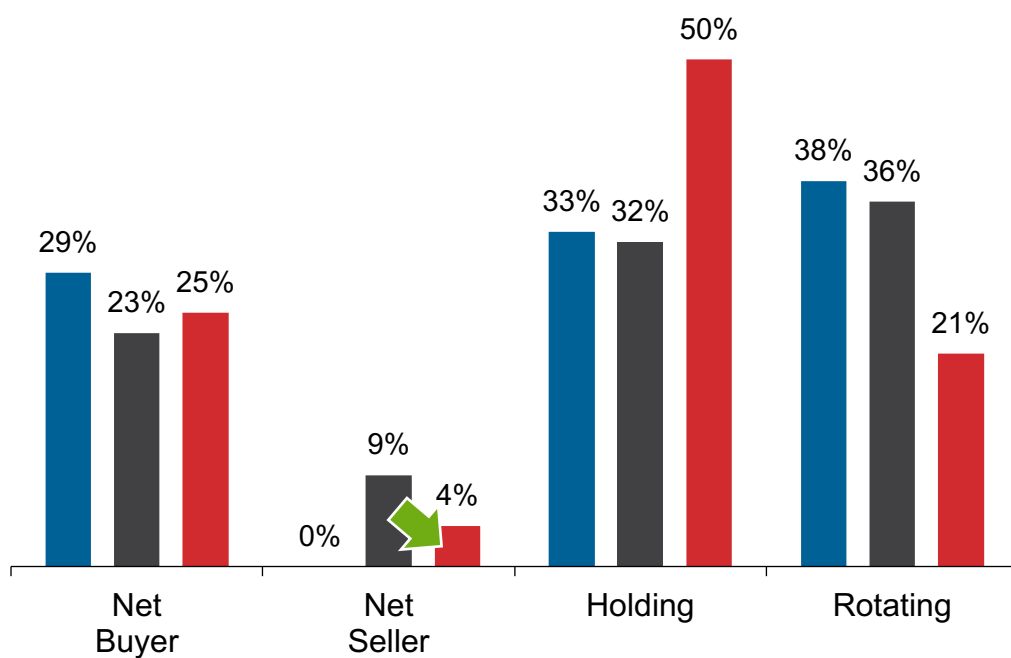


■ Strongly Accelerate   
 ■ Accelerate Somewhat   
 ■ Remain the Same   
 ■ Decelerate Somewhat   
 ■ Strongly Decelerate

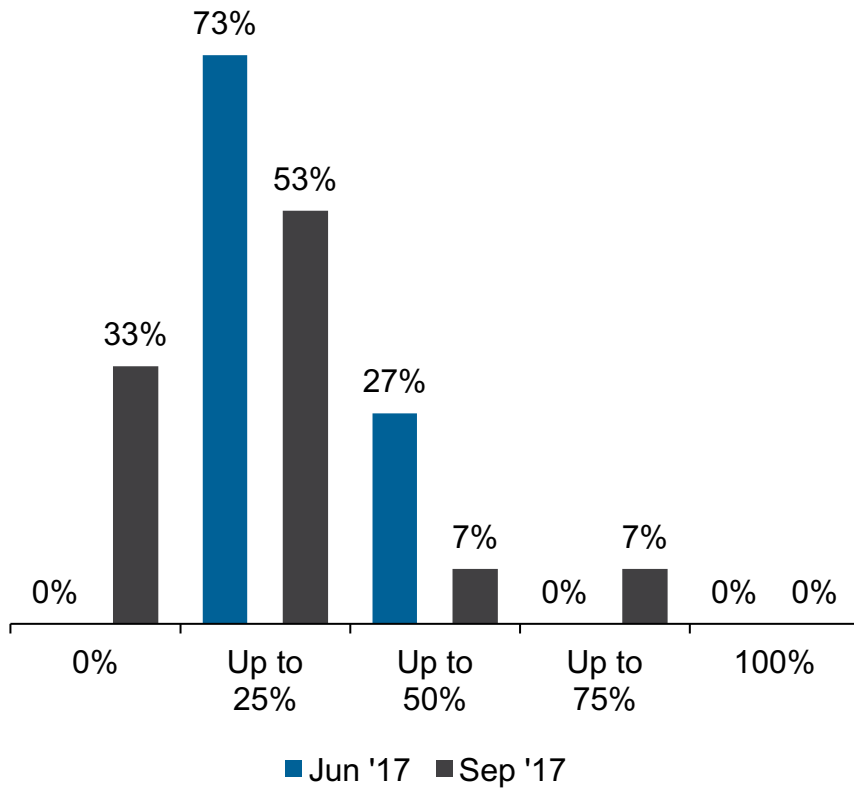
### Industrial Equity Valuations Classification



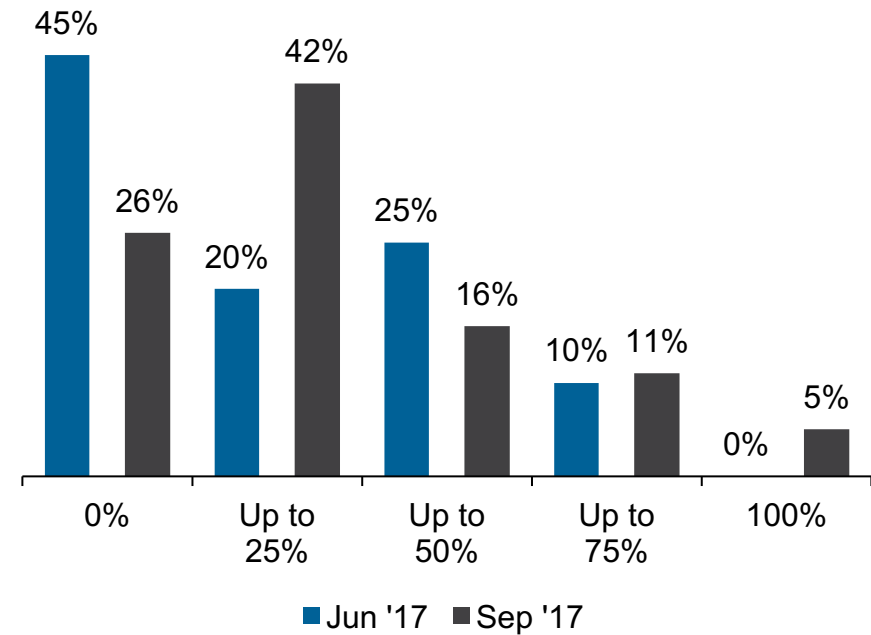
### QoQ Investment Trends



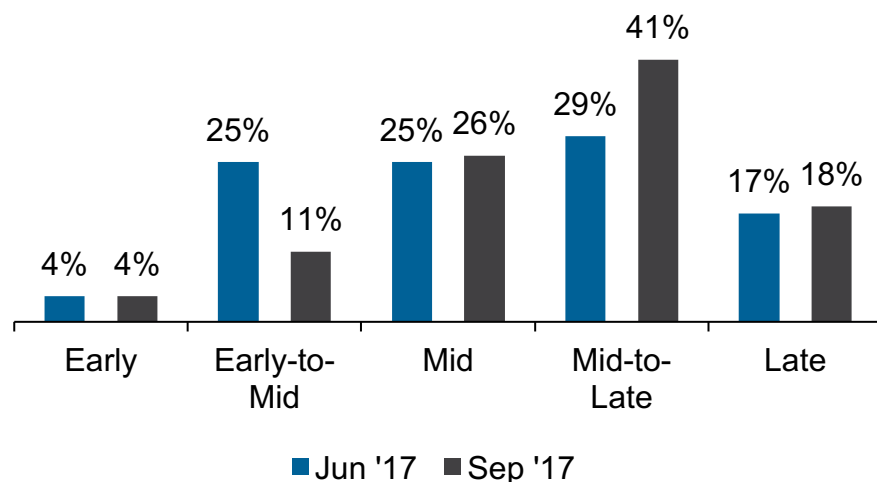
**Passage of Infrastructure Investment Priced into Valuations**



**Passage of Tax Reform Priced into Valuations**



## Industrial Cycle Views



## Early-to-Mid

*"We had a long downcycle that is now starting to get positive momentum."* **Buy Side, Industrials, N. America**

*"U.K. companies have been reporting dull demand for years, PMIs imply this should start to improve from here and Q2 suggested this was the case."* **Sell Side, Industrials, Europe**

## Mid

*"Growth of margins, level of M&A."* **Buy Side, Industrials, N. America**

*"While the overall economy is later in the cycle, Industrials went through a recession, which only ended three quarters ago. Additionally, the dearth of capex projects hasn't made the recovery very robust, which could begin in the coming year."* **Buy Side, Industrials, N. America**

## Mid-to-Late

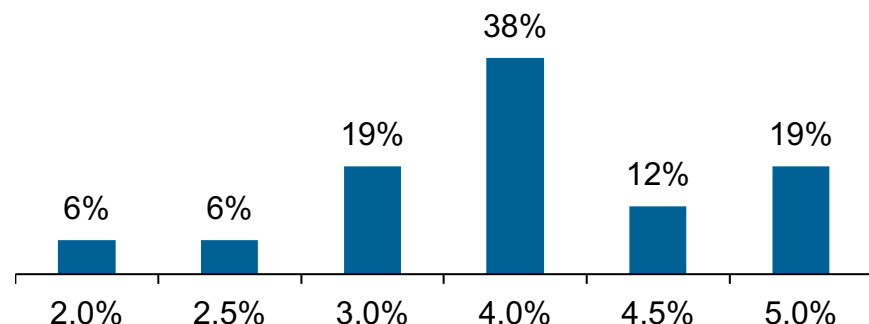
*"Duration of overall biz cycle, pickup in later cycle end markets like E&C and Aero production. I also think an infrastructure bill gets passed. Early cycle Autos/Airlines rolling over a bit."* **Buy Side, Industrials, N. America**

*"Interest rate hikes, credit availability."* **Buy Side, Industrials, N. America**

## Late

*"Shear duration of bull market."* **Sell Side, Generalist, N. America**

## Expectations for FY 2018 Organic Growth



**100%**

Believe the Fed Will Continue to Raise Interest Rates in 2018

**1** U.S. government ineptitude

**2** Geopolitical concerns, with emphasis on escalating North Korea tensions

**3** Interest rate hikes

## Buy Side

*“1) Yellen; 2) Kim Jong Un; 3) Any economics Nobel Prize.”<sup>1</sup>*

*“1) Geopolitical; 2) U.S. legislative agenda; 3) Sustainable growth outside U.S.”*

*“1) Price/cost; 2) Hurricane disruptions; 3) Inability of government to enact fiscal stimulus.”*

*“1) Earnings; 2) Pace of Fed hikes; 3) Geopolitical.”*

*“1) The Fed moving too fast; 2) No tax reform; 3) Broader conflict with North Korea.”*

*“1) No tax bill; 2) No infrastructure bill; 3) Shortfall in Non-Resi Construction.”*

## Sell Side

*“1) Fed rate hike/balance sheet missteps; 2) Disruptive legislation (primarily Healthcare).”*

*“1) Price/cost; 2) Effective capital deployment; 3) Valuations.”*

*“1) China financial stability; 2) North Korea political instability; 3) Trump unpredictability.”*

*“1) China slowing; 2) Valuations; 3) Consumer electronics slowing.”*

*“1) Duration of bull market; 2) Chinese economy; 3) Dysfunction in Washington.”*

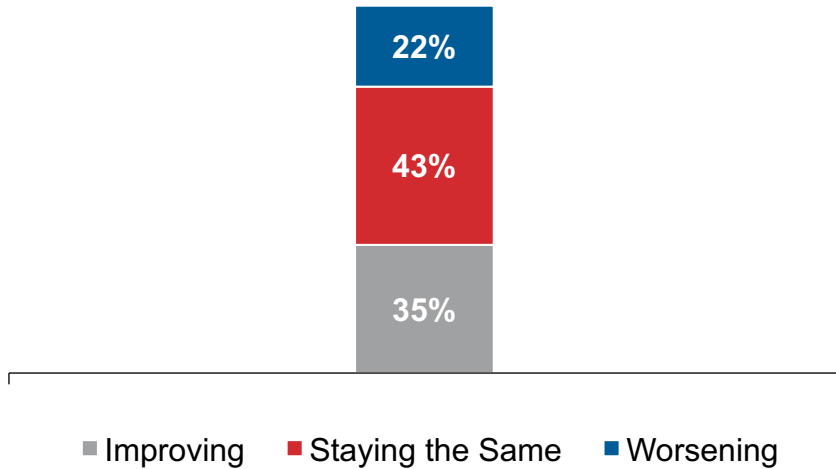
*“1) Geopolitical tensions; 2) Trade wars; 3) Policy missteps.”*

*“1) Trump impact; 2) Brexit impact; 3) FX.”*

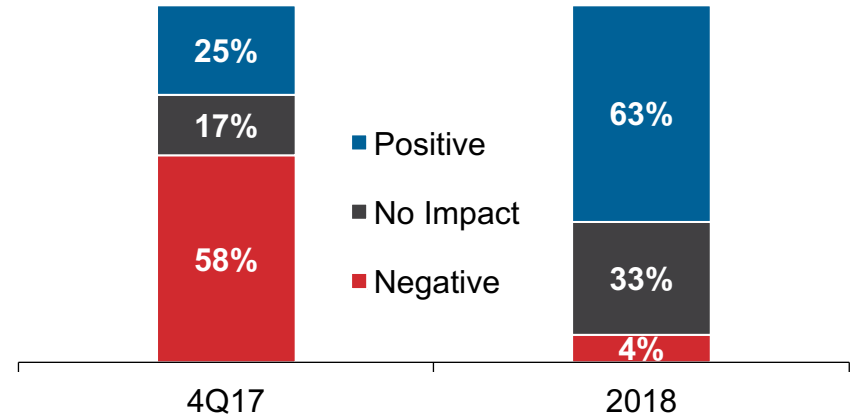
*“1) Monetary policy normalization in U.S. and Eurozone; 2) Geopolitical risks in East Asia and Middle East; 3) Painful economic reform in China.”*

<sup>1</sup> Our favorite quote of the survey

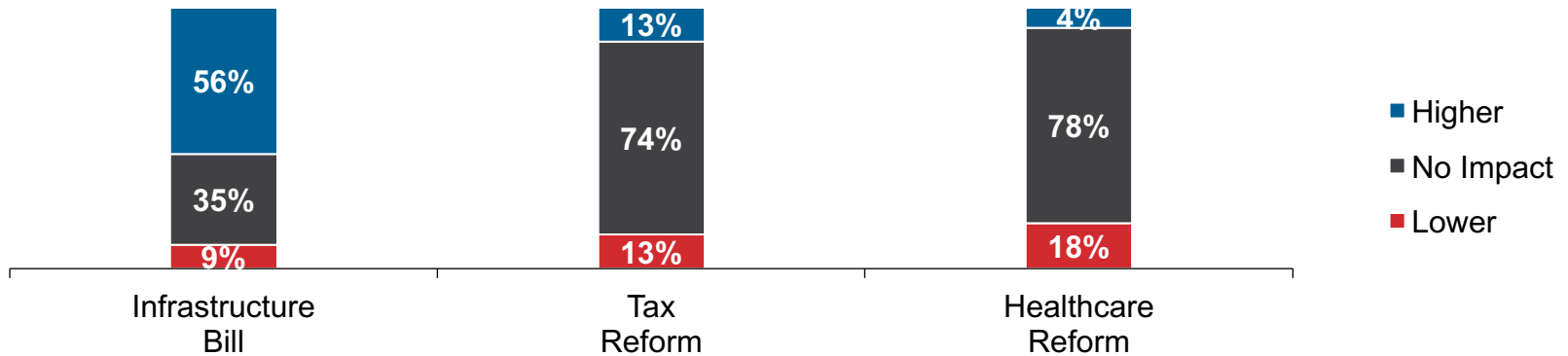
### Washington D.C. Political Scene Trend Versus First Half of the Year



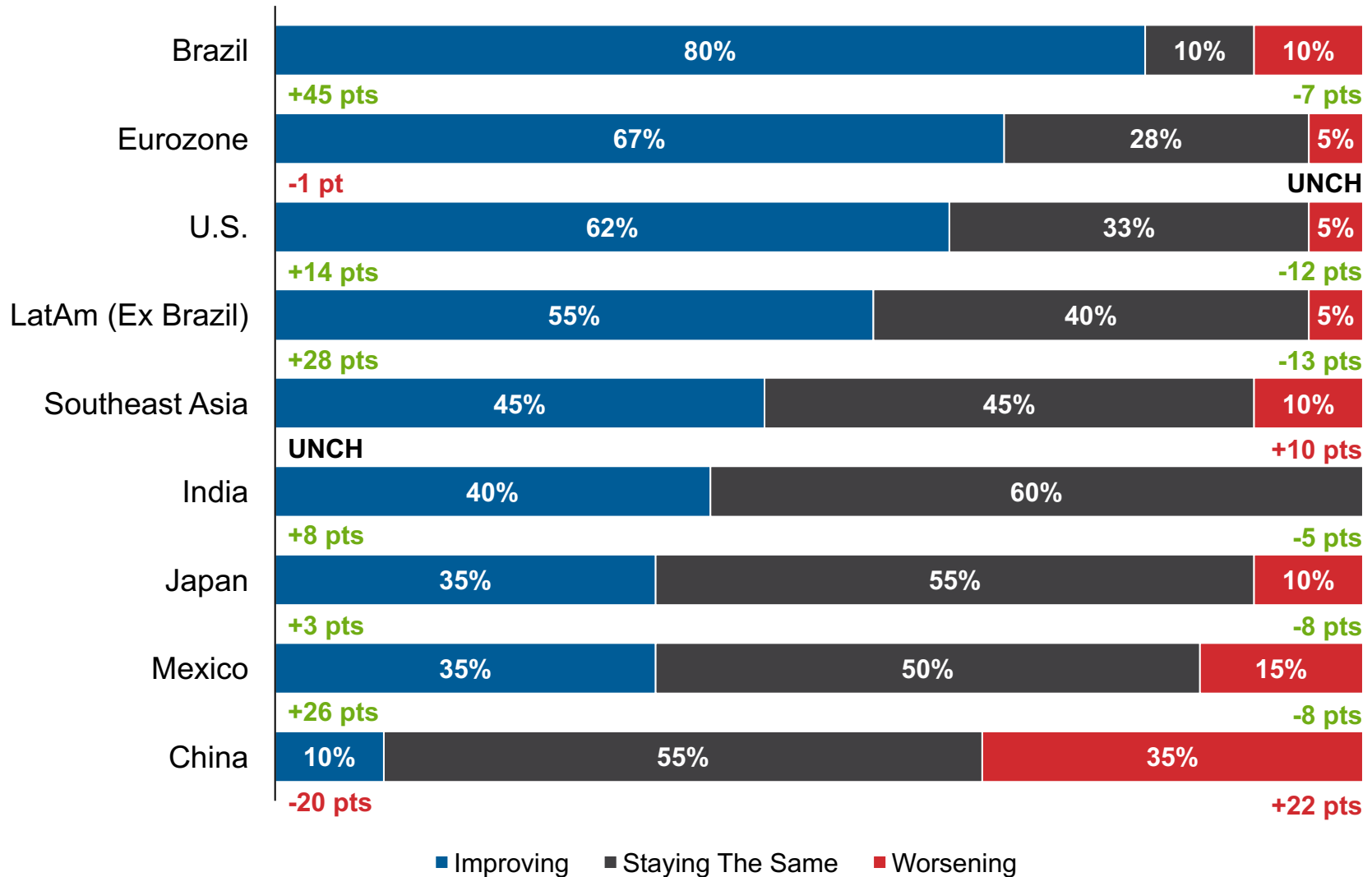
### Impact of Hurricanes Harvey & Irma on U.S. GDP



### Probability of Passing Due to Impact of Hurricanes Harvey & Irma

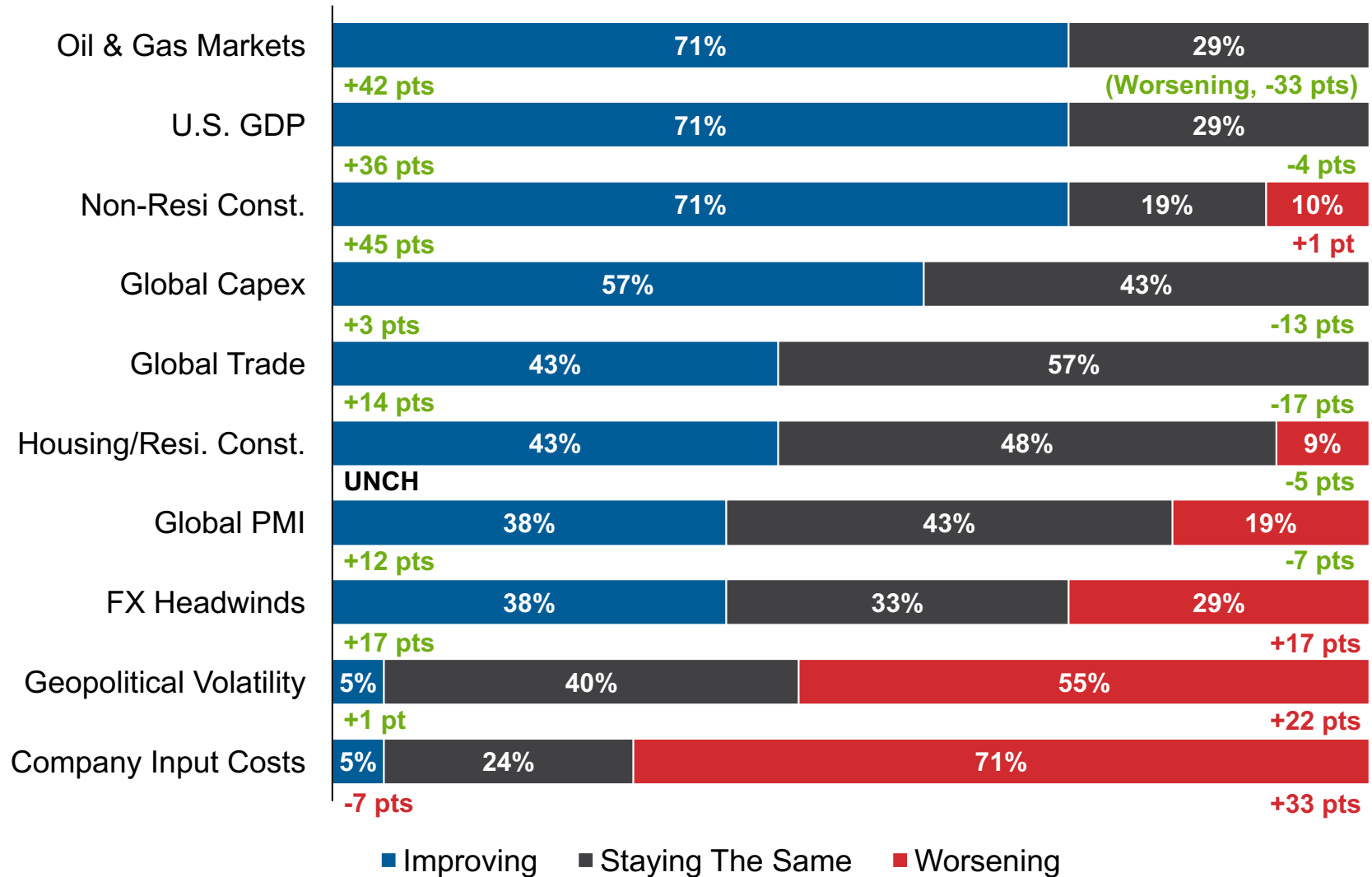


### Global Economy Expectations over the Next Six Months



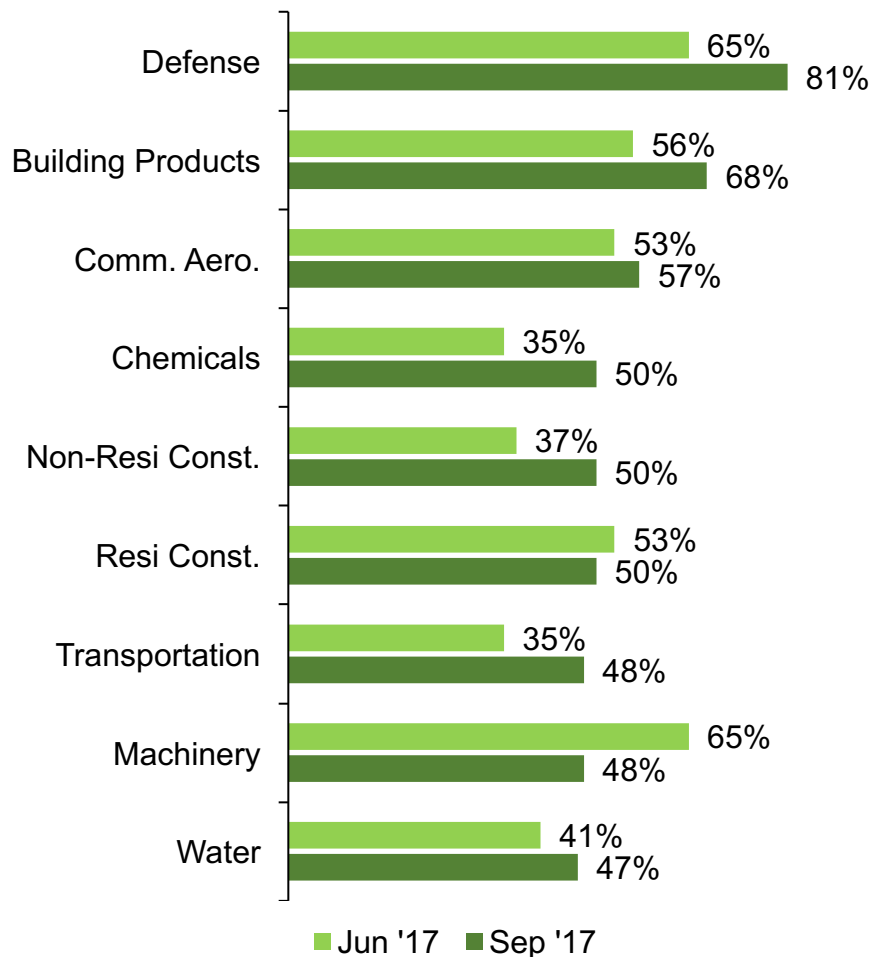


Expectations over the Next Six Months





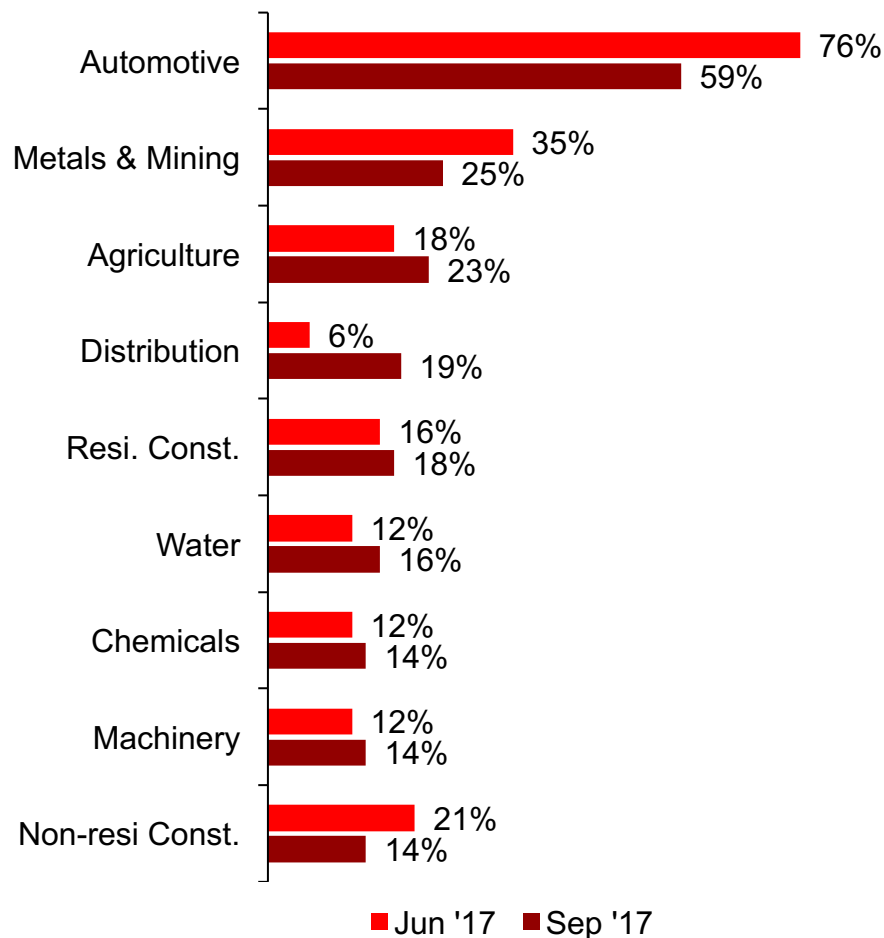
**Predicted to *Grow Faster* than GDP**



Defense Sees Spike in Bullish Sentiment, Reaches Highest Level since Survey Inception



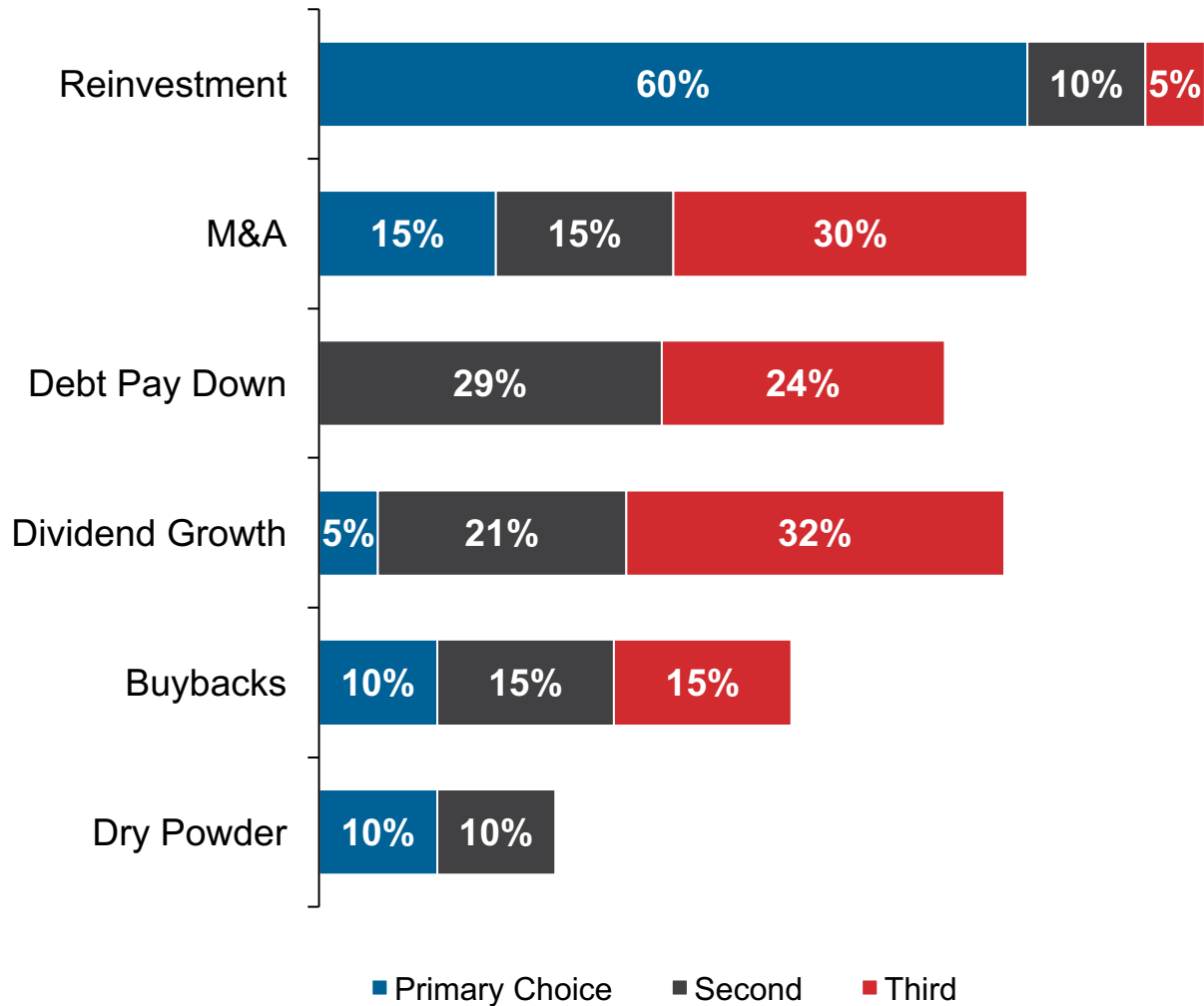
**Predicted to *Grow Slower* than GDP**



Auto Sees Most Bearish Sentiment Again While Distribution Sees Largest Uptick

**Preferred Uses of Cash**

*In Descending Order of Top Two Combined Preferences*



## Topics of Interest for Earnings Calls

**1** Margins/sustainability actions

**2** Capex

**3** End Market Demand

*“Can they find enough deplorables (welders, assemblers, plumbers, carpenters, mechanics) to rebuild America?”* **Buy Side, Industrials, N. America**

*“Cost inflation, cost reductions, pricing actions.”* **Buy Side, Industrials, N. America**

*“Ability to raise margins.”* **Buy Side, Industrials, N. America**

*“Raw materials outlook, capex outlooks, transportation network capacity.”* **Buy Side, Industrials, N. America**

*“Organic growth trends.”* **Buy Side, Industrials, N. America**

*“Strength and sources of end market demand, competitive pressures, supply chain challenges and opportunities.”* **Buy Side, Generalist, N. America**

*“Changes in the ability to compete and/or operate globally given rise in nationalist rhetoric.”* **Sell Side, Industrials, N. America**

*“Exposure to Chinese and Indian economies and risk management against same.”* **Sell Side, Generalist, N. America**

## Most Compelling Tech Themes

**1** Automation/robotics

**2** IoT

**3** E-commerce

*“Robotics.”* **Buy Side, Industrials, N. America**

*“Connected cars, autonomous cars, flying pods.”* **Buy Side, Industrials, N. America**

*“E-commerce, digital transformation.”* **Buy Side, Industrials, N. America**

*“Automation, autonomy, water treatment/analytics.”* **Buy Side, Industrials, N. America**

*“Growth in semiconductors and IoT.”* **Buy Side, Generalist, N. America**

*“IoT business models.”* **Sell Side, Industrials, N. America**

*“Automation, robotics; space & cyber for the Defense industry.”* **Sell Side, Industrials, N. America**

*“Nuclear and broader Energy investment/strategy, 3D printing, automation.”* **Sell Side, Industrials, Europe**

*“Automation.”* **Sell Side, Industrials, N. America**

*“Robotics/Automation.”* **Sell Side, Generalist, N. America**

## Deep Experience. Deeply Committed.

Founded

2007

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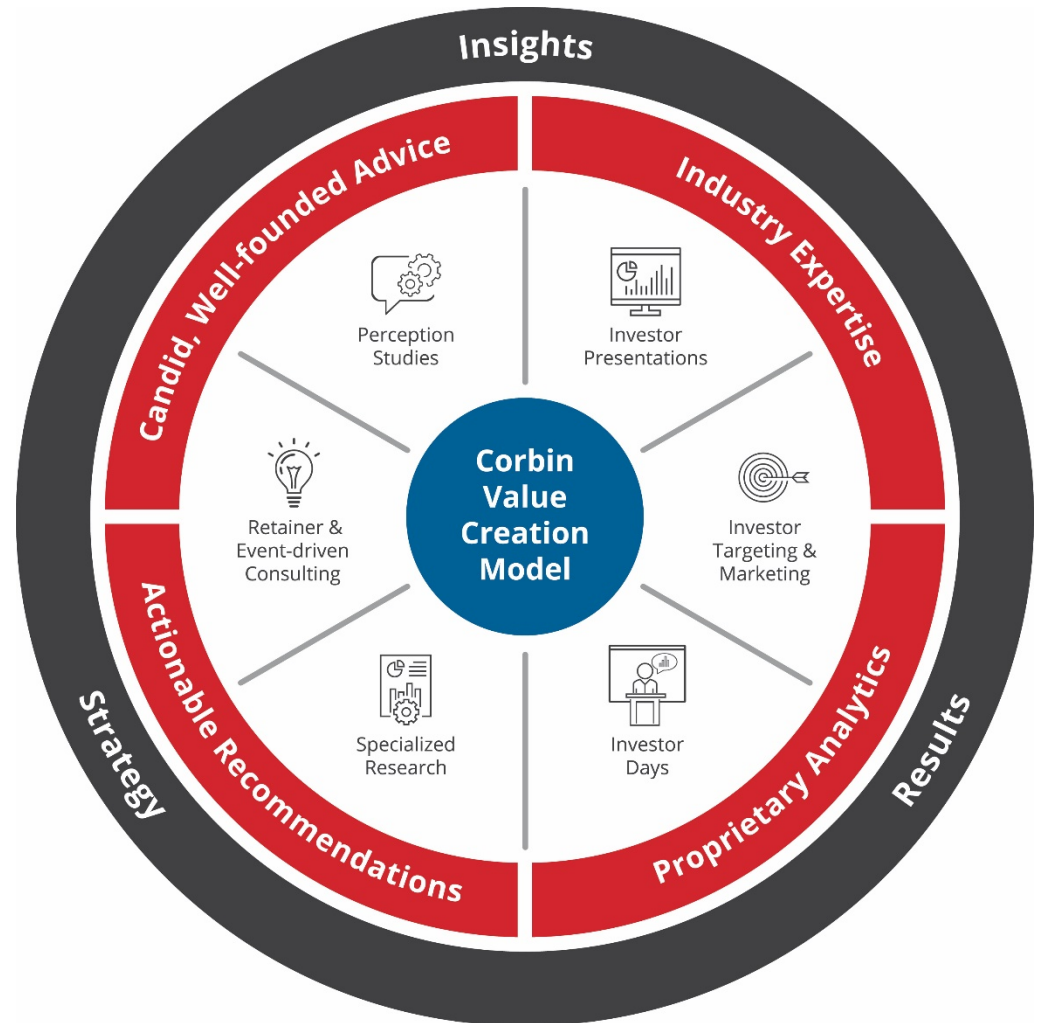
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