Western Europe Slows

COMPANIES: BEML IN, CAT, HIT, KMTUY, VOLV, SS, 000528 CH, 6301JP, 600031 CH, 009540 KS, BEML IN, CAT, HIT, KMTUY, VOLV, SS, 000528 CH, 6301JP, 600031 CH, 009540 KS, HIT, KMTUY, VOLV, SS, 000528 CH, 6301JP, 600031 CH, 009540 KS

CAT
HIT
KMTUY

005930 KS
BEML

VOLV

Western Europe Slows

Western European growth moderated during 4Q07 and North American demand slid further, but weakness was offset by growth in Russia, Asia and Latin America.

- OTR's read on CAT's heavy equipment business is mixed, as in the October report (CAT reports 1/25)
- European dealers tied exclusively to French and German markets expect moderate demand declines in 2008
- North American sales, orders down as end market demand declines
- Asian demand momentum escalating; pockets of weakness, competition from domestic manufacturers may alter expectations
- Expanding end markets in Latin America driving forward sales higher

EXECUTIVE SUMMARY

Demand for new heavy equipment remained mixed during 4Q07. Although moderating growth in Europe added to North American weakness, conditions in Asia and Latin America improved significantly. Year-end buying activity outside North America offset weakening sales, but global orders declined as dealers in North America and Western Europe expect softer demand. In contrast to the low prices and attractive financing terms offered by competitors, Caterpillar Inc. dealers reported minimal incentive activity since global inventories are low. Even so, market share movement was quiet, with the exception of emerging domestic manufacturers stirring the Asian market. Energy-related projects are the strongest end markets in North America and are expected to drive sales, but with little hope of improvements in other end markets, North American weakness is expected to weigh heavily on 2008 global new equipment sales.

KEY DATA

North American Decline, European Moderation Drive Down 4Q07 Orders

	BEML IN	CAT	HIT	VOLV	VOLVB SS	6301 JP	9540 KS
Up 31%-40% 1	–	–	1	2	–	1	
Up 11%-20% 1	–	6	1	9	-2	1	
Up 6%-10%	1	–	–	1	2	–	7
Up 1%-5%	1	6	–	–	2	–	1
Flat	1	–	10	1	–	6	–
Down 1%-40%	1	3	–	1	2	–	1
Weighted average	flat	up 2%	flat	down 1%	up 3 %	up 1%	flat
4Q07 average	up 2%	flat	down 1%	up 3 %	up 1%	flat	down 1%

TIME SERIES ANALYSIS: Global new equipment orders remain down yy during 4Q07 and deteriorated 300 bps from OTR's 3Q07 findings, with improvements in Asia, Russia and Latin America helping offset the drop-off in North America and

SOURCES & BACKGROUND

64 Caterpillar heavy equipment dealers representing more than $7.7 billion in new equipment sales annually

North America 23 heavy equipment dealers (the U.S., 20; Canada, 3) with more than $3.8 billion in 2006 new equipment sales; **Europe/North Africa** 12 heavy equipment dealers (France, 5; Germany, 4; the U.K., Belgium and North Africa, 1 each) with more than $1.2 billion in 2006 new equipment sales; **Asia** 19 heavy equipment dealers (China, 6; India, 7; Japan, 6) with more than $1.4 billion in 2006 new equipment sales; **Latin America** 5 heavy equipment dealers (Brazil, 3; Argentina and Chile, 1 each) with more than $860 million in 2006 new equipment sales; **Russia/CIS** 5 heavy equipment dealers with more than $365 million in 2006 new heavy equipment sales

REPEAT SOURCES 44 (10 in North America, 11 in Europe/North Africa, 16 in Asia, 5 in Brazil and 2 in Russia/CIS) from OTR's October report

INTERVIEWS Early December

AVERAGES Regional averages weighted according to each source's 2006 equipment sales; global averages weighted according to each region's percentage of Caterpillar's 2006 sales

"We see demand cooling down this quarter. Orders are down because customers bought what they needed. Tax subsidies are over, Bauma is over. There is no more euphoria."

Sales director of a large German Caterpillar dealership

Western Europe Slows

EUROPE/RUSSIA

European demand losing momentum

European sources said new equipment sales increased an average 7% to 12% during 4Q07 to date yy, as dealers in France and North Africa experienced a flurry of late-year buying activity. “Sales are up in all regions, with some showing exceptional growth,” a French dealer said. Quarry and heavy construction projects continued to drive U.K. sales, but unfavorable weather hurt some construction activity. German sources reported a lackluster demand environment, with several reporting significant declines in compact equipment demand. “We see demand cooling down this quarter. Orders are down because customers bought what they needed,” one said. “Tax subsidies are over, Bauma [the international trade fair for construction machinery] is over. There is no more euphoria.”

“There is a seasonal slowdown, the weather is bad and clients are waiting for the next buying cycle to really spend massively.”

European sources expect 4Q07 orders to increase just 3% to 8% yy — driven by declines in Germany and the United Kingdom — a deterioration from OTR’s 3Q07 findings. “There is a seasonal slowdown, the weather is bad and clients are waiting for the next buying cycle to really spend massively,” a source said. “I think it will take place in the second half of 2008.” However, French sources reported continued order growth. “Orders are up almost 15% on the national level,” one said. “Construction remains strong and there are several large infrastructure projects being launched still.”

RUSSIAN STRENGTH CONTINUES

However, 4Q07 heavy equipment sales and orders in Russia continued an upward charge, increasing 41% to 46% and 42% to 47% yy, respectively. Sources said though previous supply shortages loosened during the period, lead times remained “unacceptably” long. “Market conditions are better for us thanks to better availability, but we could still sell more if lead times were shorter still,” one said. “We are especially lacking excavators and bulldozers.” Other Russian sources said construction was booming in Moscow and Siberia, as mining and pipeline projects drove demand and the equipment rental market continued to develop. “New rental companies take a big share of our total sales,” one said. “They are a new and very important end market.”

Long deliveries, low incentives continue

European sources said improving lead times on Caterpillar’s compact construction equipment helped recapture share from competitors with greater availability. The reorganization of the Caterpillar factory in Belgium allowed lead times for compact construction equipment (CCE) to decline from eight weeks to three, according to sources. “It’s a little revolution for Caterpillar in a segment which is traditionally the weakest for the brand. We expect to gain a lot,” a French source said. Another said, “The compact equipment market is traditionally the most competitive, where brand names don’t play much of a role. It’s all on price and availability. It’s good for Caterpillar to have acceptable lead times now.”

However, sources said lead times for large equipment remained unchanged during 4Q07 qq. “I see no sign of the U.S cool down in terms of shorter lead times,” a U.K. source said. Sources close to Moscow said availability for large equipment continued to cost Caterpillar market share. “We can’t meet all the demand. People go to **Volvo [AB], Hyundai [Heavy Industries Co. Ltd.]**, or **Komatsu [Ltd.]**. New, cheap Chinese manufacturers also gain share, like **Sany [Heavy Industry Co. Ltd.]**.” Russian sources also complained about Caterpillar’s premium prices. “Caterpillar offers no discounts, Volvo and JBC are a lot more flexible,” one said.

Western Europe Slows

LATIN AMERICA

End market demand expands

Latin American demand for new heavy equipment increased significantly during 4Q07 as end market strength gained momentum. Dealers said new equipment sales increased an average 16% to 21% during 4Q07 to date yy, an improvement from OTR's 3Q07 findings. "The market is really high in Argentina. We've received many orders and expect more in the coming months," an Argentine dealer said. A Brazilian dealer said, "It was the best year in many years." Sources said heavy construction, general construction and mining projects continued to fuel demand, while forestry and wind energy projects also gained momentum. "There are a bunch of Italian, French and German organizations surveying wind projects," a Brazilian dealer said.

Sources said new equipment orders also increased 16% to 21% during 4Q07 yy, an improvement from OTR's September report. In addition to expanding end markets, sources credited the increase to improved lead times as the U.S. housing crisis dragged on and production at Caterpillar's Brazil plant improved. "Caterpillar's equipment exports to the U.S. declined because of the housing crisis, leaving more machines to be sold in the domestic market," a large dealer said. With availability problems at least partially alleviated, sources reported no reason to attempt new inventory increases. "Now that delivery improved we can rely in Caterpillar's availability and don't need to load anymore," a leading source said.

"Heavy construction projects are already under way, and if government energy projects come out of paper our growth may double."

Demand growth has potential to soar

Sources expect 2008 new equipment sales to increase an average 7% to 12% yy with the most moderate growth coming from Argentina, Chile and Uruguay. "I forecast 5% growth in 2008," an Argentine source said. "The market is pretty good today, and I don't think it is going down, but at the same time I don't see many reasons to have such aggressive growth as we had in previous years." However, Brazilian sources reported potential for more significant growth as demand across a number of end markets is expected to improve next year. "Heavy construction projects are already under way, and if government energy projects come out of paper our growth may double," one said, referencing a massive hydroelectric project. After speaking with the dealer, news broke of an accepted bid on the project. The dealer estimated more than 700 machines could be needed as a result.

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Western Europe Slows

EUROPE/RUSSIA

ON END MARKET DEMAND

"We are starting to see a psychological effect from the U.S. slowdown on our own economy." Benelux

"We are building roads, highways, railroads, dams, houses. … The entire economy is booming." Morocco

ON MARKET DEMAND

"Caterpillar equipment is a value when the overall market is down." France

"Customers accept long lead times because our main competitors also suffer." France

"Cat raises prices a lot faster than competitors. We lose a lot of tenders because of that." Russia

"Mining customers all go for Caterpillar equipment because it is a lot more reliable." Russia

ON INCENTIVES

"We can't expect anything from Caterpillar. They told us Russia was getting more incentives than any other country." Russia

NORTH AMERICA

ON SALES & ORDERS

"Our orders are down, but it's not just business related — it's Caterpillar. They wanted our inventories down." U.S. West Coast

ON END MARKET DEMAND

"There's been an unexpected uptick in mining business due to the price of coal." Midwestern United States

"Demand is slow, very slow. We've got some government jobs going on and some large machines are moving, but there is no development type work." Southern United States

"Commercial is still there but showing signs of slowing down. With everybody preaching about this market, commercial project owners are getting hesitant." Southeastern United States

ON INVENTORY & INCENTIVES

"Residential activity is dead and non-residential is holding. The governmental sector is making plans for spring, but they have released nothing yet." U.S. West Coast

"They don't have the programs released and finished for next year. I don't think the market will take price increases. There is too much availability from Deere [& Co.], Komatsu and Volvo." Western United States

"Caterpillar has made it clear that we are on our own. Support is being removed. There used to be a lot more of a partnership. You really just have your own ingenuity to work with." Eastern United States

"I think it will be mid-year before our manufacturer realizes what's going on." Midwestern United States

"Everybody is in on the deals — and not just for equipment, for jobs. A year ago, you'd see two people bidding on a job; now, they have 12. Everybody is feeling the same crunch." Southeastern United States

"Volvo is selling articulated trucks at the same price as they were five years ago. Komatsu is offering financing and availability guarantees we have no idea how they'll be able to fulfill." Midwestern United States

Western Europe Slows

1] Are 4Q07 conditions and demand in the machinery market getting better, worse or remaining the same to date?

	N. AMERICA	EUROPE	RUSSIA/CIS	L. AMERICA	ASIA	TOTAL
Better:	4	2	2	5	11	24
Same:	7	8	3	-	4	22
Worse:	12	2	-	-	4	18

2] Did 4Q07 sales of new Caterpillar construction and mining equipment increase, decrease or remain the same yy?

	N. AMERICA	EUROPE	RUSSIA/CIS	L. AMERICA	ASIA	TOTAL
Up 51% or more:	-	-	2*	-	-	2
Up 46%–50%:	-	-	-	1*	1	2
Up 41%–45%:	-	-	-	-	1	1
Up 36%–40%:	-	2	-	-	-	2
Up 26%–30%:	-	-	1	-	-	1
Up 21%–25%:	2	-	1	-	1	4
Up 16%–20%:	-	2	1	1	3	7
Up 11%–15%:	1	1	-	2	-	4
Up 6%–10%:	1	1	-	1	5	8
Up 1%–5%:	2	2	-	-	3	7
Flat:	2	4	-	-	3	9
Down:	3	-	-	-	1	4
Down 1%–5%:	1	-	-	-	-	1
Down 6%–10%:	6	-	-	-	-	6
Down 11%–15%:	1	-	-	-	-	1
Down 16%–20%:	3	-	-	-	-	3
Down 46%–50%:	1	-	-	-	1	2
Weighted average:	**Down 6%–11%**	**Up 7%–12%**	**Up 41%–46%**	**Up 16%–21%**	**Up 8%–13%**	**Flat–down slightly**
3Q07 average:	**Down 5%–10%**	**Up 2%–7%**	**Up 23%–28%**	**Up 12%–17%**	**Up 4%–9%**	**Flat–down 3%**

** One outlying source not included in the averages*

3] Have 4Q07 orders for new Caterpillar equipment increased, decreased or remained the same to date yy?

	N. AMERICA	EUROPE	RUSSIA/CIS	L. AMERICA	ASIA	TOTAL
Up 51% or more:	-	-	1	-	-	1
Up 46%–50%:	-	-	-	-	1	1
Up 41%–45%:	-	1	-	-	-	1
Up 31%–35%:	-	-	2	-	-	2
Up 26%–30%:	-	-	-	-	1	1
Up 21%–25%:	-	-	1	-	1	2
Up 16%–20%:	-	-	1	1	3	5
Up 11%–15%:	-	3	-	2	-	5
Up 6%–10%:	-	-	-	1	4	5
Up 1%–5%:	1	4	-	-	3	8
Up:	1	-	-	-	-	1
Flat:	5	1	-	-	4	10
Down:	6	-	-	-	1	7
Down 1%–5%:	2	2	-	-	-	4
Down 6%–10%:	2	1	-	-	-	3
Down 11%–15%:	1	-	-	-	-	1
Down 16%–20%:	1	-	-	-	-	1
Down 46%–50%:	2	-	-	-	-	2
Down 51% or more:	-	-	-	-	1	1
Don't know:	2	-	-	-	-	2
Not applicable:	-	-	-	1	-	1
Weighted average:	**Down 12%–17%**	**Up 3%–8%**	**Up 42%–47%**	**Up 16%–21%**	**Up 10%–15%**	**Down 2%–7%**
3Q07 average:	**Down 9%–14%**	**Up 11%–16%**	**Up 27%–32%**	**Up 8%–13%**	**Up 8%–13%**	**Flat–down 3%**

**One outlying source in Europe and one in Asia not included in the averages.*