



# **INDUSTRIAL STOCKS: SIGNS OF RECOVERY**

## ***THE MONTHLY RESEARCH CONFERENCE CALL***

**MODERATOR:**

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**Director of Research**

*Wednesday, September 2, 2020*

*11:00 a.m. ET*

**61 Broadway • NYC, N.Y. 10006**

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## ■ **Industrial Stocks: Signs of Recovery**

- **John Eade: President of Argus**
- **Bill Selesky: Senior Analyst**

## ■ **Argus Quick Notes**

- **Industrial Ideas**
- **Activist Stocks**
- **Clean Water Investing**
- **Top Healthcare Stocks**
- **Find these on the homepage of our website**

## ■ **Argus ESG Model Portfolio**

- **Sustainable Impact gaining traction with investors**
- **Sustainable: Good Neighbors, long-term best practices**
- **Impact: Products that directly benefit E, S, & G**
- **Global AUM in ESG doubled in 4 years to \$40.5 trillion**
- **Find our Theme Portfolios under Portfolio Strategy on our website**

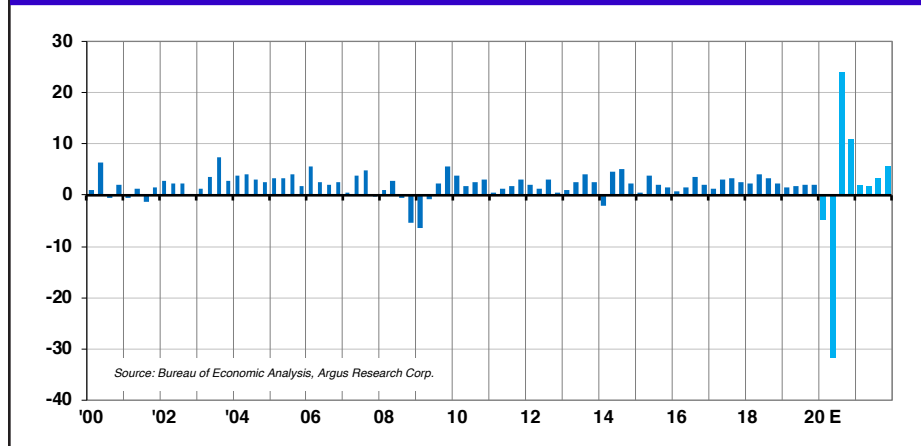
## ■ **Argus in the News**

- **Stephen Biggar: Comments on Trading Flows (CNBC.com)**
- **Chris Graja, CFA: Comments on D.R. Horton (MoneyShow.com)**
- **Find it on the site: Home Page, News & Media**

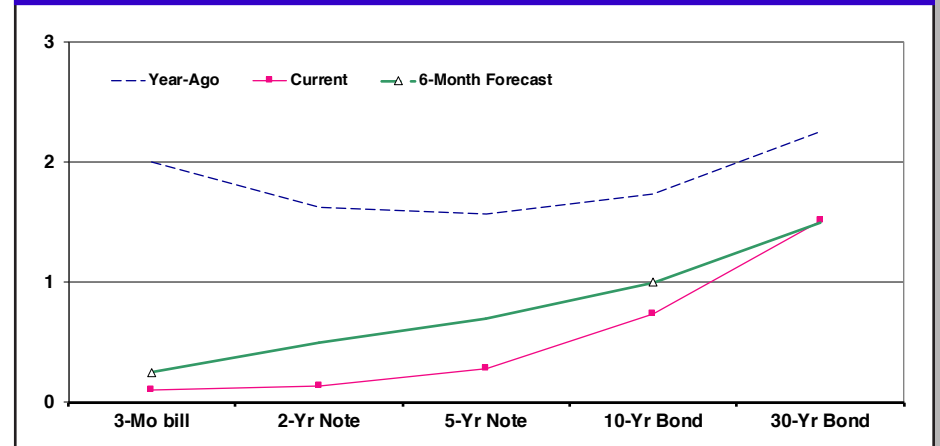
# MACRO FORECASTS



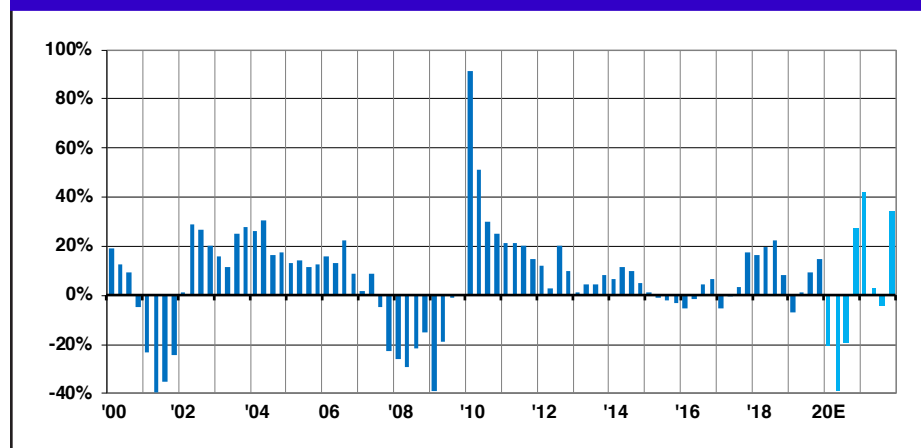
## REAL GDP W/FORECASTS (%)



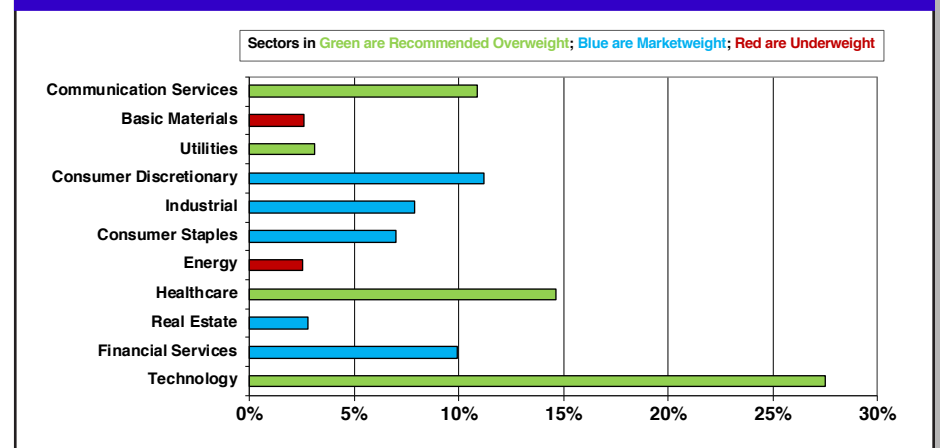
## TREASURY YIELD CURVE (%)



## S&P 500 QUARTERLY EARNINGS GROWTH

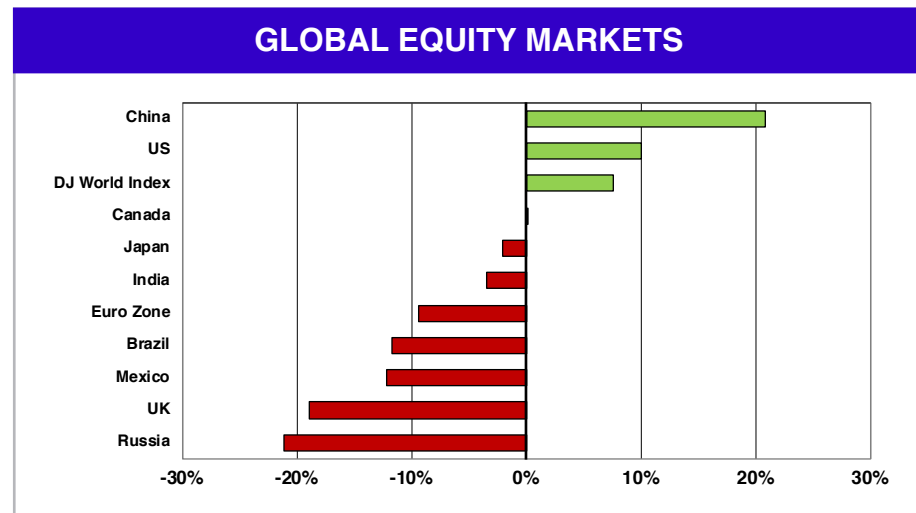
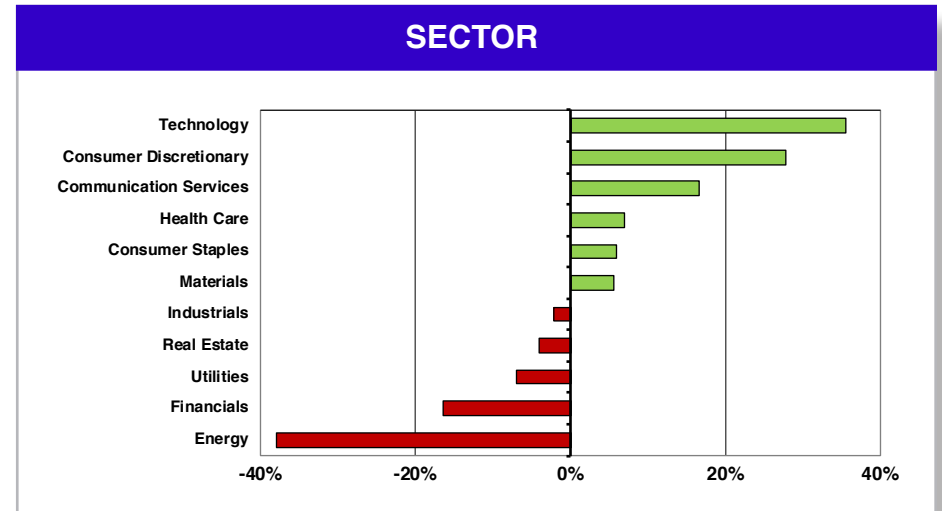
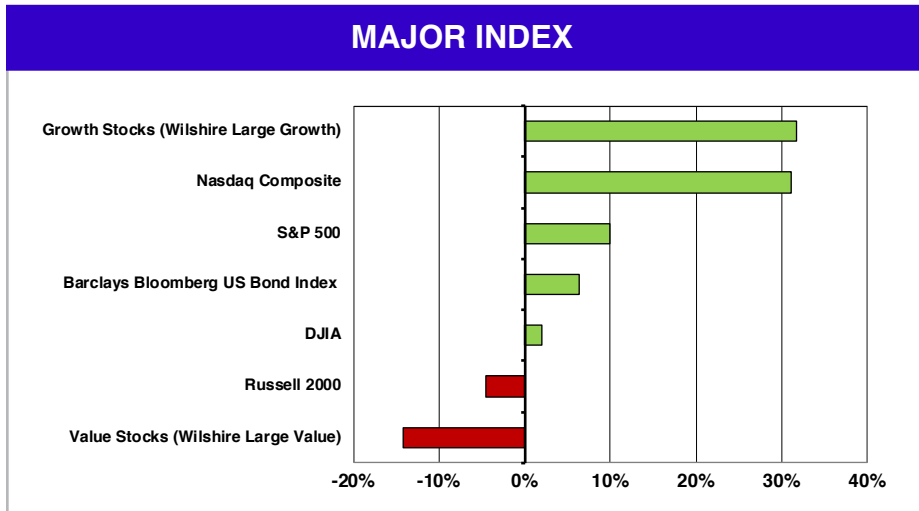


## MARKET SECTOR DISTRIBUTION - PERCENT OF S&P 500



# MARKET PERFORMANCE

DATA AS AUGUST 31, 2020



**The Industrial sector accounts for 8% of the S&P 500**

**Our Recommendation is MarketWeight**

## **Performance**

- Sector down 6.0% YTD through late August vs 9% gain for broad market
- Transportation, Air Freight lead performance
- Conglomerates, Construction Machinery lag

## **Historical Perspective**

- Sector lagged in 2019 as well.
- Headwinds have included trade wars, strong dollar, low oil prices.
- Sector, which includes many leading companies, at low end of historical market cap range of 7-12%.

## **Looking Ahead**

- Focus on clean balance sheets and experienced management teams
- Recent 2Q likely represents EPS trough
- Some subsectors likely to recover quickly – ie, environmental, cleaning, water
- Some subsectors likely to lag – commercial aerospace, oilfield equipment
- Political elections a wild card – taxes, regulations, tariffs, budget priorities

## Lockheed Martin Inc. (LMT: BUY)

- No 1 Defense company, supplies F-35, also missiles, Sikorsky helicopters.
- Pandemic has not yet had a material impact on the company's results.
- 2Q earnings rose 16% as net sales rose 13%; management raised guidance.
- New CEO, formerly CEO of AMT.
- High dividend yield of 2.4%, regular dividend growth
- P/E is 15x 2021 EPS, in range of 14-24.
- The shares have been more impacted by the presidential race than by the pandemic.
- In our view, politics don't really matter for Lockheed Martin. The company has a consistent record of positive earnings surprises and dividend growth, no matter which party is in power.
- Also on BUY list: NOC, LHX
- Special Situation: BA

## Old Dominion Freight Line Inc. (ODFL: BUY)

- Trucks consistently hold top market share in Transport Industry.
- Unlike rails, industry very fragmented – Top 25 companies <10% share.
- Old Dominion is among the most efficient operators in the trucking industry.
- Strategy is to provide customers with best-in-class service and network capacity, supporting premium pricing and ultimately improving yield, which then allows management to further reinvest in the business.
- On the other side of the crisis, the domestic supply chain will be more important than ever.
- Consistent outperformer vs Industry & Mkt: 3-month, 1-year, 5-years.
- Shares are in a bullish technical pattern of higher highs and higher lows that dates to January 2016.
- Also on BUY list: JBHT, UPS, FDX, UNP, NSC

## Illinois Tool Works Inc. (ITW: BUY)

- Businesses include Auto, Welding, Food Equip., Construction Products & others.
- \$60 billion market cap.
- 2Q EPS down 47%.
- The company is looking to the other side of the pandemic. Management believes that the company has 'significant margin cushion' that will allow it to support customer demand as it reaccelerates and take share from competitors who cannot.
- Operating margin in 2Q 17.5%; ROIC 16.8%; cash conversion ratio: 213%.
- Consistent outperformer vs Industry & Mkt: 3-month, 1-year, 5-years.
- 50-year History of dividend growth.
- Shares are in a bullish technical pattern of higher highs and higher lows since double-bottom in 4Q18.
- Also on BUY list: ROP, IEX, PH, EMR
- Special Situations: GE, MMM



## Deere & Co Inc. (DE: BUY)

- Agriculture (65%), Construction & Forestry businesses.
- Surprisingly innovative:
  - Precision Ag integrates GPS, sensors, machine automation – automatic fill control, turn automation
  - Improves fuel efficiency, seed & chemical usage, increases land productivity
  - Tractors, who knew?
- Focus on margins. The company's goal is to achieve a mid-cycle operating margin of 15%, up from previous 12%.
- Steps taken to improve asset turnover, sell more Precision Ag offerings, & via acquisitions.
- Recent relative weakness in past quarter, but strong longer-term record.
- Shares are in a bullish technical pattern of higher highs and higher lows since double-bottom in 1Q16.
- Also on BUY list: CAT, ETN, CMI

## Recent Ratings Changes

- FDX, RTX, GD, PH, EMR

## Recent Target Price Changes

- FAST, IEX, JBHT, OC, ROP, UNP, UPS

## New CEOs

- DE, GE, LMT, NOC, CSX, OC, CARR, OTIS, EMR

## Top ESG

- LMT, DE, UPS, GE, NOC, WM, NSC

## Dividend Growth

- HON, LHX, LMT, UNP, ODFL, ROP, FAST

## Dividend Yield

- MMM, RTX, ETN, EMR, CAT

## ■ AUTOMOTIVE

- **Manufacturers: Big 3 trending > plan amid low expectations; July20 SAAR of 14.5 million (LY was 16.9 million); Inventories at 54 days (LY was 66 days); Maintain 15.5 SAAR Argus forecast.**
- **Suppliers: Sales trending lower before the pandemic; Then, its factory shutdowns and global supply chain disruptions; Industry in a “slow-growth” mode at best.**
- **Parts (Retail): Significantly > plan post April 2020 bottom; The average vehicle age is setting new records (11.9 years) and more are driving versus flying; Vehicle miles driven now rebounding.**

## ■ ENERGY INFRASTRUCTURE

- **Pipelines (Oil): Soft demand stemming from weak commodity prices and lowered shale production growth have pushed a potential recovery in pipeline volume growth into 1H21.**
- **Pipelines (Natural Gas): Pipeline volumes steady, as gas replaces coal, but regulatory challenges and policy uncertainty around the election dim future growth prospects.**
- **Highways: Declining US shale production has nearly stopped all tanker trucking demand, with no recovery yet visible. But, post-2Q20, commercial trucker PCAR confirmed a rebound in demand.**

## ■ **CLEAN ENERGY (the narrative continues to grow louder)**

- **Overview:** During the past year, energy companies have advanced the storyline of “energy transition” and the need to address the issue of climate change.
- **IOCs:** The “first steps” for the Big Oil players are focused on three areas: lowering carbon intensity, increasing renewables, and investing in new breakthrough technologies.
- **E&Ps:** For the E&P companies, their transition hinges on engaging with the U.S. EPA on emission limits and acceptable work practices, along with developing U.S. flare reduction plans.
- **OFS:** Oilfield Services & Equipment firms are working towards reducing greenhouse gas emissions by 30% by 2025 and using technologies to develop geothermal power generation projects

## ■ **RECOMMENDED STOCK PICKS**

- **AUTOMOTIVE:** Tesla Inc. (TSLA), Autozone (AZO), Advance Auto Parts (AAP) and Genuine Parts Co. (GPC)
- **ENERGY INFRASTRUCTURE:** Enterprise Products Partners (EPD), Enbridge Inc. (ENB), and Magellan Midstream Partners (MMP)

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