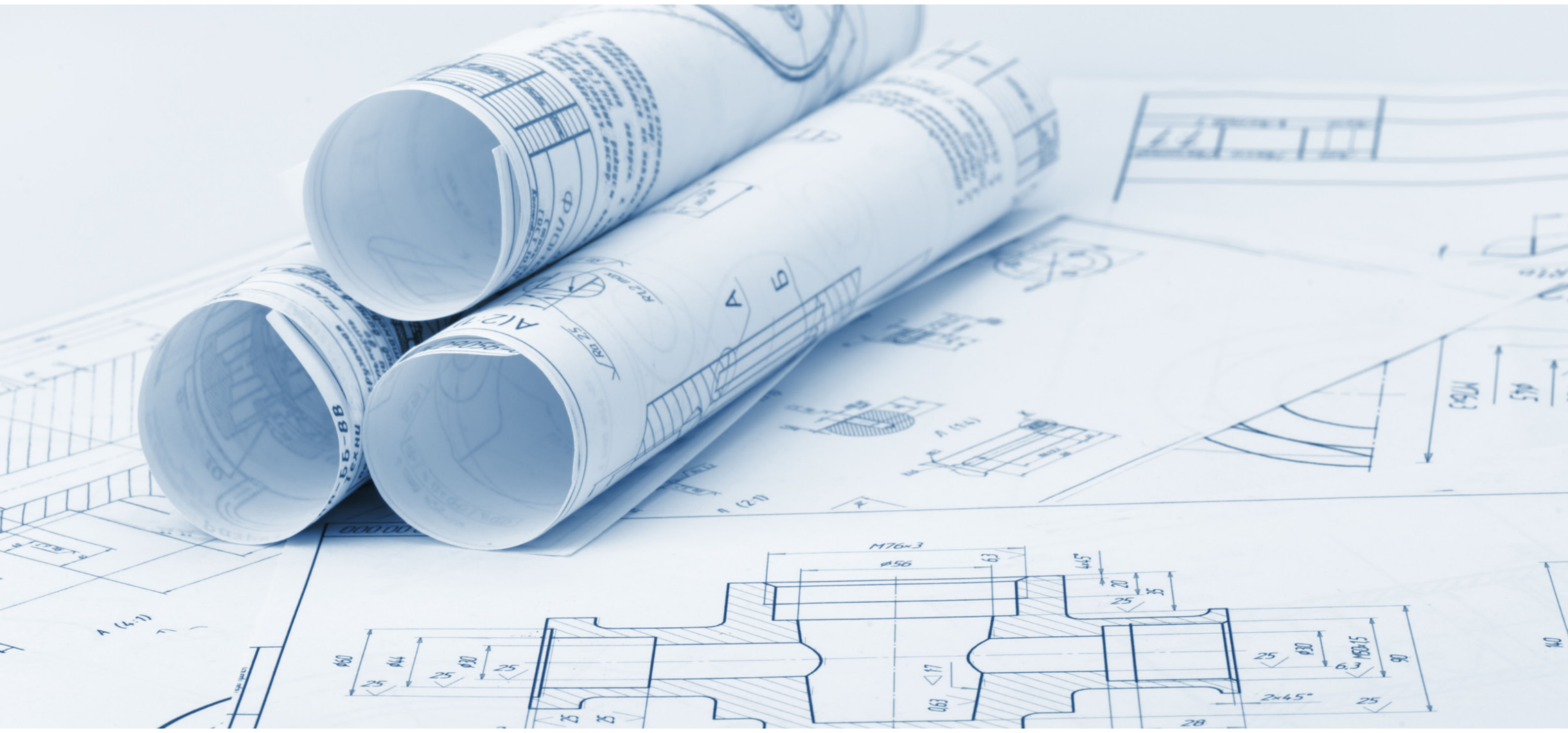

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Global Capex: Where Are We Now?

OVERVIEW

- **Crescendo.** Cuts to commodity-related capex have reached a crescendo. We were already pessimistic about the broader capex outlook because of likely retrenchment in this area, but the severity of recent cuts has been remarkable. We estimate that global oil and gas capex fell by 24% in 2015 and will shrink a further 15% this year. Metals and mining capex appears to have fallen by22% in 2015 and is likely to drop by another 20% this year.
- **Diminuendo.** Global capex spending continues to contract as a result. On current estimates it fell 10% in 2015, and is likely to shrink by a further 4% this year and 2% next. If these projections are realized, the real term value of global corporate capex in 2017 will have slipped back to where it was in 2006. Forecast momentum also remains poor. Of the 32 companies in our Global Capex 2000 universe that were expected to invest more than $10bn in 2016, 25 have seen estimated spending fall in the past six months. Their total expected capex outlay has fallen by $58bn from $549bn to $491bn.
- **Counterpoint.** One crumb of comfort is that capex growth excluding energy and materials remains likely to return to positive growth (+2%) this year. Capex expansion is expected in the IT, consumer discretionary (autos and media) and health care sectors. But, taken as a whole, this is thin gruel given renewed concerns about the fragility of the global economy and questions about the efficacy of central bank efforts to trigger investment.
- **Discord.** Why is capex still so weak? In addition to the slump in commodity capex, global overcapacity remains a problem for industries such as steel and shipping. More broadly, poor revenue and EBITDA trends explain much of the paucity of capex growth.

A CRESCENDO OF COMMODITY CAPEX CUTS

Shrinking commodity capex means global capex is likely to have fallen 10% in 2015 and to fall by 4% in 2016

The commodity capex crunch reached a crescendo in the 2015 results season, with the announcement of further large-scale cuts to capital spending in the energy and materials sectors. Our pessimism regarding the corporate capex[1] outlook is founded on the weak prospects for commodity-related capital investment but, even so, the scale of recent cutbacks has been remarkable. It warrants an interim update of our capex projections to determine the scale of the damage and to assess what remains of the modest improvement apparent six months ago in non-commodity sectors.

Our latest estimates suggest that inflation-adjusted global corporate capex fell by around 10% in 2015, matching the slump in capex that occurred during the depths of the global financial crisis in 2009 (see Chart 1). The outlook for 2016 and 2017 remains poor, with projected contractions of 4% and 2%, respectively. Excluding energy and materials (see Chart 2), the scale of 2015 cuts is less severe at 2%, and current projections suggest growth will return to positive territory in 2016 (+2%). That global non-commodity capex is expected to grow this year is encouraging news but this is thin gruel for a global economy struggling to maintain upward momentum.

GLOBAL CORPORATE CAPEX CONTINUES TO FALTER WITH LITTLE SIGN OF POSITIVE MOMENTUM

CHART 1 | GLOBAL NON-FINANCIAL CAPEX GROWTH

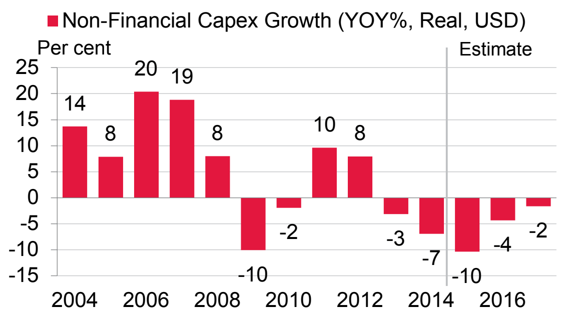


CHART 2 | GLOBAL NON-FINANCIAL CAPEX GROWTH EX ENERGY AND MATERIALS

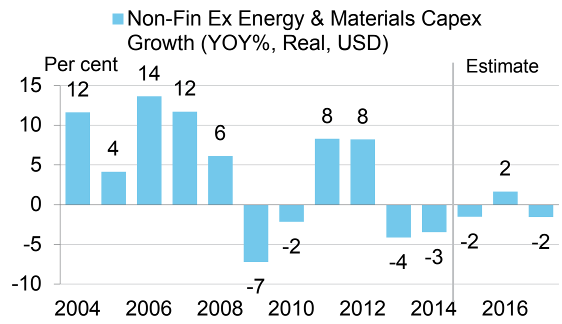


CHART 3 | GLOBAL NON-FINANCIAL CAPEX VALUE

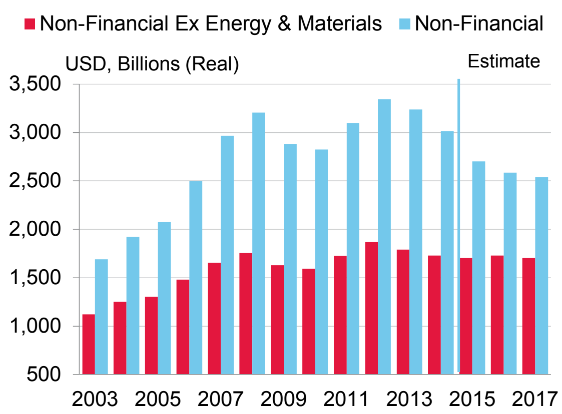
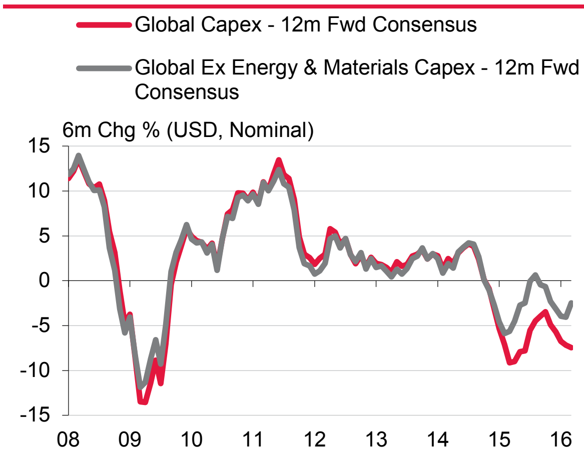


CHART 4 | | GLOBAL NON-FINANCIAL CORPORATE CAPEX CONSENSUS FORECAST REVISIONS



Source: S&P Global Market Intelligence, Standard &Poor's Ratings calculations, IMF. Universe is Global Capex 2000. Data calculated on March 4, 2016.

The picture in level terms is no more comforting. On current estimates, the inflation-adjusted value of global corporate capex in 2017 will have dropped back to where it was

[1] See 'Global Corporate Capital Expenditure Survey 2015', August 3, 2015 on Ratings Direct

in 2006 (see Chart 3). The decline is less pronounced if energy and materials companies are excluded, but, even on this basis, annual capital spending is more or less where it was a decade ago. Moreover, there is little sign of trends changing. Consensus-forecast momentum remains negative and has actually deteriorated in the past six months (see Chart 4). This is true both including and excluding commodity capex. The positive six-month forecast momentum for non-financials ex energy and materials that we highlighted at the time of our last annual survey faltered in the latter part of last year. One crumb of comfort is that the decline here is levelling off.

2016 CAPEX FORECASTS CUT FOR MOST OF THE BIG SPENDERS

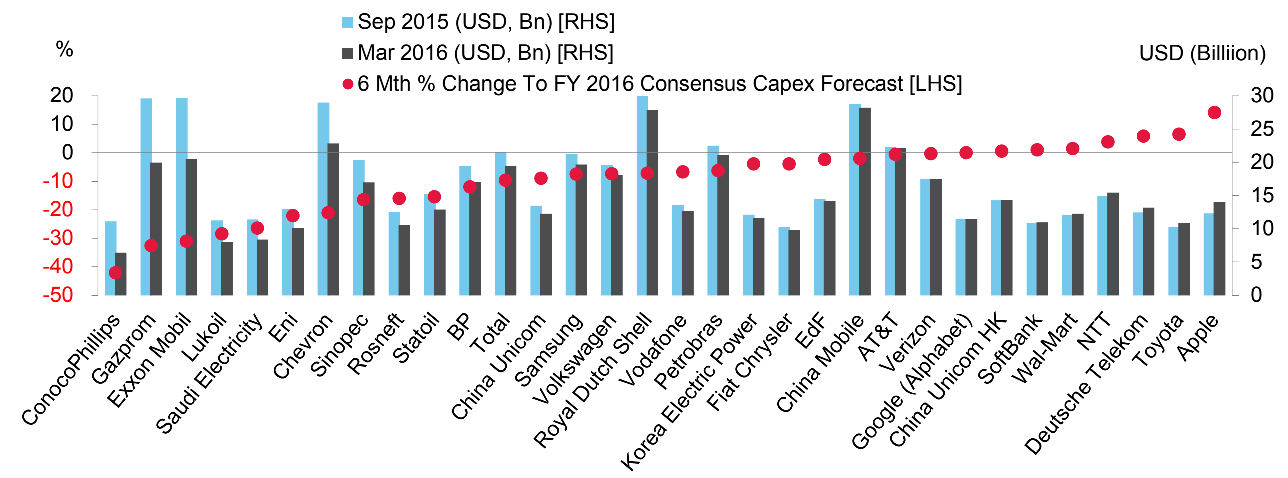
Big capex spenders have seen 2016 capex estimates fall by US$ 58 billion in six months

As one would expect, based on the 2015 results season so far, cuts to commodity capex have done much – although not all – of the damage to hopes for a recovery in non-financial corporate investment. Chart 5 shows how consensus capex expectations have shifted over the past six months for some of the biggest global corporate capex spenders, those who – six months ago – were expected to spend more than 10 billion U.S. dollars on fixed investment in 2016.

Investment intentions have deteriorated in the great majority of cases, with 25 out of 32 global capex leaders seeing 2016 forecasts cut in the past six months. Eleven companies have seen double-digit percentage cuts to forecasts and of these nine are from the energy sector. In nominal terms, the big capex spenders have seen expected 2016 spending fall by $58bn from $549bn to $491bn. The picture is not entirely gloomy, however. Apple, Toyota, Deutsche Telekom, NTT, Walmart, Softbank and China Unicom (HK) are big capex spenders that have seen estimates for 2016 capex rise.

MOST BIG CAPEX SPENDERS HAVE GUIDED TO LOWER EXPECTED OUTLAYS IN 2016

CHART 5 | CHANGES TO EXPECTED 2016 CAPEX FOR THE LARGEST CORPORATE SPENDERS OVER THE LAST SIX MONTHS



S&P Global Market Intelligence, Standard &Poor's Ratings calculations. Data calculated on March 4, 2016.

Chart shows the percentage change to CIQ Consensus Capex for FY 2016 between September 2015 and March 2016, and the underlying nominal values in billions of U.S. Dollars converted at current rates. The companies shown are those where expected capex for 2016 exceeded $10bn in September 2015.

Given the pivotal role commodity capex has played in this deterioration, the critical question remains: where are we in the commodity capex cycle? Has the marked acceleration in the pace of cuts in recent months moved us nearer the end of the downswing? We now estimate that the oil and gas companies in our Global Capex 2000 universe cut their capex by nearly a quarter (24%) in 2015, with a further 15% reduction slated for 2016 (see Chart 6). The magnitudes in metals and mining are similar, with a 22% capex decline in 2015 and a further 20% cut expected this year (see Chart 7). These cuts are far more severe than our August 2015 survey suggested, and point to the extreme urgency with which commodity-related companies are addressing the pressures on cash flow created by slumping prices and global overcapacity.

The oil and gas capex cycle appears closer to bottoming out than metals and mining

There does appear to be evidence that the oil and gas sector may be nearer the bottom of the investment cycle, with the decline in projected capex expected to level-off this year and rise slightly in 2017 (see Chart 8). For metals and mining, substantial cuts are expected to persist into next year (see Chart 9) with little sign that capex levels are stabilizing. This may reflect the greater reliance for metals and mining companies on Chinese consumption at a time when that economy is attempting to transition away from investment-driven growth. Oil and gas have a broader geographic demand base and the steady improvement still apparent in developed markets may be underpinning consumption and the longer-term need to replenish oil reserves, however difficult the immediate environment is for higher-cost producers.

THE COMMODITY CAPEX SLUMP CONTINUES; OIL AND GAS APPEARS NEARER THE END THAN METALS AND MINING

CHART 6 | GLOBAL OIL AND GAS CAPEX GROWTH

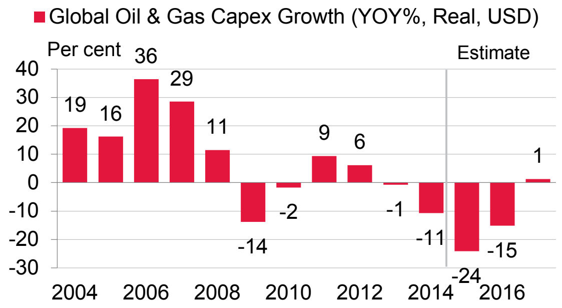


CHART 7 | GLOBAL METALS AND MINING CAPEX GROWTH

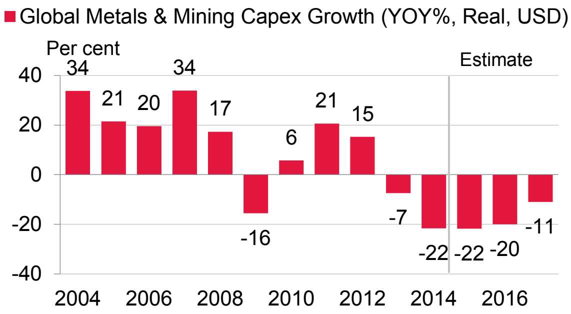


CHART 8 | GLOBAL OIL AND GAS CAPEX VALUE

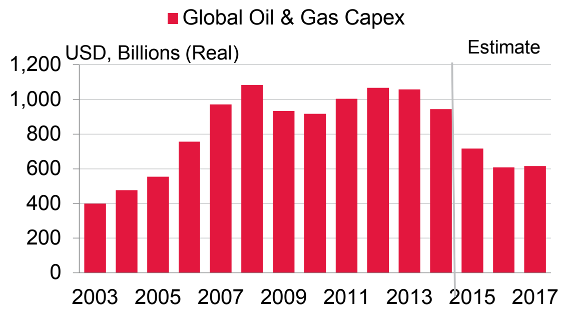
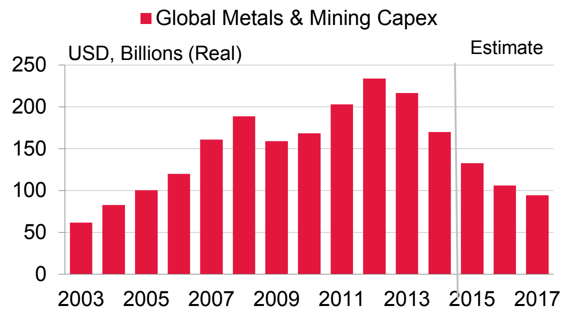


CHART 9 | GLOBAL METALS AND MINING CAPEX VALUE



S&P Global Market Intelligence, Standard &Poor's Ratings calculations, IMF. Universe is Global Capex 2000. Data calculated on March 4, 2016.

The continued importance of commodity capex can be seen both in terms of its share of overall corporate capex (see Chart 10) and in its contribution to overall capex growth (see Chart 11). Even as recently as 2014, global energy capex accounted for one third of total corporate capex. The dramatic cuts seen since then and expected over the next two years are likely to take this share down to 25% in 2017. This is a major retrenchment – from one- third to one-quarter – but, nevertheless, energy will remain the first-ranked sector globally in terms of the total value of its capex. Its importance to overall capex growth rates remains undiminished.

This is made explicit in the contribution analysis, which breaks down overall capex growth into its sector components. The falls in global corporate capex from 2014-2016 are explained almost entirely by falling energy and materials investment.

DECLINE IN GLOBAL CORPORATE CAPEX (10% 2015, 4% IN 2016) DRIVEN BY ONGOING COMMODITY CUTS

CHART 10 | SHARE OF GLOBAL CORPORATE CAPEX BY SECTOR

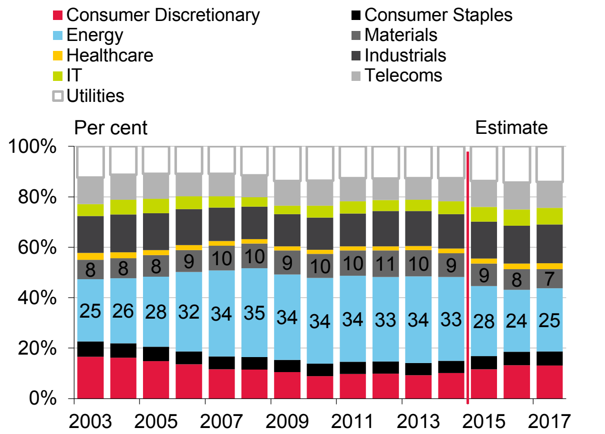
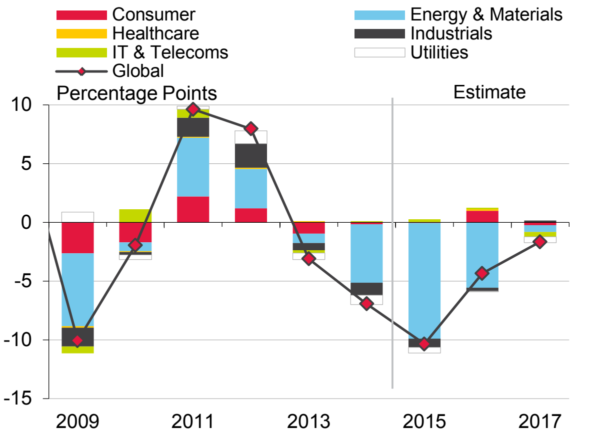


CHART 11 | CONTRIBUTION TO GLOBAL NON-FINANCIAL CAPEX GROWTH BY SECTOR



SOME SECTORS ARE INVESTING MORE – IT, AUTOS, HEALTHCARE

CHART 12 | GLOBAL CAPEX GROWTH BY SECTOR 2015-16 AND LONG-TERM COMPOUND GROWTH

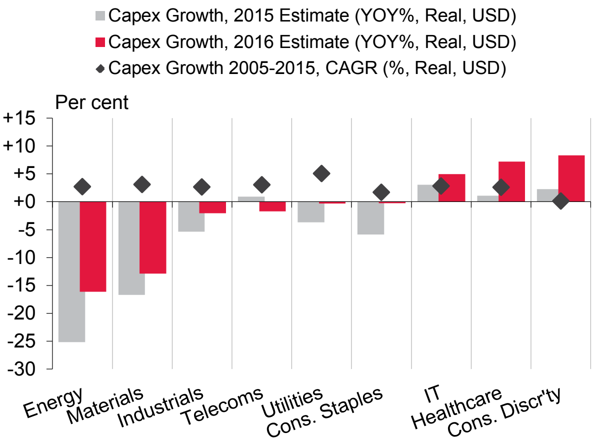


CHART 13 | CONTRIBUTION BY SECTOR TO GLOBAL NON-FINANCIAL CAPEX GROWTH EXCLUDING ENERGY AND MATERIALS

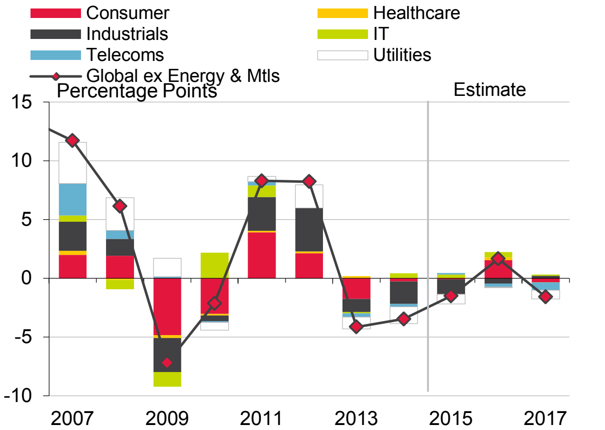
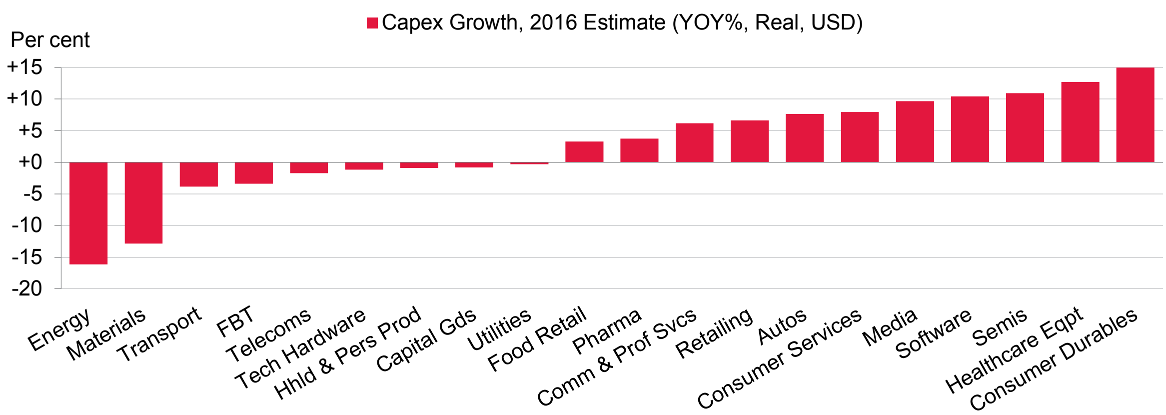


CHART 14 | GLOBAL CAPEX GROWTH BY INDUSTRY GROUP IN 2016



S&P Global Market Intelligence, Standard &Poor's Ratings calculations, IMF. Universe is Global Capex 2000. Data calculated on March 4, 2016.

There are some sectors that are still expected to increase capex in 2016, namely consumer discretionary, health care and IT (see Chart 12). Improvements here – along with less pronounced declines in industrial and utility capex – are the key drivers of the 2% increase in capex expected from non-commodity sectors (see Chart 13). Looking at prospective growth for the component industry groups (see Chart 14) reveals a broader and more encouraging picture of health with a majority of industries projected to raise capex this year. That this does not translate to a better overall trend reflects the relative size of capex by industry; those expected to cut capex are amongst the largest spenders.

The continuing weakness in aggregate capex is a global phenomenon. All regions saw corporate capex contract in 2015 (see Chart 15), and only Japan – a country with less commodity exposure – is expected to see growth in 2016. Consensus capex forecast trends duplicate this pattern (see Chart 16), with forecasts still falling for all regions bar Japan. Revision trends remain notably poor in Latin America, reflecting that regions significant exposure to weakness in commodities and China's moderating rate of economic growth.

CAPEX WEAKNESS IS A GLOBAL TREND

CHART 15 | CONTRIBUTION TO GLOBAL NON-FINANCIAL CAPEX GROWTH BY REGION

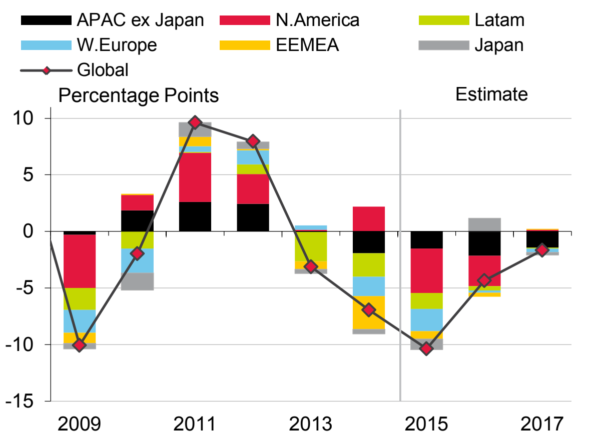
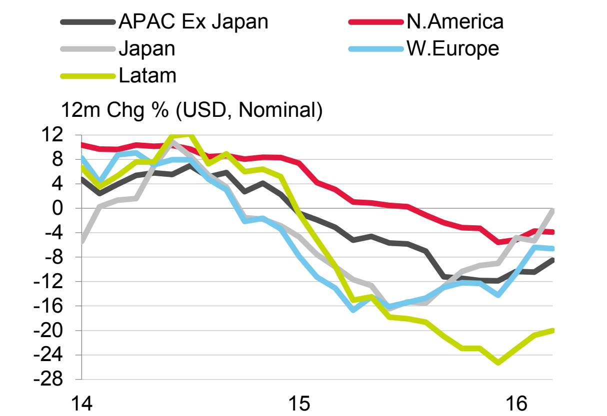


CHART 16 | GLOBAL NON-FINANCIAL EX ENERGY AND MATERIALS CORPORATE CAPEX CONSENSUS FORECAST REVISIONS BY REGION



WEAK OPERATIONAL PERFORMANCE REMAINS A KEY CONSTRAINT

CHART 17 | GLOBAL NON-FINANCIAL CORPORATE SALES, EBITDA AND CAPEX GROWTH

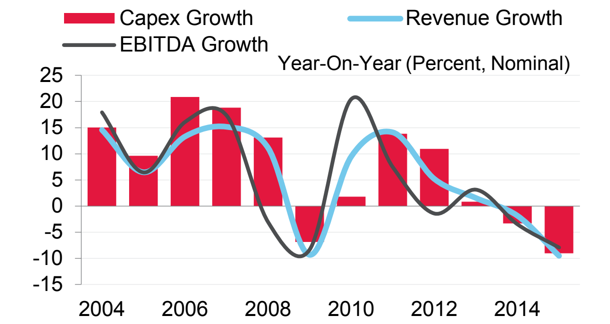
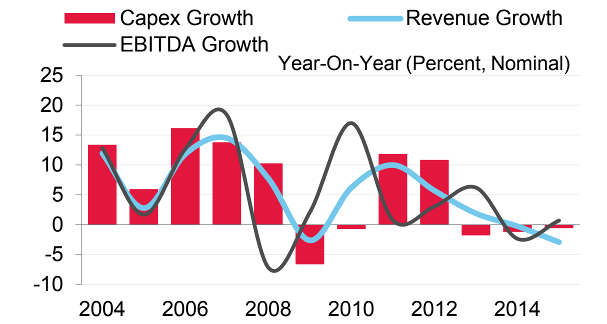


CHART 18 | GLOBAL NON-FINANCIAL EX ENERGY AND MATERIALS CORPORATE SALES, EBITDA AND CAPEX GROWTH



S&P Global Market Intelligence, Standard &Poor's Ratings calculations, IMF. Universe is Global Capex 2000. Data calculated on March 4, 2016.

The perennial question persists: why is corporate capex still so weak despite near zero interest rates in the largest economies and plentiful corporate cash balances? Part of the answer remains the issue have highlighted in our three annual surveys since 2013 – falling commodity capex inevitably drags overall corporate capex lower given the sheer weight of this spending as a share of the total. Until the commodity capex cycle has bottomed out, prospects for broader improvement are slim. Our updated figures suggest that the oil and gas sector might be approaching this point by 2017, but the adjustment may take longer for metals and mining.

Global overcapacity in a number of industries that had geared up for China's investment-led growth is another important constraining factor for prospective capex – notably for shipping and steel. The simplest explanation though is that operational performance is still unusually weak for this stage of the economic cycle, both including and excluding the commodity sectors. Capex growth appears well-correlated with revenue and EBITDA growth (see Charts 17 and 18) and poor results in 2015 – notably in terms of top-line growth – and growing uncertainty around prospects for 2016, suggest little grounds for optimism for capex in the near term.

RELATED RESEARCH

- **Global Corporate Capital Expenditure Survey 2015**, August 3, 2015
- **Lower Oil Prices Mean Less Spending For The U.S. Exploration And Production Sector, But Not Less Production**, June 30, 2015
- **Russian Companies Cut Back On Capital Spending As Debt Market Shutters Fall, But Longer Term Risks Emerge**, June 15, 2015
- **Global Corporate Capital Expenditure Survey 2014**, June 30, 2014
- **Global Corporate Capital Expenditure Survey 2013**, July 10, 2013
- **Cash, Caution and Capex – Why a Trillion Euro Cash Pile Is Unlikely To Drive A European Capex Boom**, 5 February, 2013

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