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Solutions Exchange is developed by S&P Capital IQ's Solutions Architects, a separate and independent team at Standard & Poor's. The objective of this analysis is to gain greater insight into specific events and trends in the market using S&P Capital IQ data and analytics solutions.

U.K. Manufacturing: Standout Industries And Companies

Key Observations

- Specialist U.K. manufacturers outperformed the S&P U.K. Broad Market Index (BMI) Industrials Index from Feb. 9, 2011 to Feb. 8, 2012.
- This relative equity outperformance within the sector seems to be linked to the credit health of the companies as evidenced by financial metrics, quantitative credit scoring models, and probability of defaults, among other factors.
- Creditworthiness stress testing indicates outperformance may continue as a result of the companies' resilience to downturns in their financials.
- Earnings estimates for these niche manufacturers show signs of future growth.

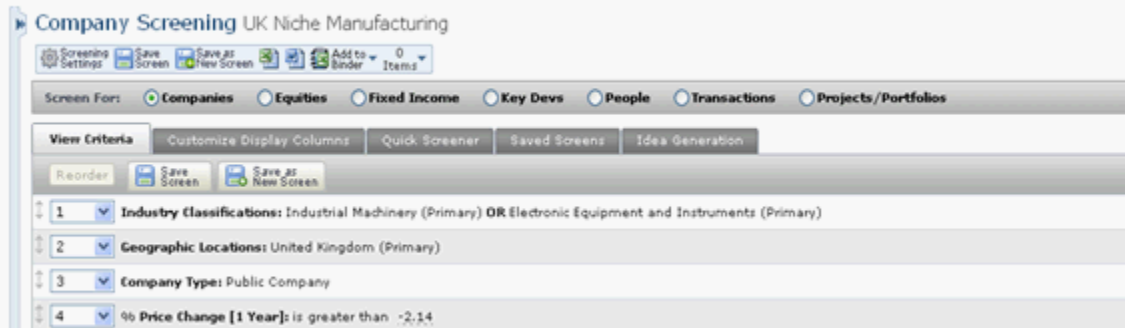
Building For The Future

It is no surprise that the U.K. manufacturing industry has declined steadily since the 1970s as manufacturers have tended to move their businesses to lower-cost countries over the last 40 years. The trade balance in the U.K. has been on a prolonged negative trend for a number of years. However, industrial production grew at a better-than-expected rate of 0.5% on a monthly basis in December 2011, with manufacturing output rising 1.0%, according to data from the U.K. Office for National Statistics. Given the positive manufacturing numbers, S&P Capital IQ's Solutions Architects team reviewed both equity and credit factors of the U.K. manufacturing sector to identify standout companies.

Screening For Standout Industrial Companies

Using S&P Capital IQ's company screening functionality (see figure 1), we looked for U.K. public manufacturing companies that outperformed their respective indices in 2011. We used the following filters in our search:

- Industries: Industrial Machinery and Electronic Equipment & Instruments (54,254 companies)
- Geography: U.K. (2,763 remaining)
- Status: Public (75 remaining)
- Returns: Outperform S&P U.K. BMI Industrials Index from Feb. 9, 2011, to Feb. 8, 2012 (29 remaining)

Figure 1: Company Screening: U.K. Manufacturing

Source: S&P Capital IQ company screener as of Feb. 20, 2012

We found that all 29 companies in our search results were niche manufacturers. For example, Halma PLC offers fire and smoke detectors, audible/visual warning devices, and elevator/lift safety sensors. Spectris PLC has a multi-niche production outlook, making instruments and data analysis machines for environmental monitoring. Both Rotork PLC and Spirax-Sarco PLC deal in steam control systems and valve actuators for controlling fluid flows from chemical and oil plants. The specialized nature of these products likely means that these companies experience lower levels of competition due to a small number of companies vying for the business. In addition, the products are generally necessities rather than discretionary items. IMI PLC, for example, produces engineering solutions for control and movement of fluids in critical applications to industrial pneumatic machinery for the rail and energy sectors.

Relative Health Analysis

Using S&P Capital IQ's Credit Health Panel (CHP), we assessed the credit health of each of the 29 companies in our search to see if and how credit health correlates to outperformance in the equity market. Figure 2 shows the overall results for the credit health analysis, which includes individual operational, solvency, and liquidity scores, along with a quantitative score from S&P Capital IQ's Credit Model (CM), which uses eight financial inputs to determine a quantitative creditworthiness score. CM scores provide a proxy-anchor to the rated universe, which helps to benchmark an unrated company to the rated universe.

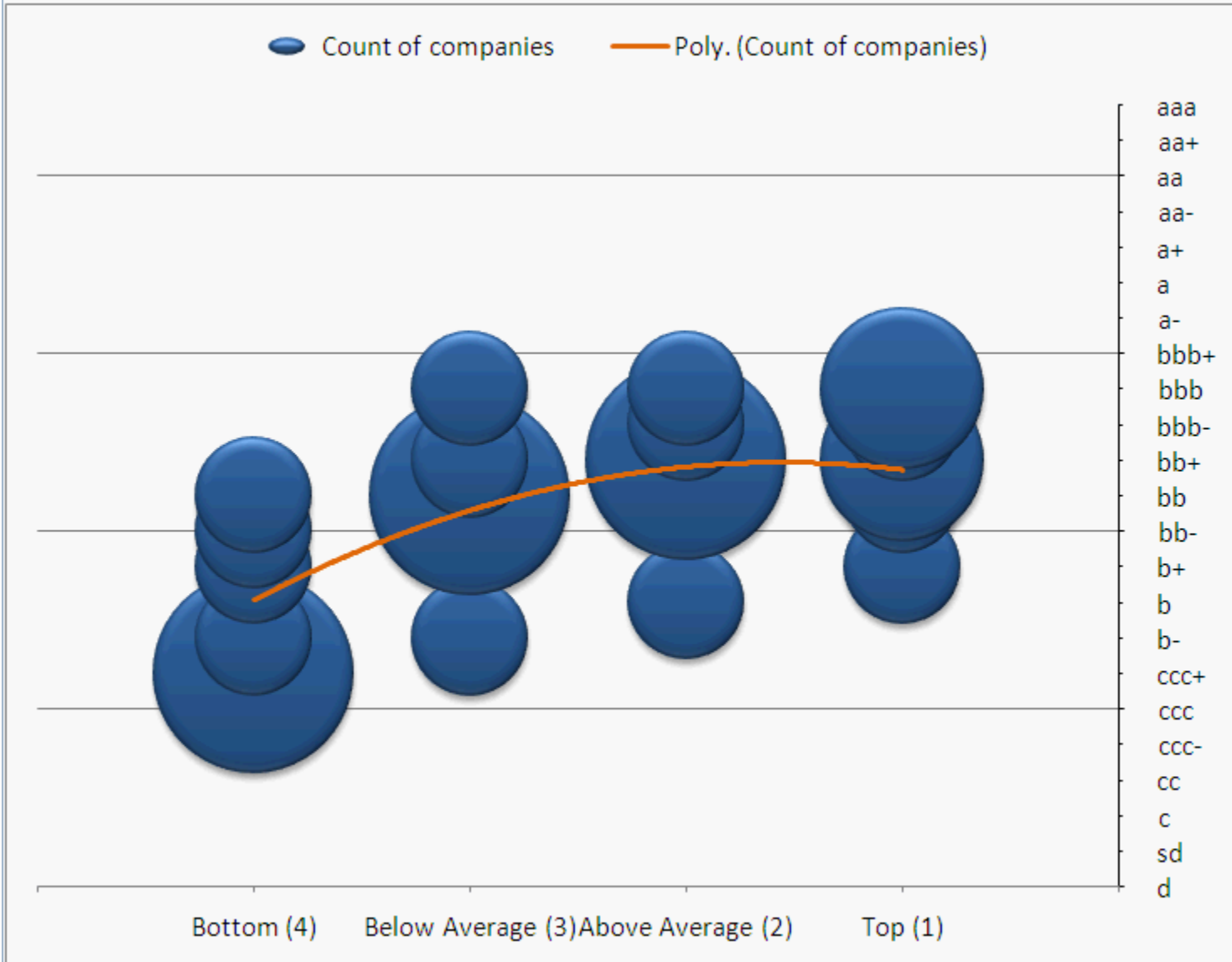
Figure 2: Industrials Credit Health Scores: 29 Filtered Companies

UK Industrials Total Companies: 29									
Company Name	Credit Health Panel Company Scores				LTM Perbd Exdg	Financial Update d	Foreign Long Term Rating	Credit Model Score	GICS Description
	Overall	Operational	Solvency	Liquidity					
Avingtrans PLC	4	4	4	4	31-May-2011	25-Dec-2011		bb-	Industrial Machinery
Croma Group PLC	4	4	4	4	30-Jun-2011	10-Dec-2011		b-	Electronic Equipment & Instruments
EZV Technologies PLC	4	2	4	3	30-Sep-2011	28-Nov-2011		bb	Electronic Equipment & Instruments
Fenner PLC	4	3	4	4	28-Feb-2011	25-Nov-2011		bb+	Industrial Machinery
Image Scan Holdings PLC	4	4	1	4	31-Mar-2011	20-Dec-2011		ccc+	Electronic Equipment & Instruments
JSJS Designs PLC	4	3	2	4	31-Mar-2011	10-Sep-2011		b	Electronic Equipment & Instruments
Pipehawk PLC	4	4	4	2	30-Jun-2011	24-Dec-2011		b-	Electronic Equipment & Instruments
Tanfield Group PLC	4	4	2	4	30-Jun-2011	28-Nov-2011		b-	Industrial Machinery
Melrose PLC	3	3	3	2	30-Jun-2011	24-Nov-2011		bb+	Industrial Machinery
Northbridge Industrial Services plc	3	3	3	2	30-Jun-2011	01-Dec-2011		bb+	Industrial Machinery
Quadnetics Group PLC	3	4	2	2	31-May-2011	28-Nov-2011		b	Electronic Equipment & Instruments
Senior PLC	3	2	3	3	30-Jun-2011	31-Dec-2011		bbb-	Industrial Machinery
The Morgan Crucible Company PLC	3	1	4	4	30-Jun-2011	24-Nov-2011		bb	Industrial Machinery
The Weir Group PLC	3	1	4	4	30-Jun-2011	24-Nov-2011		bbb+	Industrial Machinery
Tricorn Group plc	3	3	3	3	30-Sep-2011	13-Dec-2011		bb+	Industrial Machinery
Bodycote PLC	2	2	1	3	30-Jun-2011	25-Nov-2011		bbb-	Industrial Machinery
Halma Public Limited Company	2	2	2	3	30-Sep-2011	31-Dec-2011		bbb-	Electronic Equipment & Instruments
MI plc	2	1	3	3	30-Jun-2011	24-Nov-2011		bbb+	Industrial Machinery
Judges Scientific PLC	2	2	4	2	30-Jun-2011	13-Oct-2011		bbb-	Industrial Machinery
Molins Public Limited Company	2	4	3	1	30-Jun-2011	28-Nov-2011		bbb	Industrial Machinery
Oxford Instruments plc	2	2	3	2	30-Sep-2011	25-Nov-2011		bb+	Electronic Equipment & Instruments
T.F. & J.H. Braime (Holdings) P.L.C.	2	3	1	3	30-Jun-2011	08-Oct-2011		b+	Industrial Machinery
Castings Public Limited Company	1	3	1	1	30-Sep-2011	03-Dec-2011		bbb-	Industrial Machinery
LO-Q PLC	1	1	1	1	30-Apr-2011	01-Dec-2011		bb+	Electronic Equipment & Instruments
MS International PLC	1	2	2	1	31-Oct-2011	09-Dec-2011		bbb	Industrial Machinery
Robtrk P.L.C.	1	1	1	1	30-Jun-2011	28-Nov-2011		bbb+	Industrial Machinery
Sabien Technology Group PLC	1	4	1	1	30-Jun-2011	04-Dec-2011		bb-	Electronic Equipment & Instruments
Spectris PLC	1	1	2	2	30-Jun-2011	25-Nov-2011		bbb-	Electronic Equipment & Instruments
Spirax-Sarco Engineering PLC	1	1	2	1	30-Jun-2011	25-Nov-2011		bbb+	Industrial Machinery

Data as of Feb. 20, 2012. Source: Credit Health Panel, available on the Global Credit Portal

Analyzing the CHP rankings, we found that many of the companies in the top quartiles have an investment-grade CM score (an investment-grade proxy-anchor). Chart 1 illustrates the relationship between CHP rankings and CM scores. In general, the top two CHP categories correlate to an investment-grade CM score, while the bottom two CHP categories correlate to a speculative-grade CM score.

Chart 1: Correlation Between CHP And CM For Outperforming Companies



Source: S&P Capital IQ.

The correlation between the outperformance and credit health appears clear. As the CHP score increases, the CM score is also increasing for the outperforming companies. An overall above-average relative credit health score and a CM score proxy higher than 'bbb-' seems to have a positive relationship with equity outperformance.

Credit Analysis: Stress Testing

To further investigate these companies, we performed fundamental scenario stress tests. Using CM's sensitivity ranking, we can see how sensitive the CM score is to a change in each of the eight financial inputs. In our scenario stress test, we adjusted the CM inputs--the two most sensitive inputs for each company--to see how the score would change under base- and stress-case scenarios (see table 1).

Table 1

CM Scenario Stress Testing Parameters And Results							
	Rank of sensitivity 1	Rank of sensitivity 2	Current CM score	Base: -6%	Change (current to base)	Stress: -14%	Change (current to stress)
Bodycote PLC	Return on capital	Operating income (bef.D&A)/revenues	bbb-	bbb-	0	bbb-	0
Halma PLC	Return on capital	Total assets	bbb-	bbb-	0	bbb-	0
IMI PLC	Total assets	Operating income (bef.D&A)/revenues	bbb+	bbb+	0	bbb	-1
Judges Scientific PLC	Operating income (bef.D&A)/revenues	Return on capital	bbb-	bbb-	0	bbb-	0
Molins PLC	Return on capital	Operating income (bef.D&A)/revenues	bbb	bbb	0	bbb-	-1
Castings PLC	Cash flow from operating interest coverage	Operating income (bef.D&A)/revenues	bbb-	bbb-	0	bbb-	0
MS International PLC	Return on capital	Operating income (bef.D&A)/revenues	bbb	bbb-	-1	bbb-	-1
Rotork PLC	Operating income (bef.D&A)/revenues	Asset turnover	bbb+	bbb+	0	bbb	-1
Spectris PLC	Total assets	Operating income (bef.D&A)/revenues	bbb-	bbb-	0	bbb-	0
Spirax-Sarco Engineering PLC	Operating income (bef.D&A)/revenues	Total assets	bbb+	bbb	-1	bbb	-1

Based on S&P Capital IQ's Credit Model Sensitivity Analysis as of Feb. 20, 2012.

The base-case scenario lowers the CM score for two of the companies in our portfolio (MS International and Spirax-Sarco Engineering PLC) by one notch, while the stress scenario lowers the score for three more companies (IMI PLC, Molins PLC, and Rotork PLC) by one notch. This scenario analysis offers a better gauge of a company's ability to withstand periods of economic weakness. As this stress test uses 2011 financial results (many companies have not reported for 2012), the stress testing results complement the outperformance by seeing how strong the fundamentals were for each company during the outperformance.

While these 10 companies may be niche manufacturers based in the U.K., they all operate on a global scale. We created a global peer set, which shows relative credit health scores compared with global and domestic (initial) peers (see table 2). Although all 10 companies have relatively strong rankings--both globally and domestically--Casting PLC, Rotork PLC, Spectris PLC, and Spirax-Sarco Engineering PLC have top rankings in both categories.

Table 2

Credit Analysis Summary			
	CHP score for initial analysis	CHP score for global group (GICS)	CM score
Bodycote PLC	Above average	Above average	bbb-
Halma PLC	Above average	Above average	bbb-
IMI PLC	Above average	Top	bbb+
Judges Scientific PLC	Above average	Below average	bbb-
Molins PLC	Above average	Above average	bbb
Castings PLC	Top	Top	bbb-
MS International PLC	Top	Above average	bbb
Rotork PLC	Top	Top	bbb+
Spectris PLC	Top	Top	bbb-

Table 2

Credit Analysis Summary (cont.)			
Spirax-Sarco Engineering PLC	Top	Top	bbb+

Source: S&P Capital IQ's Credit Model and Credit Health Panel as of Feb. 20, 2012. GICS--Global Industry Classification Standards.

It seemed that Castings, Rotork, Spectris, and Spirax-Sarco, highlighted above, had the strongest correlations between outperformance, business strengths, and credit quality.

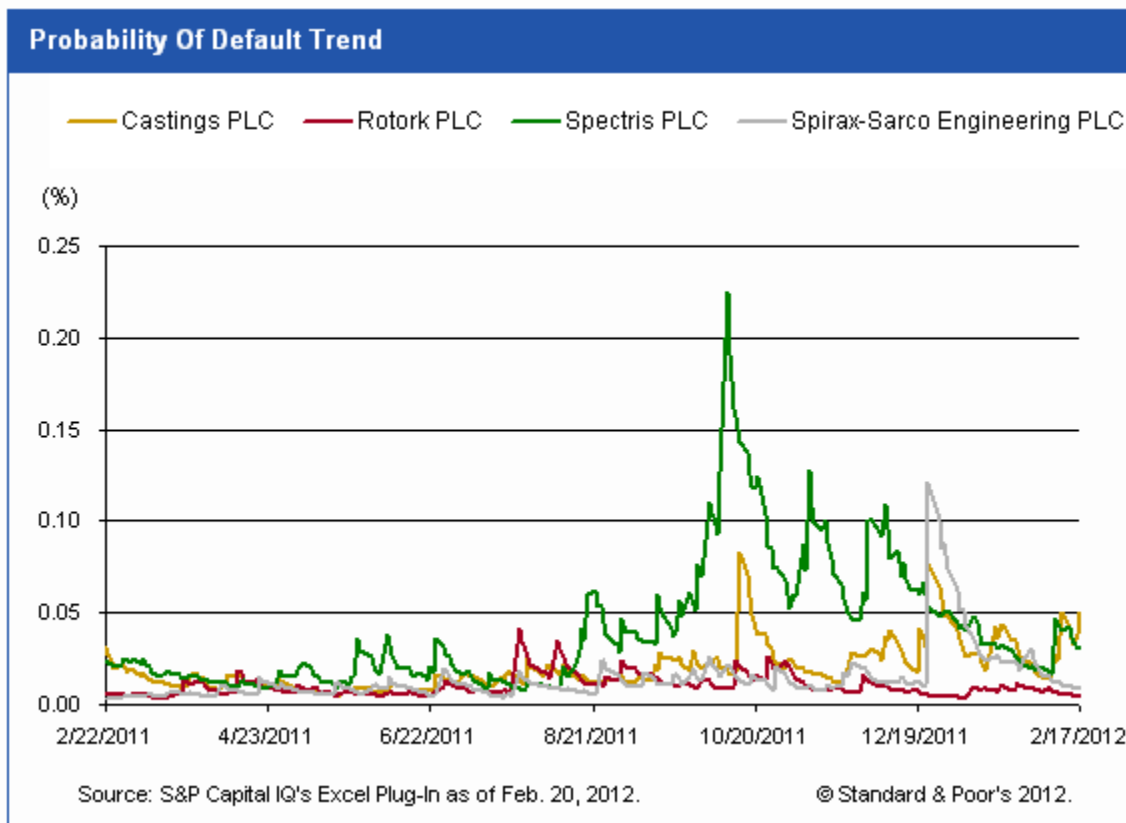
Credit Surveillance Triggers

After looking at these U.K. specialty manufacturers from a fundamentals-based point-in-time perspective, we wanted to include a surveillance trigger that could highlight any deterioration in credit quality between filing periods. As companies typically publish their financial statements per quarter or semi-annually, we used a daily probability of default (PD) with a distance-to-default-based methodology. By incorporating equity information into this model, S&P Capital IQ's Structural PD Model provides a market-based credit indicator that can be monitored regularly. We plotted the daily PD for our four remaining industrials (see chart 2). The PD for Spectris appeared to be more volatile than for the other three companies, while the PD was least volatile for Rotork.

Despite some relative volatility over the past five months, the PDs have generally remained within 0.01% to 0.13%. To put this in perspective, the U.K. industrial machinery industry has typically exhibited a 0.17% one-year default rate, as the S&P Capital IQ CreditPro tool shows.

Charting techniques that assess past performance to forecast future performance only contribute so much to an analysis. Future estimates help to provide a more balanced forecast.

Chart 2



Will These Companies Continue To Outperform?

S&P Capital IQ's analyst consensus recommendations can give us a better indication of what investors may be willing to pay for a company's shares. Table 3 shows the consensus recommendations for our four companies. Spectris and Spirax-Sarco both have "outperform" recommendations. Castings is the only entity with an outright "buy" recommendation, while Rotork lags with a "hold" recommendation.

The Intelligent Estimates Model employs a weighted consensus, whereas a conventional consensus equally weighs an analyst's estimates. Rather than focusing on the most historically accurate analyst, the Intelligent Estimate Model focuses on the attributes of an accurate forecast, including age of the estimate, broker size, forecast horizon, and tenure. For our analysis, we reviewed earning per share (EPS), dividends per share (DPS), and cash flow per share (CFPS) forecasts. The payoff between these metrics is a good indication of future growth and profitability of a company. When CFPS exceeds EPS, the company has grown shareholders' wealth over time. Because EPS alone does not give the full picture, the CFPS helps to ascertain the sustainability of the business model. Finally, DPS reflects management's belief in the company's unremitting growth.

Under this hypothesis, all companies show an upward trend in estimated DPS, showing possible signs of management confidence in future growth. IMI, Spectris, and Spirax-Sarco's future estimates show upward trends for EPS and CFPS, with higher CFPS, providing positive signs for future growth. Rotork, however, has lower 2012 forecasts for CFPS than EPS, but converse forecasts for 2013. Therefore, from our quick investigation on future growth, we found that our niche industrial companies show potential for future growth, with Castings leading the change.

Table 3: Recommendations & Intelligent Estimates Surprises / Predictions

			Intelligent Estimates Predictive Surprises / Forecasts					
Consensus Recommendation (Where 1 = Buy, 5 =			2008	2009	2010	2011	2012	2013
Castings PLC	1 - Buy	EPS (GAAP)	-	0.036 E	0.042 E	0.052 E	-	-
		DPS	-	0.060 E	0.050 E	0.105 E	0.114 E	0.119 E
		CFPS	-	-	-	-	-	-
Rotork PLC	2.53 - Hold	EPS (GAAP)	0.542 E	0.709 E	0.797 E	0.943 E	1.015 E	1.152 E
		DPS	0.230 E	0.290 E	0.464 E	0.566 E	0.393 E	0.416 E
		CFPS	0.882 E	0.733 E	0.774 E	0.688 E	0.915 E	1.175 E
Spectris PLC	1.73 - Outperform	EPS (GAAP)	0.664 E	0.249 E	0.723 E	1.141 E	1.192 E	1.323 E
		DPS	0.240 E	0.234 E	0.270 E	0.322 E	0.346 E	0.420 E
		CFPS	0.815 E	0.391 E	0.847 E	0.860 E	1.320 E	1.553 E
Spirax-Sarco Engineering PLC	2.36 - Outperform	EPS (GAAP)	0.770 E	0.660 E	1.129 E	1.190 E	1.210 E	1.280 E
		DPS	0.335 E	0.350 E	0.422 E	0.598 E	0.768 E	0.820 E
		CFPS	-	0.515 E	1.022 E	1.070 E	1.420 E	1.460 E

Note 1: Cells shaded in red or green illustrate metrics that have a predictive surprise less than -5% and greater than 5%, respectively. Within this range, the CIQ Intelligent Estimate is 58% better at predicting international surprises. Within this range, the CIQ Intelligent estimate is 58% better at predicting international surprises.

Note 2: Casting PLC's CFPS and post-2011 forecasts for EPS are unavailable.

Note 3: GAAP--Generally Accepted Accounting Principles.

Note 4: Source: S&P Capital IQ's Estimates & Intelligent Estimates as of Feb. 16, 2012.

Conclusion: Combining The Consensus

Our initial screen recognized 29 companies that outperformed the S&P U.K. BMI Industrials Index from February 2011 through February 2012. Further credit analysis showed that many of these companies' credit strength correlated to this outperformance. Four companies had particularly sound financials compared with their domestic and global peers, showed resilience in their quantitative creditworthiness when placed under scenario stress testing, and had moderating PDs, providing additional information on the companies' ability to meet financial obligations during the period in question. Matching equity and credit performance is indicative of a well-managed company that focuses on all areas of financial performance.

From our hypothesis, the success of the entities may also be attributed to the specialist nature of their businesses, in which they show the potential to thrive in their niche markets. Furthermore, Intelligent Estimate forecasts of the four companies' EPS, DPS, and CFPS show good potential for future growth.

On Feb. 15, 2012, the Bank of England said that "The path of recovery is likely to be slow and uncertain." Amid this gloomy outlook, through our research above, we have identified that specialist U.K. manufacturers continue to appear to outperform.

The Tool Set

To perform the analysis in this article, we used the following S&P Capital IQ solutions:

Global Credit Portal

Standard & Poor's RatingsDirect on the Global Credit Portal provides real-time access to integrated credit research, market information, and risk analytics. This dynamic Web-based platform leverages the latest content and technology to give subscribers the actionable credit market intelligence needed to help assess exposure and capitalize on investment opportunities.

S&P Capital IQ Platform

S&P Capital IQ offers the highest quality information on both public and private capital markets along with powerful applications for desktop research, screening, real-time market data, backtesting, portfolio management, financial modeling, quantitative analysis, and more. Our product suite empowers the world's leading financial professionals to identify investment opportunities, draw unique insights, and increase returns.

CreditModel

CreditModel is a Web-based suite of 46 industry models that use financial statement information to estimate the credit quality of publicly traded and privately owned mid-cap and large corporations. A rigorous, segment-focused modeling approach that uses a unique series of newly retrained region- and industry-specific models based on the Global Industry Classification Standard (GICS). Efficient access to estimates of creditworthiness ("credit scores") for over 50,000 companies in a pre-scored database. The scores are represented by familiar Standard & Poor's letter grade rating symbols using lowercase to indicate they are quantitatively derived. Flexibility to quickly derive scores on additional companies by simply entering key financial ratios into the CreditModel engine. A glimpse into the future with sensitivity analysis and stress testing capabilities to evaluate the impact of changes in inputs to stimulate upgrades, downgrades, and resilience. The models are rigorously validated, and credit model scores demonstrate a very high correlation with Standard & Poor's credit ratings.

Intelligent Estimate

The Intelligent Estimate is a forecast based on individual S&P Capital IQ earnings estimates for each stock, which are then weighted according to the following key attributes: the age of the estimate, the size of the issuing brokerage firm, proximity to the reporting date, and period of time for which the analyst has covered the stock.

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