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Two Cheers for the U.S. Manufacturing Rebound

Caterpillar is among the U.S. industrial companies enjoying a resurgence in profits and optimism as exports climb—amid weak domestic demand

By [Ben Steverman](#)

Profits are back at U.S. industrial companies, including [Caterpillar \(CAT\)](#), which saw earnings beat Wall Street estimates by 28% on Apr. 26.

Behind the hearty headlines there is nagging concern: U.S. manufacturers are still awaiting a rebound in domestic demand.

Caterpillar reported first-quarter adjusted earnings of 50¢ per share on Apr. 26, reversing a 19¢ loss incurred a year ago and besting the 39¢ estimate from 21 analysts surveyed by Bloomberg.

Executives at Caterpillar raised profit estimates and sounded optimistic. "We are increasing production schedules and expect sales to improve as we move through 2010," Chairman and Chief Executive Jim Owens said in an Apr. 26 statement.

Also on Apr. 26, Whirlpool ([WHR](#)) shares hit their highest level in three years after the appliance maker boosted its 2010 earnings forecast and reported a 20% increase in sales over last year's first quarter.

For the first time since the recession began, "you're starting to hear company executives truly sound optimistic," says Michael Jaffe, who covers Caterpillar and other industrial companies as an equity analyst at Standard & Poor's.

"A LOT OF GOOD NEWS FOR A CHANGE"

Indeed, much of the news and data from manufacturers is good. In March, the U.S. Institute for Supply Management manufacturing index hit 59.6, the highest reading for the survey since July 2004. Durable good orders fell 1.3% in March, but economists cheered a 2.8% rise in orders excluding transportation, which tends to be volatile from month to month.

"There is a lot of good news for a change," says Michele Gambera, head of quantitative analysis at UBS Global Asset Management ([UBS](#)).

Yet Caterpillar's results also demonstrate a glaring weakness in the industrial sector's recovery. "The main driver behind our improved outlook is robust growth in Asia/Pacific and Latin America and continued improvement in mining and energy globally," Owens said. Sales in Latin America were flat last quarter from a year ago, and revenues from Asia jumped 20%. North American sales, however, were off 18%.

Michael Englund, chief economist for Action Economics, says the same phenomenon can be seen at other U.S. manufacturers. "Much of the strength is actually being captured in exports and not domestic demand," Englund

says.

U.S. factories are supplying overseas buyers and rebuilding depleted inventories at home, says [First American Funds](#) Chief Economist Keith Hembre. But, he says, we're seeing a "less-than-robust pace of underlying demand growth."

One problem is that the construction industry is buying less equipment because of deep problems in the U.S. real estate market, both residential and commercial, Hembre says.

SMALL BUSINESS: FAR LESS OPTIMISTIC

A key variable for manufacturing is how much money businesses are willing to spend to invest for the future, whether on new vehicles, software, machinery, or other equipment. Many such purchases pay back only over long periods of time so they require a lot of optimism about the future, Englund notes. "The real key is going to be business confidence," he says, adding that banks must be more willing to finance big purchases.

So far, the data on confidence are mixed. The U.S. Conference Board's CEO survey registered a reading of 62 in the first quarter of 2010, down from 64 the previous quarter, but still well into optimistic territory. Any reading of more than 50 reflects more positive than negative responses.

Small business owners remain gloomy. The National Federation of Independent Business optimism index fell to 86.8 in March, from 88 in February, hitting its lowest level since July 2009. The index has registered below 90 for 18 months, which the NFIB says is unprecedented in the survey's history.

CEO confidence is "improving nicely," Hembre says. "Small business confidence [is] stuck in the doldrums."

UBS's Gambera argues that businesses have been "skimping on capital expenditures" for several years and will have little choice but to spend more, if only to replace aging and obsolete equipment. Pent-up demand is "likely to be the main driver of economic growth in this expansion," he says.

Optimistic economists, investors, executives, and analysts predict that the U.S. economy will gain sustainable momentum this year, driving strong underlying demand for industrial goods. It remains to be seen if serious problems in the U.S.—from the real estate mess to the weak labor market—represent speed bumps on the road to recovery, or roadblocks.

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