

MANAGEMENT SUMMARY

Oliver Wyman study on the “Recession Agenda for the Capital Goods Industry”

A clear path through the crisis

- **Ten percent of capital goods producers face a serious threat from the crisis, 20 percent can profit**
- **German companies are better prepared for the crisis than international competitors**
- **A detailed recession agenda will not only lower costs but also stabilize revenue, bolster financing and create an early-warning system**

Many companies in the capital goods industry are entering the recession in good financial shape. Those companies that closely examine their individual situations have an array of options at their disposal to survive the crisis and even profit from it. After all, this crisis presents numerous opportunities, particularly for financially strong companies, in addition to business threats. Emerging countries, for instance, continue to offer good to very good growth opportunities over the mid-term. Furthermore, the conditions for company acquisitions have become significantly more favorable, and the price of raw materials has fallen markedly. The critical factor for succeeding during the recession is to have an agenda that is tailored to the individual situation of each company and that addresses all opportunities in terms of growth, costs, financing, transparency and control. These are the findings of the latest Oliver Wyman study titled “A Recession Agenda for the Capital Goods Industry.”

Germany’s capital goods industry employs around 2.5 million people and generated about Euro 700 billion in revenue during 2007. In recent years, it has been one of the economy’s growth drivers and embodies the success that Germany has achieved in exporting. As a result of the closely interlinked international economy, the German investment goods industry cannot escape the grip of the worldwide recession. Many companies are seeing orders fall by 30 percent to 50 percent. For companies that have normal profitability within the context of an EBIT margin of five percent, a 15 percent drop in revenue in 2009 would result in losses if countermeasures were not taken. At the same time, financing costs for the manufacturers of investment goods are rising. For the entire sector, interest rates are more than ten percent on average. For companies with poor credit ratings, they have even risen above 20 percent. Against this backdrop, about ten percent of companies in the German capital goods industry could be seen as facing a serious threat.

The biggest threat is primarily faced by those producers of capital goods who did indeed grow during the broad upswing experienced in recent years but who failed to do their structural homework. The shortcomings of the weakest ten percent of companies are their extreme organizational complexity, their lack of management tools, their creation of overcapacities and

their use of excessive working capital. The earnings growth typically achieved during the good economic cycle overshadowed the decline in margins. Companies that failed to generate cash in recent years now face the threat of a liquidity crisis.

Many companies are in good financial shape

Despite the difficult situation faced by a small number of German manufacturers of investment goods, there is no cause for gloom and doom. There are many reasons to believe that most companies will get through the crisis in relatively good shape. And these reasons are quite clear: After several years of growth, many have very good financial reserves. In addition, the current downturn is different from other recessions because the financial crisis had heightened people's awareness even before the recession hit the real economy.

Many companies have become more flexible and have developed management instruments that enable them to take action in a timely manner. For this reason, the capital goods industry as a whole has not been affected so rapidly as sectors that are more closely related to consumers, including the automotive industry, have been. The crisis will ultimately not be as bad as predicted. The year of 2009 will be a year of consolidation and restructuring. A turnaround is possible in 2010.

This conclusion is supported by several factors. The positive effects helping the sector include markedly lower prices for raw materials. The industry has seen oil prices fall by 60 percent and aluminum prices by 30 percent. The opportunities for acquisitions have risen as well. For instance, valuations of companies in emerging countries have fallen by two-thirds. They roughly correspond to the price of companies in saturated markets – despite significantly higher growth potential. Established markets are also creating opportunities for acquisitions. For example, some companies being sold as a result of the financial crisis can be acquired for half of their normal valuation.

The moderate wage agreement in the metal industry of about four percent is significantly below expectations. This eases pressure on costs. Moreover, individual segments in the sector have long order cycles (plant construction, special-purpose machinery) that are hardly being affected by the downturn at the moment. In this area, companies should also profit from the infrastructure activities foreseen in government economic programs. Companies with good credit ratings in stable markets are continuing to receive very good loan terms. When financially weak international companies begin to falter, additional gains of market share could be possible among the strong players in Germany's capital goods industry. Companies that are currently in a position of investing in the development of new products and locations as well as in promising acquisitions will create a significant competitive edge for themselves during the next upswing.

Four levers for the recession agenda

Oliver Wyman sees about 20 percent of German companies in the sector as being among the potential winners of the crisis. These companies are market leaders, possess a strong technological position and have a good equity base. In international comparison, Germany has many excellent companies. For this reason, it is very likely that the German capital goods industry as a whole will emerge strengthened from the crisis. For this to happen, the appropriate steps must be taken now and the companies must make the right decisions. The issues of cost and liquidity are indeed being addressed. But, frequently, the courage to make radical changes is lacking. In many cases, companies restrict themselves to introducing isolated steps defined by their daily business activities that generally lower costs by only three percent to five percent. In times of crisis, however, dramatic measures that cut costs by 20

percent to 30 percent are frequently necessary – and, as a result of the economic crisis obvious to management, employees, and works council alike, they are easier to push through. In addition, many companies pay too little attention to the range of opportunities offered by a recession. These include generating new growth and making acquisitions in markets like Russia and China.

A critical success factor during a crisis is having a recession agenda that is tailored to the particular situation of the individual company. This agenda covers the levers of growth, costs, financing, transparency and control. It includes both short-term and long-term measures. A company that must react on a short-term basis should take action particularly in the areas of costs and finance – by introducing programs on working-capital optimization and strengthening the capital structure. Other short-term measures include intensifying marketing or selling company segments. The issue of strengthened cash flow and equity belong on the agenda of all companies at the moment. Within six months, cuts in fixed costs can take hold, lowering the break-even point. Programs to lower product costs and increase efficiency have a similarly fast impact. The introduction of processes and systems that improve the transparency and manageability of the company – in such areas as strategic risk management or key-figure controlling – usually take only several months to implement.

Thinking beyond acute crisis management

Long-term steps are recommended for companies whose existence is not immediately threatened. Optimizing manufacturing programs at production sites to meet customer needs will improve a company's strategic and cost positions. Developing new products and services as well as business models in the after-sales area will create consistent, margin-strengthening revenues that will be decoupled from traditional capital goods cycles. Such long-term measures extend beyond acute crisis management. They are an investment in strengthened competitiveness for future years.

The opportunities created by a recession also include tackling structural issues, an action that would be blocked by individual interest groups during normal times. In the face of increased pressure, employees, customers, partners and investors are more likely to accept forward-looking decisions. Because general forecasts about market developments are extremely volatile at the moment and are unreliable as a result, every company must develop its own crisis compass. For this reason, it is necessary for a company to take its own look at the relevant market and be prepared for alternate scenarios, particularly the worst-case situation. Even though tough times must be withstood, a company that operates shrewdly can emerge from the crisis as a winner in the end.

The recession's opportunities

Favorable acquisition conditions resulting from low company valuations

Prices for companies have plunged particularly in emerging countries – despite continued high growth potential, particularly in Russia and China.

Market adjustment caused by the elimination of competitors

The recession will drive financially some weak companies into bankruptcy. The remaining competitors will profit from their closure.

Lower individual cost factors

Falling prices for raw materials and moderate wage agreements remove pressure from the cost structure.

Sufficient time for action

In segments with longer project terms, order books remain full. This creates time for countermeasures.

Increased opportunities for tougher measures

An awareness for the crisis situation makes it easier to push through sweeping changes that would be difficult to approve during good times.

Immediate action on a recession agenda

Any company that energetically applies the levers of costs, growth, financing, transparency and control at the moment will enter the next upswing in a strengthened position.

Contact person

Pierre Deraëd
Head of Corporate Communications
Oliver Wyman
Marstallstraße 11
80539 Munich

Tel.: 089.939 49 599

Fax: 089.939 49 515

pierre.deraed@oliverwyman.com

www.oliverwyman.com/de

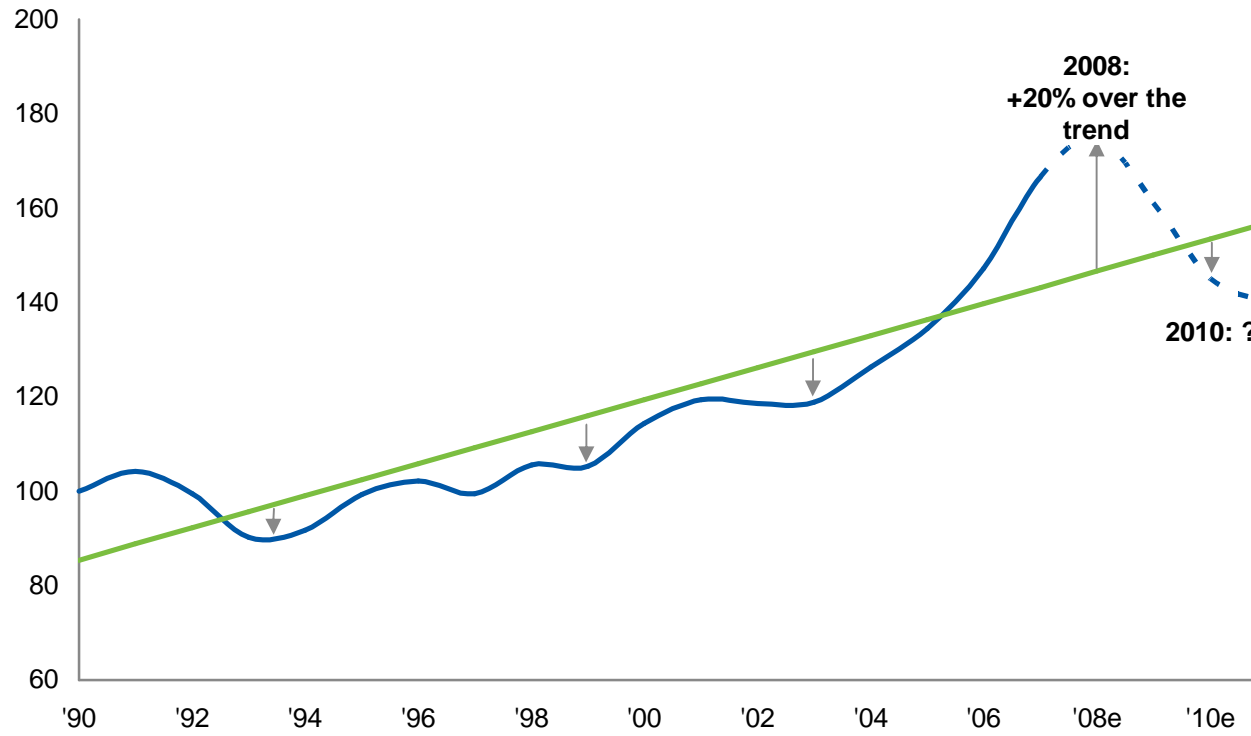
ABOUT OLIVER WYMAN

With more than 2,900 professionals in over 40 cities around the globe, Oliver Wyman is an international management consulting firm that combines deep industry knowledge with specialized expertise in strategy, operations, risk management, organizational transformation, and leadership development. The firm helps clients optimize their businesses, improve their operations and risk profile, and accelerate their organizational performance to seize the most attractive opportunities. Oliver Wyman is part of Marsh & McLennan Companies [NYSE: MMC]. For more information, visit www.oliverwyman.com.

Oliver Wyman is one of the leading strategy consulting firms in the German-speaking world as well, with above-average growth rates. At Oliver Wyman offices in Munich, Frankfurt, Duesseldorf, Hamburg, and Zurich, 560 employees work for leading companies from the following industries: automotive, retail, manufacturing, financial services, aerospace, mechanical and plant engineering, media, telecommunications, and transport. They are supported by a worldwide network of experts, allowing us to put together the best possible team for every assignment.

After years of above-average growth, a significant downturn seems possible

Example: production in German mechanical engineering
Index 1990 = 100

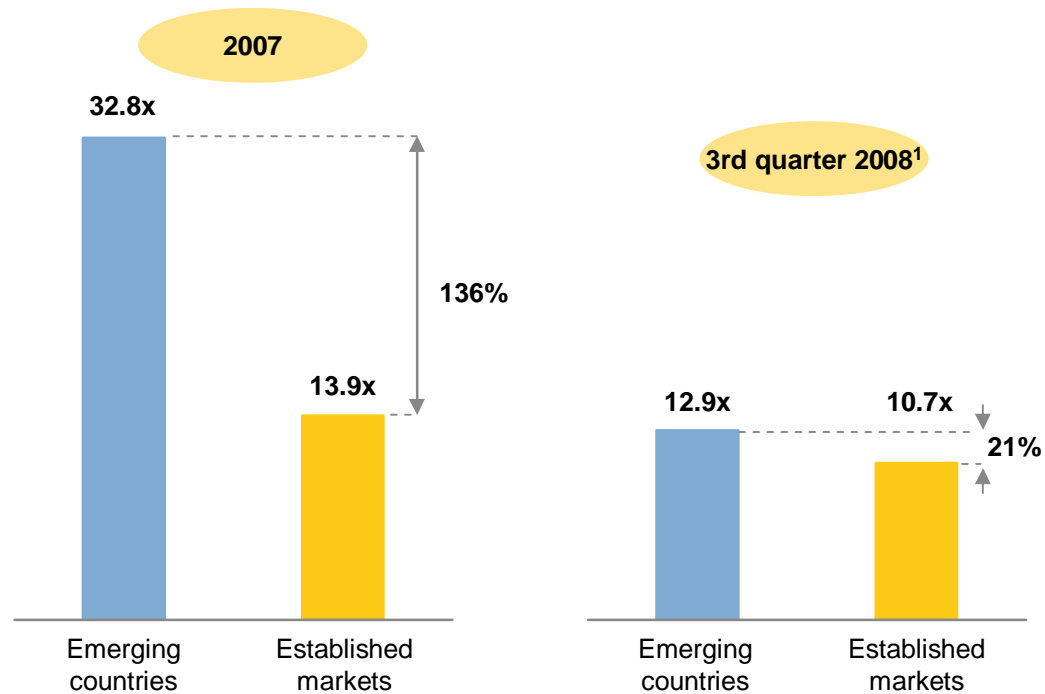


Source: German Engineering Federation (VDMA), Oliver Wyman

The crisis offers unique opportunities for acquiring competitors in emerging countries

Falling prices for company acquisitions

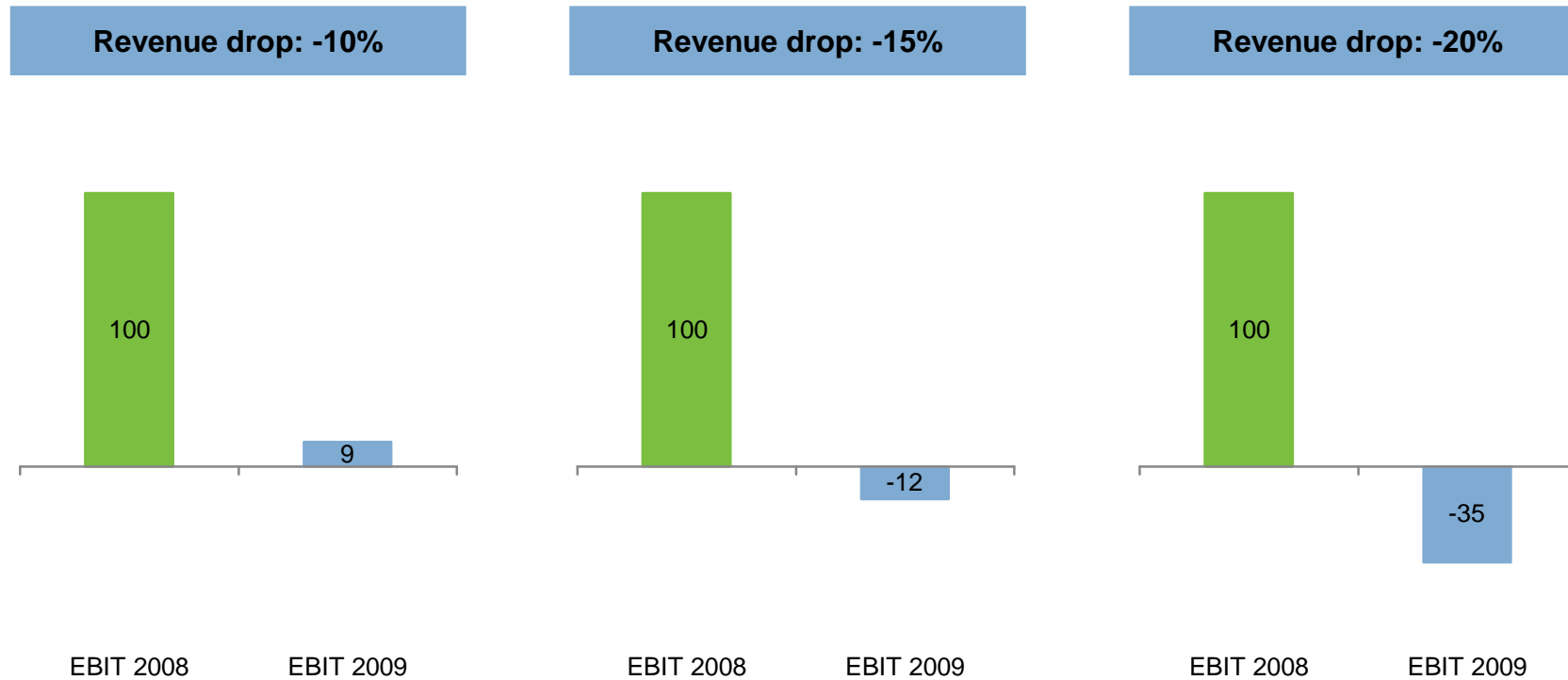
Price-earnings ratios¹ for agricultural and construction equipment



¹ Average of 120 listed companies, status: mid-September 2008

Without countermeasures, earnings are nearly consumed when revenue decreases by ten percent

Model calculation¹: earnings trends in yearly comparison when revenue declines
for illustrative purposes, actual EBIT = 100



¹ Assumptions: typical cost structure, rate of price increases (materials, personnel) of a manufacturing company

Cost structure: material costs 65%, personnel costs 20%, depreciation 5%, miscellaneous 5%

Rate of price increases: materials 5%, personnel 4%; positive effects: price increases 1%, CIP 2%

Variable factors: material costs and miscellaneous costs can vary by 100%, personnel costs by 30%; depreciation is completely fixed