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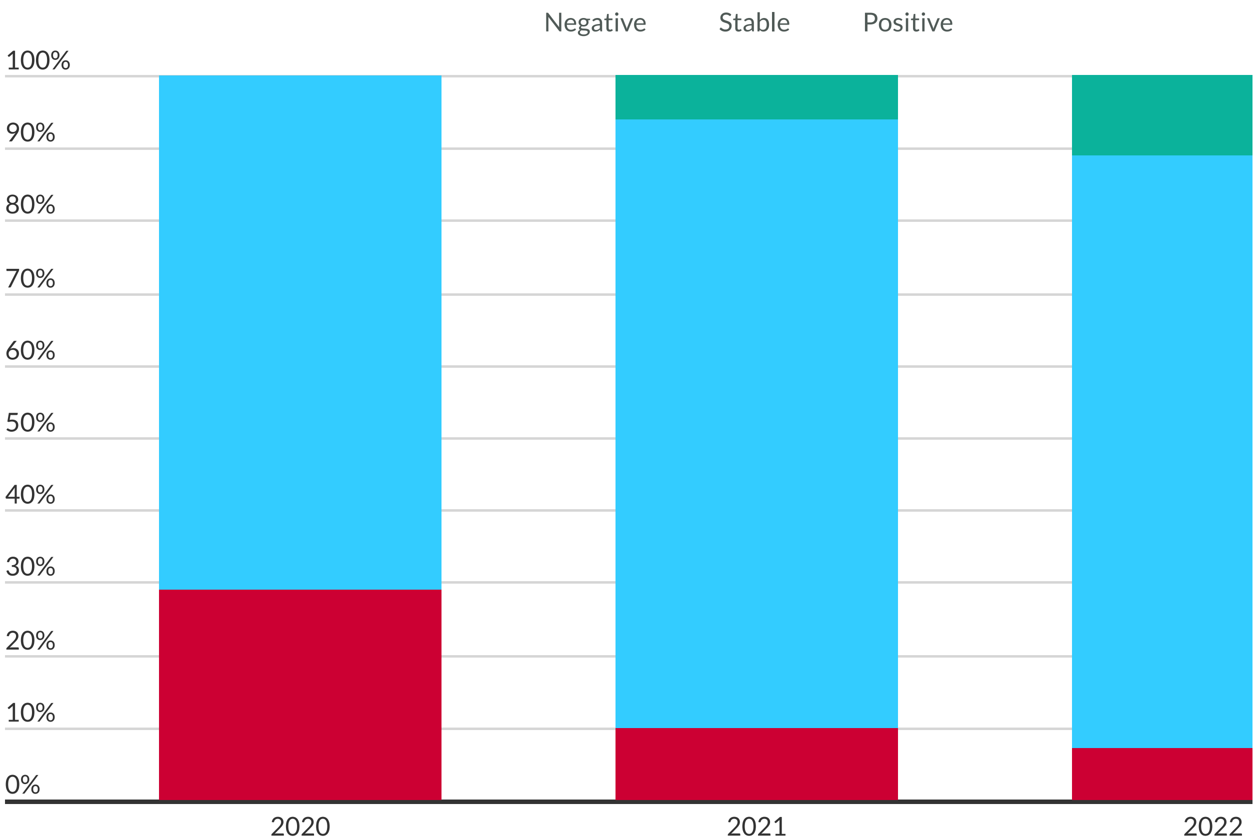
Neutral US Diversified Industrials & Mfg. Sector Outlook for 2023

Thu 01 Dec, 2022 - 3:14 PM ET

Related Content: U.S. Diversified Industrials and Capital Goods Outlook 2023

Fitch Ratings-Chicago/New York/Toronto-01 December 2022: The US Diversified Industrials and Manufacturing sector outlook is neutral for 2023, as high order backlogs, easing supply chain pressures and margin tailwinds from recent price increases offset weaker macroeconomic growth, Fitch Ratings says. Ratings across the sector consider cyclicality and generally should withstand a moderate downturn. Most of our portfolio has a Stable Rating Outlook; however, Positive Outlooks outnumber Negatives, largely due to improving FCF and declining leverage.

US Diversified Industrials and Capital Goods - Rating Outlooks



Source: Fitch Ratings.

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Pent-up demand has driven solid orders through 3Q22 for most issuers, which should support mid-single digit sector revenue growth next year. Companies aligned with secular growth trends, including increasing electrification and use of digital technology, should outperform over the near to medium term. Still, some pockets of weakness have emerged in certain end markets, such as residential construction. Other demand risks include China's Zero Covid policy, the Ukraine war and capital spending.

We expect sector EBITDA margins to improve by more than 100bps in 2022 and remain stable thereafter. Slower international trade growth in 2023 and the strong US dollar will likely shift the mix of revenue to the US and dampen margins. Positively, international shipping capacity is returning toward normal levels, which should alleviate high freight costs and long lead times in the supply chain.

FCF margins should improve to 6% in 2023 from our 4.7% 2022 forecast, supporting continued de-leveraging. Working capital has pressured cash flow since the pandemic began but should begin to reverse in 2023. A gradual normalization of inventory days should boost sector cash flows. Inventory levels are unusually high, largely due to products waiting on components for completion and companies holding higher a safety stock of key raw materials. While the risk of inventory obsolescence risk is limited, an unexpectedly sharp economic downturn could cause write-offs.

US Diversified Industrials and Capital Go Credit Metrics

F - Forecast
Source: Fitch Ratings, Fitch Solutions.

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