

David Raso	212 446 5647	draso@isigrp.com
Oliver Liao	212 446 9444	oliao@isigrp.com
Jeff Morrison	212 446 5652	jmorrison@isigrp.com

Industry Note: Machinery

Monday in Moscow More Positive for Construction & Mining Equipment than for Farm Equipment

- **Monday in Moscow** – On our first trip back to Russia since September 2008, right before crisis was in full bloom, we spent Monday visiting one of the largest Russian farming operations & visiting Komatsu Russia-CIS
- **Key Takeaways** – Oil & gas and mining to drive construction/mining equipment revenues +20%+ in 2010 while Russia farming still profitless & in need of improved export infrastructure
- **Credit Availability** – Only very modest signs of improvement – still mostly a cash business though some leasing companies loosening up
- **Import Tariffs** – Russia still significantly protecting local combine harvester manufacturers (15% import tariff) and dump truck/mining truck manufacturer (25% import tariff)
- **Increased BRIC Protectionism:** Our BRIC travels past 9-12 months have seen a noticeable shift to greater protectionism (overtly or discretely) than pre-crisis; we also wonder how much is it simply stronger, more focused local competitors given their export markets have shrunk, magnifying that increased protectionism?
- **Unsatisfied and Surprisingly Not Consulted Large Deere Russian Customer**
- **We continue to favor Deere (Buy rated) over Caterpillar (Hold rated) though today's feedback was modestly disappointing for that relative positioning**

Coverage Universe

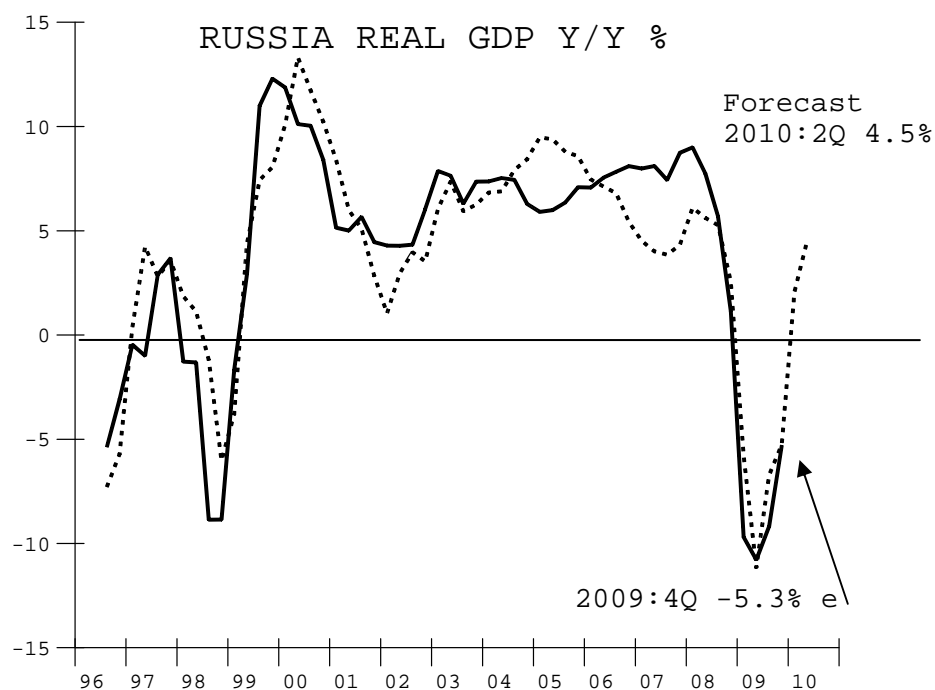
Caterpillar Inc. (CAT)
 CNH Global NV (CNH)
 Cummins Inc. (CMI)
 Deere & Company (DE)
 Eaton Corporation (ETN)
 Ingersoll Rand Co Ltd (IR)
 Illinois Tool Works Inc. (ITW)
 Oshkosh Corporation (OSK)
 Parker Hannifin Corporation (PH)
 Terex Corporation (TEX)
 Timken Company (TKR)
 United Rentals Inc. (URI)

Russia Economy ABCs:

Figure 1: Russia, as measured by 2008 GDP, was the world's 9th largest economy

		(\$ Billions)	% Total
1	United States	14,204	23.4%
-	Eurozone	13,565	22.4%
2	Japan	4,909	8.1%
3	China	4,326	7.1%
4	Germany	3,653	6.0%
5	France	2,853	4.7%
6	United Kingdom	2,646	4.4%
7	Italy	2,293	3.8%
8	Brazil	1,613	2.7%
9	Russia	1,608	2.7%
10	Spain	1,604	2.6%
	Others	20,878	34.5%
	World	60,587	100%

Source: World Bank

Figure 2: Russia Real GDP Y-O-Y with ISI Economic Team Forecast

Source: ISI Group Economic Research and Haver Analytics

Moscow Monday Highlights

- Monday in Moscow – Visit to one of Largest Russian Farming Operations & to Komatsu Russia:** We returned today to Russia for the first time in 16 months, interested in Russia/CIS trends directly and also being cognizant of how a weak or strong Russia/CIS market impacts equipment pricing across a large territory given equipment flows east from Western Europe to Eastern Europe to Russia/CIS, particularly of used equipment. We spent Monday visiting Black Earth Farming, which controls 323,000 hectares (approximately 800,000 acres) of Russian farm land (we also visited them last trip) and planted approximately 450,000 acres last year, with winter wheat nearly 50% of total planted acres and spring barley 25% of total. We also visited the top management of Komatsu Russia/CIS today for some perspective on the construction and mining equipment markets. We will be visiting a variety of trucks, construction, ag, rail, steel and component companies the rest of the week.
- Monday Key Takeaways – More Positive for Construction/Mining Equipment Than Farm Equipment:** Russian farmers look set for another year of operating losses in 2010 and limited **farm equipment** buying with Russian farmers' greatest need is government help/private market stimulus to greatly improve Russia's crop export infrastructure as this could help address local market crop oversupply (Black Earth feels costs from export infrastructure inefficiency alone costing an extra \$8-\$15 per ton, equivalent to 7%-10%+ operating margin loss; crop oversupply driven by wheat & coarse grain production has now shown its sustainability at 10m-30m metric tons above domestic consumption – approx 80m-100m tons of annual production vs 70m metric tons of annual domestic consumption thus Russia needs to improve its export competitiveness further; Black Earth believes the infrastructure need could be \$100b – government has spoken to it but no clear funding channels or significant enough actions yet though trying via consolidating government owned storage terminals). For perspective, we estimate Eastern Europe/Russia CIS market sales were 9% of Deere's global farm equipment sales in fiscal 2008 (pre-crisis).

Meanwhile the picture is brighter for **construction & mining equipment** as sales into the oil & gas and mining markets are expected to drive total Komatsu mining & construction equipment revenues in Russia over 20% in 2010 (fiscal 2011 to be exact, spanning 4/1/10-3/31/11). The general construction markets remain weak with often talked about significant government infrastructure projects still not materializing into activity though 2 events, the Sochi 2014 Winter Olympics and the 2012 APEC meeting in Vladivostok, will continue to provide incremental equipment demand. As we note below that the Russian government is protecting the local dump truck/mining truck producer Belaz, much of the mining equipment related growth expected by Komatsu is for mining shovels and other mining support equipment such as motor graders, dozers, wheel loaders for overburden, etc.

For perspective, Komatsu's Russia sales peaked in fiscal 2009 (fiscal year ended 3/31/09) at \$700m, having peaked with annual run rate closer to \$900m mid-fiscal year 2009. The current fiscal year to end 3/31/10 will post only \$300m of Komatsu Russia revenues (thus the 20%+ fiscal 2011 growth still represents levels not that much higher than 50% of the last peak in fiscal 2009). With global players dominating the Russian excavator market, Komatsu believes it is #1 in Russia's excavator market with 25%-30% market share, slightly ahead of #2 Hitachi, followed by CAT and Volvo. The Russian market for excavators (20+ tons) was 6,000 units pre-crisis, one-third the size of the North American market at that same time.

High Margin Geography - At its peak, the Russian market enjoyed the strongest operating margins geographically for Komatsu.

- Credit Availability Only Very Modest Signs of Improvement – Still Mostly a Cash Business:** Also noteworthy from today's meetings was that credit availability has not improved much with transactions continuing to be all cash deals though Komatsu noted some local leasing companies have

started to loosen up in recent weeks and Komatsu Financial is even considering to lend in Russia this year (for perspective, Deere Capital does not lend in Russia, CAT Financial does though most only with its largest customers).

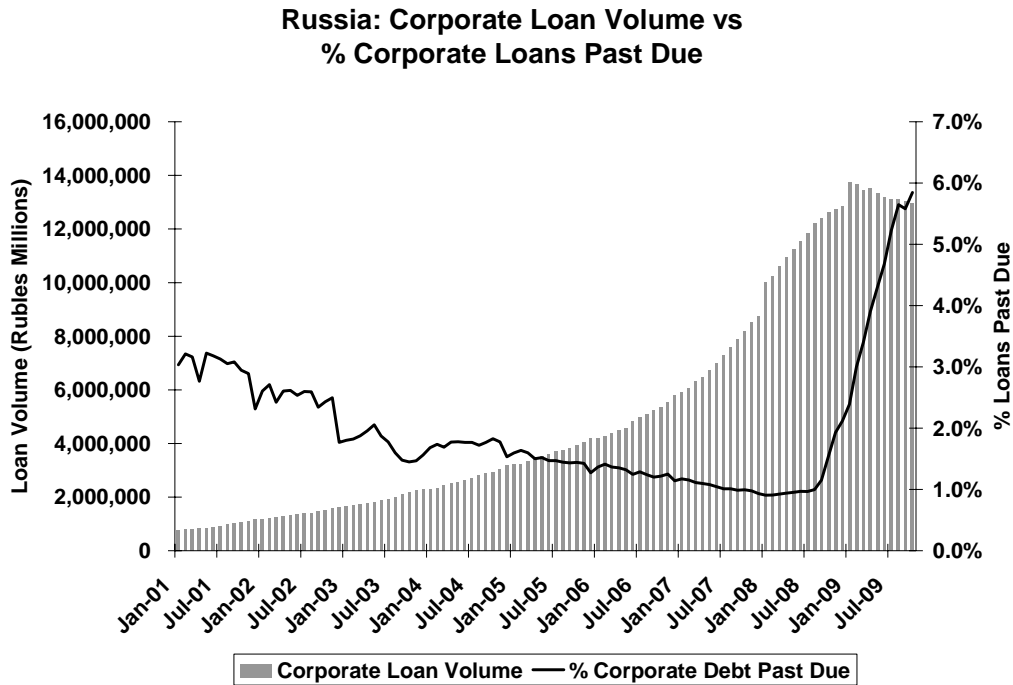
- **Import Tariffs – Still Most Protecting Local Combine Harvesters and Dump/Mining Trucks:** Import tariffs for both construction and farm equipment have not changed of late, still similar to a year ago when Russia took pointed measures to protect the few key domestic producers they have in the region. The Russians are still most focused on protecting its key local manufacturer of combine harvesters (Rostselmash) with a 15% import tariff and protecting the local dump truck & mining truck manufacturer Belaz (actually from Belarus but treated as domestic producer by the Russian government) with a 25% import tariff. We'll have more color on the tariff issue this week from subsequent meetings but for now it appears the tariff is based on where the machine had final assembly and certain foreign content to be administered the import tariff, not based on where the engine in the machines were manufactured as some have speculated.

Based on current regulations, it looks like Deere and CNH will be able to avoid the tariff with their new Russian assembly plants coming soon (Deere this quarter, CNH shortly thereafter) as well as Komatsu's new Russian excavator plant coming in June (imported excavators face a 5% import tariff).

- **Unsatisfied and Surprisingly Not Consulted Large Deere Customer:** One would think Black Earth would be provided high priority attention by leading equipment manufacturers in the region due to Black Earth's size and added significance given it could be a poster child customer for any leading agricultural input or equipment supplier looking to show its presence in this important future growth market. Thus we were surprised to hear about Black Earth's challenging experience with its equipment suppliers, both Deere and Claas (as Deere and private company Claas comprise most all of Black Earth's equipment fleet).

Challenges ranging from dealers' financial condition, product support, product availability, confusion over dealer designated territories, to access to senior Deere management, Black Earth's experience will likely have them considering alternative suppliers when their next purchasing cycle resumes which they expect to be 2011. We were also surprised to hear top Black Earth management was not consulted when Deere was making its decision to build an assembly facility in Russia – not saying that one customer would have that much sway but you would think a large customers' view of the significance of Deere having a local assembly presence would have been discussed just for due diligence.

Figure 3: Russia corporate loan volume and percentage of loans past due



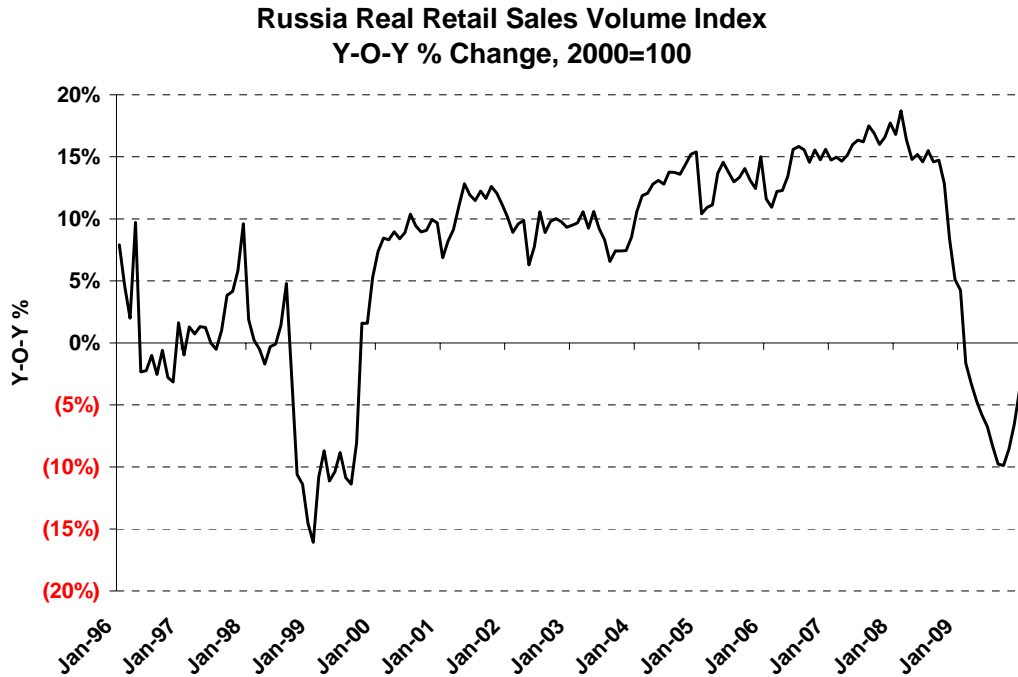
Source: Haver Analytics, ISI Group

Figure 4: Russia Freight Sales



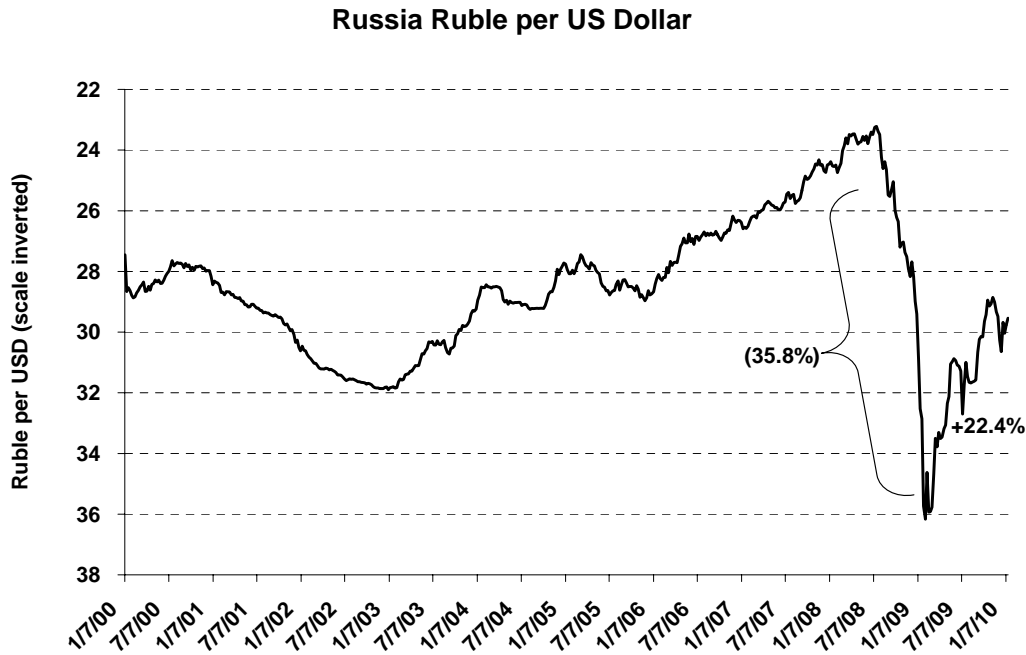
Source: Haver Analytics

Figure 5: Russia retail sales on the mend, albeit after a sharp decline (unlike the relative resiliency of retail sales in Brazil, China & India this downturn)



Source: Haver Analytics

Figure 6: Russia Ruble has appreciated vs US\$ over the past year though still weaker than pre-crisis



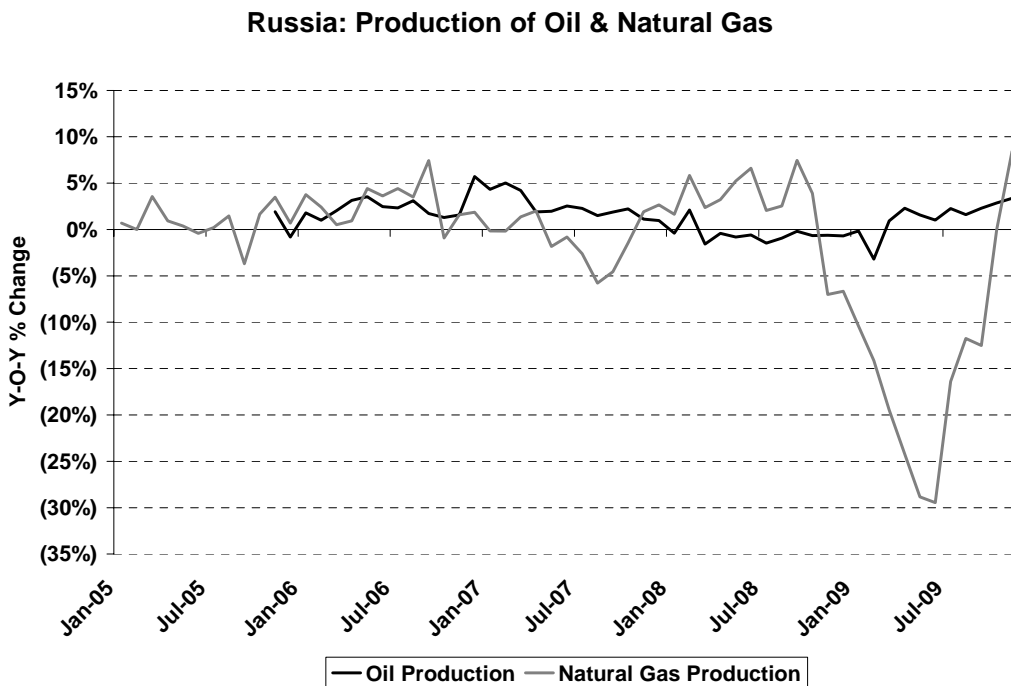
Source: Haver Analytics, ISI Group

Figure 7: Russia exports still down y-o-y but improving sequentially (energy driven given 75%+ of Russian exports are energy related)



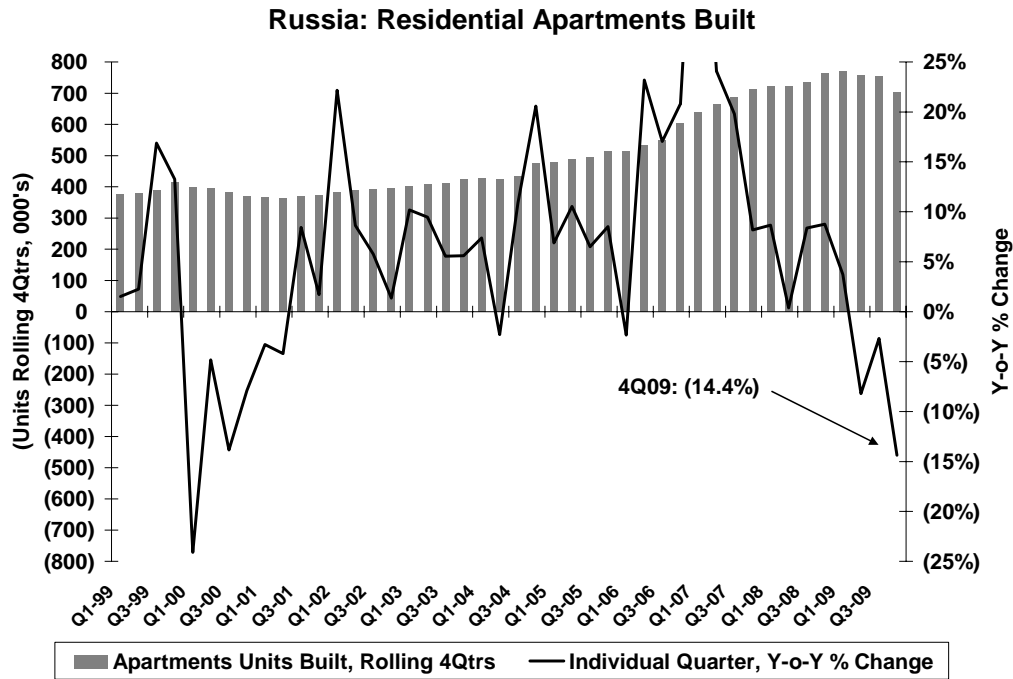
Source: Haver Analytics

Figure 8: Russia increased production of oil and natural gas helping construction equipment sales (pipelayers, related construction activity, etc)



Source: Haver Analytics

Figure 9: Russia building of residential apartments have not yet found a bottom (interestingly, though, The Moscow Times today reported the Russian population grew in 2009 for the first time in 15 years, driven by immigration, hopefully reversing or slowing the negative demographic trends for housing formations).



Source: Haver Analytics

Figure 10: Russia construction activity maybe finding a bottom



Source: Haver Analytics

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Buy Low Risk ETR >+10%	Buy Medium Risk ETR >+15%	Buy High Risk ETR >+20%
Hold Low Risk ETR 0% to +10%	Hold Medium Risk ETR -5% to +15%	Hold High Risk ETR -10% to +20%
Sell Low Risk ETR <0%	Sell Medium Risk ETR <-5%	Sell High Risk ETR <-10%

RISK RATING:

30% based on stock price volatility, 30% on EPS volatility, 30% on debt rating & 10% on mkt cap