

# FARM EQUIPMENT'S

# Ag Industry Watch

News, Information & Analysis for the Ag Equipment Marketer

October 15, 2005

## New Business Trends Survey Results Show Dealers Remain Fairly Confident About 2006 Sales Levels

With everything that has gone on with the weather during the past several months — hurricanes, floods, droughts — conventional wisdom might tell us that ag equipment sales will be in for a tough year in 2006. So, either no one told North American equipment dealers that they are in for a difficult year, or the dealers know more than the rest of us.

*Ag Industry Watch* surveyed North American ag equipment dealers in mid-August and asked them to look ahead to 2006 and tell us what they see for the coming year. Using '05 as the baseline year for comparison purposes, 341 dealers, representing businesses with an average of 23.3 employees, from the U.S. and Canada responded. If their projections hold up, it appears that the momentum

from the past few years will carry the industry well into '06.

### Confidence Continues

Responding to this first-ever Farm Equipment Dealer Business Trends Survey, nearly 74% of the participants believe that sales in 2006 will be as good or better than the business levels seen in '05. By any means of measuring "confidence," clearly, dealers expect the coming year to be a solid one for sales.

Breaking it down further, 9% of survey respondents expect new equipment sales to improve by 8% or more in '06. Some 32% believe the sale of new ag wholegoods will increase 2-7%. One-third say they think sales for the year will come in at about the same levels seen in 2005,

with "little or no change."

On the other side of the ledger, slightly more than 26% of those questioned are projecting overall sales of new equipment to decline during the year. Of those looking for a slowdown, 16% expect revenues to slip 2-7%, while another 10% of the respondents think it will fall 8% or more.

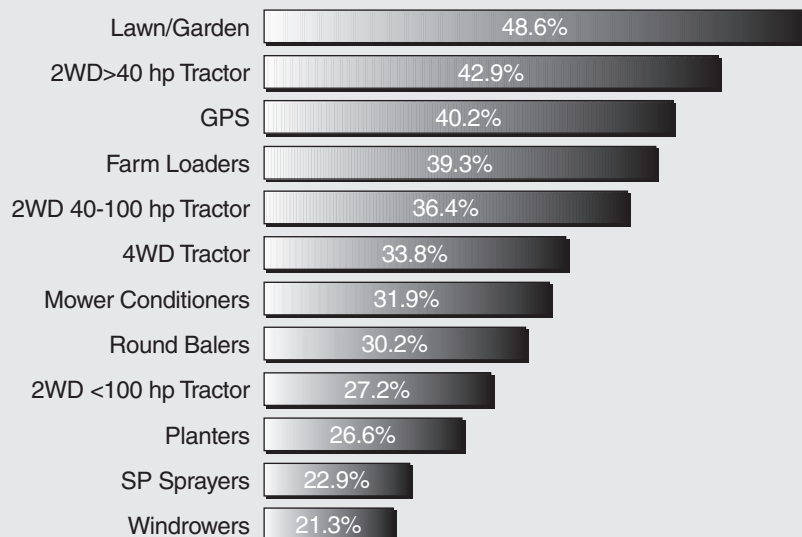
### A Canadian Rebound

To a somewhat larger degree, Canadian ag equipment dealerships are more optimistic about the coming year than all North American dealers as a whole.

Only about 9% of Canadian dealers look for sales revenue from new equipment to slip in 2006 compared with '05. Of those that are projecting lower levels, 3% see sales falling between 2-7%, and 6% express a more dire view, forecasting declines of 8% or more.

That leaves more than 90% who have moderate-to-high expectations for '06. While 39.5% of the Canadian dealers say they expect little or no change for the year, 51.5% see improving sales. Of that group, 42.4% forecast revenues to increase 2-7%, with

### TOP UNIT SALES INCREASE POTENTIAL FOR 2006



Percentage of Dealers Forecasting Growth of 2% or More vs. 2005

### 2006 PROJECTED SALES NEW EQUIPMENT — NORTH AMERICAN AG EQUIPMENT DEALERS

+ 8% or more	8.8%
+ 2 to 7%	31.9%
Little or No Change	33.0%
- 2 to 7%	16.3%
- 8% or more	10.0%

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## PROJECTED NORTH AMERICAN SALES OF FARM EQUIPMENT FOR 2006

Tractor Type (Size)	Sales +8%	Sales +2-7%	Little or No Change	Sales -2-7%	Sales -8%	Forecasting Growth	Forecasting Loss
2WD (<40hp)	9.2%	33.7%	47.3%	5.8%	4.1%	42.9%	9.9%
2WD (40-100hp)	3.7%	32.7%	52.7%	8.8%	2.0%	36.4%	10.8%
2WD (>100hp)	1.7%	25.4%	57.4%	12.3%	3.2%	27.2%	15.5%
4WD (All)	7.0%	26.8%	51.4%	8.8%	5.6%	33.8%	14.8%
SP Combines	2.6%	17.7%	60.2%	11.7%	7.8%	20.3%	19.5%
<b>Equipment</b>							
Rect. Balers	2.9%	14.4%	74.1%	8.6%	0.0%	17.3%	8.6%
Round Balers	3.3%	26.9%	55.3%	10.2%	4.4%	30.2%	14.6%
Forage	0.9%	8.6%	77.4%	7.7%	5.4%	9.5%	13.1%
Planters	5.2%	21.4%	58.9%	10.9%	3.6%	26.6%	14.5%
Mowers	3.8%	28.1%	58.6%	6.1%	3.4%	31.9%	9.5%
Windrowers	3.4%	17.9%	68.9%	6.4%	3.4%	21.3%	9.8%
Field Cultivators	2.4%	9.5%	65.6%	12.3%	10.3%	11.9%	22.6%
Farm Loaders	8.7%	30.6%	49.3%	7.3%	4.2%	39.3%	11.5%
Chisel Plows	1.2%	8.5%	72.8%	10.2%	7.3%	9.7%	17.5%
Disk Harrows	2.0%	16.0%	66.4%	8.2%	7.4%	18%	15.6%
Air Seeder/Drill	2.9%	11.9%	74.1%	3.7%	7.4%	14.8%	11.1%
SP Sprayers	2.7%	20.2%	67.4%	1.7%	6%	22.9%	7.7%
Lawn/Garden	12.8%	35.8%	41.3%	6.6%	3.5%	48.6%	10.1%
GPS	15.4%	24.8%	53.7%	2.0%	4.1%	40.2%	6.1%

the remaining 9% believing sales will improve by 8% or more.

On an even brighter note, not one Canadian dealer who responded to the survey expects revenues from the sale of used equipment to decline in '06. While slightly more than 42% say that used equipment sales will come in at about the same level in '06 as they experienced in '05, almost 58% see improvement in used equipment revenues during the coming year.

### Tracking the Majors

For the purposes of the study, dealers were asked to identify the equipment maker they considered their "major line," and were offered the choices of AGCO, Case IH, John Deere, New Holland or no major complete line (Independent). Their responses broke out in this way in terms of total respondents:

- ✓ AGCO .....19.1%
- ✓ Case IH .....20.2%
- ✓ John Deere .....19.7%
- ✓ New Holland .....25.2%
- ✓ Independent .....15.8%

Breaking it out by these five manufacturer categories, the independent dealers generally came across as slightly more optimistic about their prospects in '06 than were the others. Nearly half of dealers not affiliated with the "Big 4" expect sales revenue to increase next year. Combining this with those who believe sales revenues will remain about the same during the coming year, about 77.4% forecast a pretty good year in '06.

Deere dealers came in a close second in their positive outlook for the next sales cycle. Case IH dealers expressed the most pessimistic view toward the coming year as more than 30% of them look for a downturn in

sales for '06. New Holland dealers weren't far behind in their pessimism.

### Tracking Tractor Sales

Over the years, the sale of tractors and self-propelled combines has typically been used as the standard for measuring the relative health of the ag equipment industry.

Using this same measure, nearly half of all dealers look for little or no change in 2006, which isn't all bad. On the other hand, those dealers looking for sales to improve in all tractor categories far outweigh those who are forecasting a downturn in tractor sales.

As has been the growing trend in recent years, the compact tractor category (40 hp or smaller) is expected to continue to lead the way in 2006. More than a third of dealers look for the sale

of compact tractors to grow 2-7%, while another 9% expect sales increases of 8% or more. About 10% of the dealers say that unit sales of the smaller tractor lines is finally going to slow down in '06.

Dealers also see a similar trend in the sale of 2WD, mid-size and 40-100 hp tractors, though in a slightly different breakdown. Less growth is projected for larger 2WD tractors (100 hp and higher), as nearly 60% of dealers expect little or no change in sales levels between '05 and '06.

Sale of 4WD machines, too, is expected to continue plugging along at a steady pace. While over half of the dealers responding see little change in sales revenue coming from 4WDs during the coming year, nearly 34% are forecasting increasing sales.

Overall, dealers appear to be gear-

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ing up for little or no growth in the sales of self-propelled combines in '06. They are split evenly in their forecast with about 20% expecting some growth and nearly 20% projecting a slowdown. A big majority, 60%, project little change in combine sales between '05 and '06.

### Other Equipment Outlook

Dealers are seeing a mixed bag when it comes to the sale of other farm equipment for 2006. A couple of obvious winners are lawn and garden equipment and GPS-related equipment with nearly 40% of dealers looking for some level of growth.

More traditional farm equipment that could see fair to moderate sales growth during the coming year, according to dealer projections, will be farm loaders as 39% of dealers expect their sales to grow.

At the same time, more than 70% of dealers see little or no change in sales levels for implements like forage harvesters, rectangular balers, chisel plows, air seeders and drills, as well as windrowers, disc harrows and field cultivators.

And if dealers feel that their peers are good judges of equipment demand, they will want to watch inventory levels on items such as field

cultivators, combines, chisel plows and disc harrows. These are the types of equipment types that dealers are most often forecasting a loss for in '06 compared to current levels. *AIW*

Complete tabulated survey results, covering additional issues in farm machinery, will be published in *Ag Equipment 2006 & Beyond*, a special management bulletin for *Ag Industry Watch* subscribers.

## Alert: Steel Prices Climbing Once Again

While steel prices had reached a new stable ground after last year's highs, steel mills are now reporting that the costs of scrap, energy and transportation are driving prices higher again. And if demand were to cool, some steelmakers say they will pull back production to tighten the supply and support their price targets.

As of early October, hot-rolled band steel in the Midwest had risen as much as 5 times (to \$610/ton) from 2 months earlier, with increases of another \$40/ton expected in November.

A decline in steel imports, coupled with the aftermath of Hurricane Katrina, could put supplies of some materials at risk, according to the

Precision Metalforming Assn., Cleveland. With declining inventories in steel service centers (now at or below normal levels) and the decline in steel imports from a year ago, there could be greater supply shortages on the horizon for manufacturers, particularly if hurricane rebuilding suddenly boosts steel demand, says PMA President Bill Gaskin.

A major problem for steelmakers is the reduced supply of liquid hydrogen. An Air Products & Chemical plant (a major source of liquid hydrogen) in New Orleans was knocked out by Hurricane Katrina, and a temporary shutdown of a Canadian liquid hydrogen facility also sent a further shock wave through the steel industry. Air

Products' supply will remain "materially constrained and disrupted" for the next several months.

Katrina impacted steel in other ways too. Steel bound for the Port of New Orleans had to be routed to other ports, adding to transportation costs. Nearly 25 local scrap-metal yards were also knocked out of service by the hurricane, causing disruptions in scrap supplies.

One report predicted that the scrap supply issues would be mitigated when thousands of tons of scrap metal flow into the market from the rebuilding of New Orleans. At the same time, however, rebuilding the Gulf Coast could result in shortages of steel materials nationally. *AIW*

### FARM MACHINERY TICKER (AS OF 10/11/2005)

Mfr.	Symbol	10/11/05 Price	9/14/05 Price	1-Year High	1-Year Low	P/E Ratio	Avg. Volume	Market Cap.
AGCO	AG	\$17.23	\$19.84	\$22.69	\$16.50	10.91	863,000	1.56 B
Alamo	ALG	\$19.38	\$19.13	\$29.23	\$17.85	14.68	11,800	188.90 M
Art's Way	ARTW	\$5.36	\$5.75	\$11.50	\$4.25	6.70	5,100	10.49 M
Caterpillar*	CAT	\$55.56	\$58.30	\$59.88	\$38.38	16.44	3.07 M	37.60 B
CNH	CNH	\$19.16	\$22.00	\$22.38	\$16.18	29.94	79,100	2.56 B
Deere	DE	\$59.57	\$63.48	\$74.73	\$56.72	9.44	2.28 M	14.37 B
Gehl*	GEHL	\$26.47	\$28.53	\$34.53	\$12.63	15.95	96,300	211.66 M
Kubota	KUB	\$34.62	\$33.84	\$36.49	\$22.10	8.53	9,300	9.01 B

\*Caterpillar implemented a 2-for-1 stock split on July 13, 2005.

\*Gehl implemented a 3-for-2 stock split effective to August 10, 2005.



# CNH Brand Reorganization Plans 'May Not Help'

CNH Global announced on September 30 that it is reorganizing its operations into four global brand structures to include Case IH and New Holland agriculture, and Case and New Holland construction equipment. Four presidents with full accountability for the individual global brands have been appointed.

Heading up the ag sector are Mario Ferla, Case IH, and Marco Mazzù, New Holland, replacing Roland Sundén, who left the company. Heading the construction equipment business are Jim McCullough, Case and Franco Fenoglio, New Holland.

According to Charlie Rentschler, director of Industrials Research for the New York-based Foresight Research Solutions, the strategy "may not help" the underperforming equipment maker.

"Putting Case and New Holland into their own silos will require additional staff and more overhead," says Rentschler. "They have already undergone significant restructuring of their operations aimed at getting their costs in line during the last 5 years and they are still lagging behind Deere and AGCO when it comes to operating mar-

gins and other factors."

Harold Boyanovsky, CNH president and CEO, has openly said that CNH has not lived up to expectations. During the announcement of the realignment, he said: "This represents an aggressive transformation agenda to invigorate our brands, whose heritages and loyal dealer networks are our most powerful asset. We're convinced that organizing the company around the brands is a strong first step to increase shareholder return."

"CNH has been underperforming the industry and the challenge for CNH, as with all Fiat Group companies, is to achieve competitive excellence over the next 2 years. We realize our growth plans requires a resolute focus for each of our brands to satisfy the differentiated needs of brand dealers and customers," Boyanovsky said.

Though CNH Global N.V. is 91% owned by Fiat and, in fact, is its best performing business segment, the parent badly needs capital to turn around its flagship auto empire. "CNH represents less than a quarter of Fiat's total revenues, but is the company's most profitable business," says Rentschler.

"We have no way to divine Fiat's

intentions, but our hunch is that, as poorly as CNH has performed in recent times, Fiat views CNH as a cash cow, which, at this point, is better to retain than sell."

CNH is the world's second largest ag equipment manufacturer with an estimated 21% market share of a \$38 billion market. In addition to a full line of farm machinery, CNH also competes in construction equipment as the seventh biggest producer with a 4% share of an \$85 billion industry. In its strongest market, farm machinery, CNH is the best balanced geographically of the major farm machinery.

Despite its strong positions, CNH's operating margins trail its competitors in both of these segments.

"We believe CNH's margin problems represent a mix of insufficient pricing for its products due to efforts to hold on to market share, severe pressure on costs resulting from insufficient volume to absorb overhead, and a lack of recent competitive product development and innovation," says Rentschler.

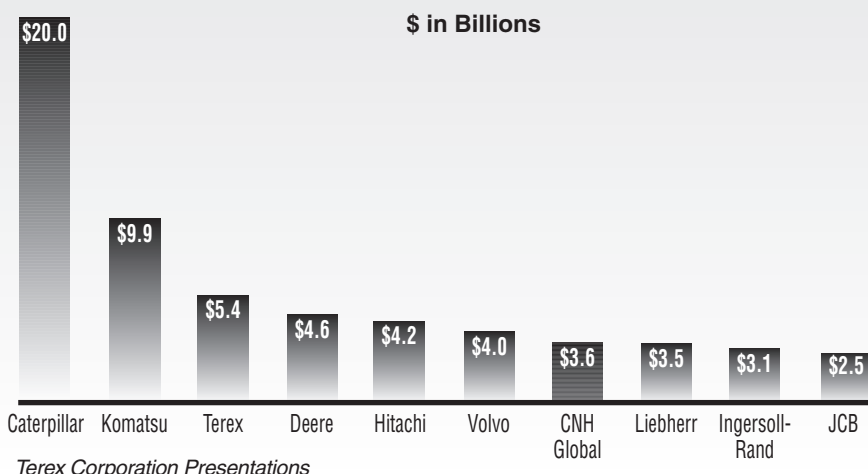
"Clearly, CNH's margins, which are worse than its competitors, are inadequate. Farm machinery operating profit margins, while exceeding 5% in '02, have drifted down the last 2 years during record times in North American agriculture. And construction machinery returns are so low that we conclude that CNH has been consistently losing money on the sale of new machines and making its meager profits on parts."

## FARM MACHINERY MARKET SHARE BY REGION

North America	Europe	South America
Deere .....37%	Deere .....23%	AGCO .....26%
<b>CNH</b> ..... <b>26%</b>	AGCO .....22%	<b>CNH</b> ..... <b>23%</b>
AGCO .....11%	<b>CNH</b> ..... <b>21%</b>	Deere .....10%
Others .....26%	Others .....34%	Others .....41%
100%	100%	100%

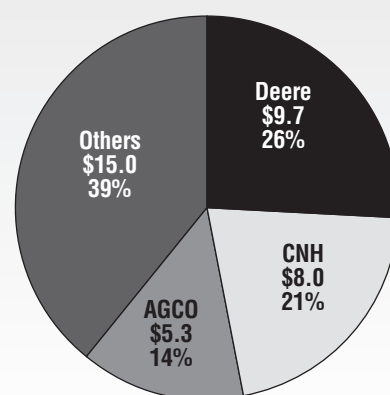
Foresight Research Solutions, LLC

## CONSTRUCTION REVENUES: CNH IS ONE OF THE 'SEVEN DWARFS' BEHIND CAT, KOMATSU AND TEREX



## CNH: THE WORLD'S NO. 2 PRODUCER OF FARM MACHINERY

\$ in Billions



Foresight Research Solutions, LLC

Despite the strong sales years for ag equipment in '04 and '05, CNH has been unable to improve margins. During the past 5 years, the company has undergone massive restructuring, but still lag behind its main competitors in output per plant. For example, CNH closed 26 of its 60 manufacturing facilities that it operated in 1999. Nonetheless, its 34 remaining plants are not experiencing the output that AGCO, holding the third spot overall, is producing.

Rentschler suggests that CNH management has become too absorbed, or even worn down, in the restructuring of recent years and has

given product development the "short-shrift." And despite CNH's targeted gross margin of 20% in the middle of the cycle and 24% at its peak in '04, its equipment operations only achieved a 15.3% level in '04 and 15.8% during the first half of '05.

Deere's continuous push in product development and AGCO's successful acquisitions are leaving CNH behind in the ag equipment race.

AGCO's Challenger program with Caterpillar dealers is the best, recent example of how rapidly the industry is changing and what some, including Rentschler, believes is the model for the future.

"AGCO with Challenger is instituting a distribution model for the U.S. — one central location dealer and mobile dispatched mechanics — which we believe has the potential in a few years to outstrip, if not obsolete, the 'many small stores' approach of Deere and CNH. The Cat approach is the most cost-effective manner to sell

and service the 'corporate' farms that, after all, buy the bulk of farm machines.

"Unfortunately for CNH and Deere, their distribution problem will require a great amount of time and money to fix." *AIW*

#### SALES PER FACTORY

	No. of Factories	2004 Sales	Sales/ Factory
AGCO	14	\$5.3B	\$379M
CNH	34	\$11.3B	\$332M

*Company Annual Reports, Foresight*

#### AVERAGE OPERATING MARGINS: PAST 5 YEARS

Farm Equipment	Average
Deere .....	6.9%
AGCO .....	5.4%
CNH .....	3.9%

Construction	Average
Caterpillar .....	8.6%
Terex .....	5.9%
Deere .....	5.4%
Hitachi .....	4.8%
Volvo .....	4.7%
Komatsu .....	4.1%
CNH .....	1.4%

*Company Annual Reports*

## Demand for Radials Contributed to Ag Tire Shortage

Along with the almost-unprecedented boom in ag equipment sales during the last 18 months or more, the growing demand for radial tires also played a significant role in timing of equipment deliveries through '04 and '05, says Bill Schafer, Michelin's vice president of sales and marketing for North American ag tires.

But as equipment sales level off, and some additional tiremaking capacity comes on line, Schafer sees the shortages easing in '06.

"The market in '05 has slowed somewhat and is now relatively stable, and we don't expect an increase during '06 in the overall market," Schafer told *Ag Industry Watch*. "We

are also adding production capacity in our existing plants in France, Poland, Spain and Hungary.

"If you looked at just the radial segment of the total market you can see that this is where the demand is growing most rapidly," says Schafer. "Both OEMs and large commercial farmers are switching over to radial tires. The increase between '03 and '04 was about 20%. This is unprecedented in the North American market. This was the sharpest increase we've seen in years."

The use of radial tires on ag equipment now makes up about 30% of the total market as tractors and combines have gotten larger. "Radial tires are growing in usage because farmers

today are buying larger and heavier equipment. The wider footprint of the radial tire lends itself to better traction in the field and reduces soil compaction even in wet weather," says Schafer. "This is a trend that we think will drive future production of tires for the ag market. We will concentrate on radials as a strategy for the future."

On the supply side, Schafer says that Michelin is working more closely with the OEMs and others to better understand future equipment trends, both in terms of sales demand and machine design. "We have increased our supply in North America roughly 20% this year compared with last year and expect that to continue in '06." *AIW*

## World's No. 4 Tractor-Maker Mahindra Aims for Top Spot by '08

With the acquisition of an 80% stake in China's Jiangling Tractor, Mahindra & Mahindra (M&M) says that it has become the fourth-largest tractor company in the world. At the same time, Mahindra has established an alliance with Renault and plans to launch the Logan, a mid-sized car for

the domestic Indian market. It also recently inked a pact with International Truck and Engine Corp. to begin building heavy trucks.

M&M's farm equipment division game plan is driven by its goal to become the world's largest tractor manufacturer by '08. Last year, M&M,

India's largest tractor maker, launched a failed bid to acquire a large tractor maker in Europe, underscoring the company's global ambitions in the tractor business.

More recently, it has made a bid to acquire Universal Tractors based in Romania. *AIW*

## German Farm Machinery Sales Up 6.5% Through First Half of '05

After a record year in '04, when sales volumes reached \$5.4 billion, the momentum continued for sales of German farm equipment through the first half of '05. During the first 6 months of the year, shipments of German ag machinery grew by 6.5% compared with the same period of '04, according to the VDMA (German Agricultural Machinery Assn.) in a September 14 report issued by Dr. Bernd Scherer, managing director. The value of first-half sales was \$3.2 billion.

German equipment manufacturers accounted for 23% of the European Union's \$24 billion farm machinery production in '05. Total EU sales during the past year were up 6% compared with the prior year. VDMA estimates that 200 German firms manufacture equipment for the farming industry.

In the first half of '05, 30,849 German-made tractors were sold both domestically and abroad. This compares to sales of 31,874 tractors during the same period of '04, a downturn of 3%.

While non-tractor ag equipment experienced slower growth than seen in '04, overall sales still saw a 13% increase to reach nearly \$1.7 billion through the first half of this year.

### Exports

As compared with the boom in the first half of '04, exports of German-made tractors slowed by 4% in '05. Much of the decrease was seen in the export of tractors ranging from 50-80 hp and 90-110 hp. At the same time, overseas shipments of higher-power equipment exceeded the level of the previous year. Strong overseas demand earlier in the year is expected to push orders up by as much as 5% for the entire year.

The number of tractors exported into the U.S. amounted to slightly more than 5,000 units, about 2% less than the comparable period in '04. Except for an increase in exports to Switzerland, Denmark and Sweden, German tractor shipments to western European markets remained consistent with the previous year.

On the other hand, export of tractors to the U.K. dropped by 15% to

2,500 units. Tractor shipments to CIS countries have also decreased, but have generally increased to the new member states of the EU.

The export of non-tractor ag equipment increased 10% to date in '05, to \$1.2 billion. France has been the largest market for this type of farm equipment. German exports to the U.S. were also significantly higher (25%) than in the year before.

German farm machinery exports into central and eastern European countries show continued, slow growth. Investment from new member countries, especially Romania and Bulgaria, while comparatively small, is showing an increase as well.

### German Demand

Through July of this year, the German tractor market had grown by 4% to 15,272 units. The most significant growth has taken place in eastern Germany, where the market grew by 14% to 2,618 tractors. In total, the eastern German states accounted for 17% of the new sales during the first 7 months.

Given a share of 28% of the entire German market, Bavaria remains the most important state. However, sales there declined 2% to 4,231 units. Otherwise, the only other reduction within the country occurred in Hesse, which, in recent years, has generally seen a higher growth rate than the rest of Germany.

Currently, there is a greater demand for compact tractors as well as for equipment in the upper power ranges. Growth rates for tractors 130 hp and higher are above those of the mid-range range equipment, which remained consistent with the previous year. In terms of total tractor sales, and including imports, the German market for all tractors grew 11% to \$860 million in the first half of the year.

Following 2 weak years, the German market for other farm equipment is showing significant growth again. Combining all sales of German equipment, with its 19% increase, and imports, which are up by 14%, the German market for all agricultural machines (excluding tractors) shows a 15% growth rate and totaled nearly

\$1.5 billion in the first half of 2005.

In the harvesting machinery segment, Germany experienced a strong recovery in '05. Through the end of August, the selling season for combines and balers was completed, and this segment demonstrated a strong rebound following 2 years of declining sales.

In the first half of the year, baler sales grew by nearly 20%. The increase in combine sales was even more significant. In the first half of the year, the production of forage harvesting machines for the German market exceeded the level of the previous year by 18%. Over the course of the entire seasonal year (July through June), sales of mowers, turners and swathers increased by 11%. The sales of loaders and harvesting wagons grew slightly above that level.

Overall sales of ag implements in Germany also grew compared with the previous year. With tillage, seeding, fertilizing and spraying equipment, manufacturers increased their domestic sales by almost 20% to \$95.1 million in the first half of the year.

### Domestic Outlook

For the German market, an overall growth of 10% is expected for '05. This means that the market would still remain below 2002 levels, but performed better than that in '03 and '04. The reasons for the improvement include a recovery of farm incomes and increased investment in replacement equipment. The higher farm incomes generally resulted from good producer prices, with the exception of reduced dairy prices.

Yields from this year's harvest are still in question as the weather caused considerable delays. However, good overall production is expected but late threshing may result in quality losses. It has become more likely that the total grain production can also be sold at a reasonable price.

About one-quarter of capital spending by German farmers currently is aimed at new equipment. At the same time, investments in regenerative energies (i.e. biogas and photovoltaic plants) are also growing and using up large amounts of liquid funds. *AWW*

## Retail Sales Strong in September

North American farm equipment retail sales strengthened in September, with yearly increases posted in all product classes. "The improvement is notable given the relatively low recent crop prices and the logistical problems associated with Hurricane Katrina, which had the potential to distract farmer attention from equipment purchases," says Robert McCarthy, Baird U.S. Equity Research. "We expect sales in the far more seasonally important October to set the tone for the balance of the year."

**Tractors** — North American retail sales of row-crop tractors rose 9% in September vs. a year ago, following a 4% such increase in August. According to McCarthy, September is typically the second weakest month of the year for sales of row-crop tractors, which remain up 3% year-to-date.

North American 4WD tractor sales surged 45% vs. last September, the second straight month of high year-to-year increases. "Sales of 4WD tractors are now up 9% year-to-date, stronger than the 8% decline forecast by AEM in its original 2005 forecast," says McCarthy.

Retail sales of mid-range tractors (40-100hp) rose 7% for the month vs. last year, and were up 3% for each of the last 3 months. Utility tractor retail sales surged 11% in September. McCarthy notes that this is the fastest rate of improvement since November '04 and a considerable improvement over August's year-to-year decline of 4%.

**Combines** — Combine sales rebounded from poor August (-26% vs. last year) with a 19% increase vs. last September. October is the only month more important for combine sales, which are up 8% year-to-date.

**Inventories** — While McCarthy notes that U.S. row-crop tractor and combine inventories were consistent with historical levels in August, he notes that 4WD inventories are relatively tight at 98 days, down considerable from last year's 154 days and the 115-day 5-year average. September's strong sales could draw 4WD inventories even lower next month, he says.

*AJW*

### SEPT. U.S. UNIT RETAIL SALES



Equipment	Sept. 2005	Sept. 2004	Percent Change	YTD 2005	YTD 2004	Percent Change	Aug. 2005 Field Inventory
<b>Farm Wheel Tractors-2WD</b>							
Under 40 HP	11,593	10,505	+10.4	102,407	110,238	-7.1	60,110
40-100 HP	6,287	5,806	+8.3	58,233	53,364	+9.1	32,358
100 HP Plus	1,191	1,127	+5.7	14,559	14,336	+1.6	7,276
<b>Total-2WD</b>	<b>19,071</b>	<b>17,438</b>	<b>+9.4</b>	<b>175,199</b>	<b>177,938</b>	<b>-1.5</b>	<b>99,744</b>
<b>Total-4WD</b>	<b>275</b>	<b>187</b>	<b>+47.1</b>	<b>2,676</b>	<b>2,368</b>	<b>+13.0</b>	<b>1,031</b>
<b>Total Tractors</b>	<b>19,346</b>	<b>17,625</b>	<b>+9.8</b>	<b>177,875</b>	<b>180,306</b>	<b>-1.3</b>	<b>100,775</b>
<b>SP Combines</b>	<b>1,233</b>	<b>987</b>	<b>+24.9</b>	<b>5,076</b>	<b>4,671</b>	<b>+8.7</b>	<b>2,441</b>

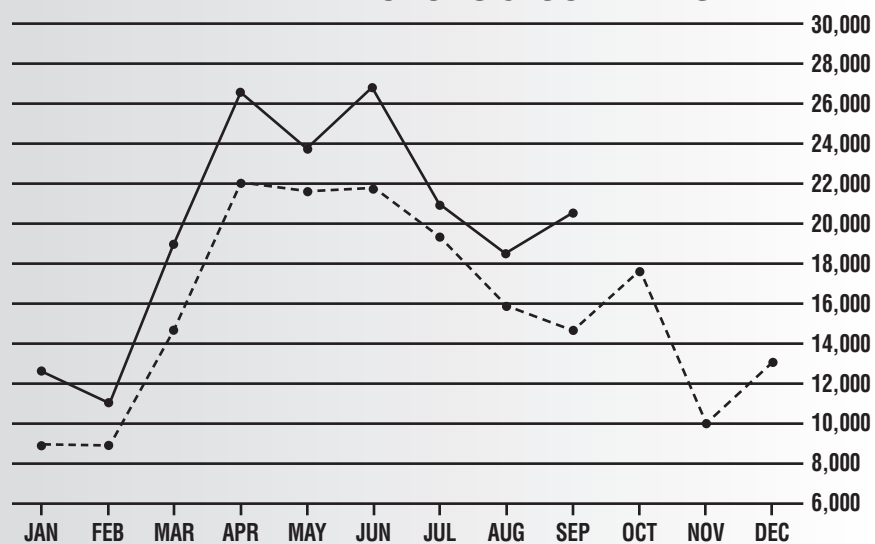
### SEPT. CANADIAN UNIT RETAIL SALES



Equipment	Sept. 2005	Sept. 2004	Percent Change	YTD 2005	YTD 2004	Percent Change	Aug. 2005 Field Inventory
<b>Farm Wheel Tractors-2WD</b>							
Under 40 HP	602	529	+13.8	5,995	5,257	+13.3	4,236
40-100 HP	416	462	-10.0	4,453	4,199	+6.0	3,290
100 HP Plus	217	161	+34.8	2,566	2,359	+8.8	1,727
<b>Total-2WD</b>	<b>1,235</b>	<b>1,152</b>	<b>+7.2</b>	<b>12,974</b>	<b>11,815</b>	<b>+9.8</b>	<b>9,253</b>
<b>Total-4WD</b>	<b>19</b>	<b>15</b>	<b>+26.7</b>	<b>439</b>	<b>496</b>	<b>-11.5</b>	<b>237</b>
<b>Total Tractors</b>	<b>1,254</b>	<b>1,167</b>	<b>+7.5</b>	<b>13,413</b>	<b>12,311</b>	<b>+9.0</b>	<b>9,490</b>
<b>SP Combines</b>	<b>167</b>	<b>189</b>	<b>-11.6</b>	<b>1,177</b>	<b>1,152</b>	<b>+2.2</b>	<b>539</b>

### U.S. UNIT RETAIL SALES OF 2-4 WHEEL DRIVE TRACTORS & COMBINES

— 2005  
--- 5 year average





# Katrina Creates Question Marks for Ag, Demand for Construction

In the aftermath of Hurricane Katrina, industry observers are offering a variety of thoughts and projections on the potential effects of weather events on ag and construction equipment sales. There's little doubt that the demand for construction equipment will push many manufacturers to the limit for production. Questions remain, however, on how farm machinery sales will be affected.

## Crop Damage

Initial estimates from the USDA have Katrina costing farmers in Alabama, Florida, Louisiana, Mississippi and Tennessee \$900 million in lost crop production. This compares with total cash receipts of \$20 billion in 2004 in these five states.

The agency's September crop production survey shows that cotton losses in Alabama and Mississippi will come in at around 4% of the total. Estimated losses to the sugarcane crop in Louisiana are about 9% or 1.5% of U.S. production. Livestock losses in the region are projected to be about \$30 million.

The American Farm Bureau Federation, on the other hand, suggests that ag losses will reach \$2 billion. This could rise further once the effect on river barge shipping is fully ascertained. Currently, it estimates that roughly \$1 billion will come in direct damage to crops and livestock, and

another \$1 billion in higher shipping and energy costs.

## Equipment Sales Implications

Early thinking from David Bleustein, UBS analyst, covered equipment demand and pricing as well as energy costs.

"Given the complexity of the issues, we view these as preliminary thoughts. Although we do not have a formal estimate of the potential size of the reconstruction effort, we have assumed a \$40 billion reconstruction effort, and that 10% of the cost of reconstruction will be allocated to the purchase of industrial/construction equipment and that the capital expenditures will be spread evenly over 2 years," says Bleustein.

"At the present time, we believe construction and industrial equipment is being transported and deployed in the region from virtually all corners of the country. We expect the thinning out of the fleet in areas including the Midwest and West Coast that results from the equipment transfer to the Gulf will create a tightness of supply of equipment in those regions, which could support higher prices for used equipment and equipment rentals," Bleustein says.

"Additionally, we expect the firming up of the construction equipment outlook to support nationwide price increases by the major equipment

manufacturers."

A major manufacturer of agricultural telescopic handlers recently told *Ag Industry Watch* editors that its handlers are literally flying out of the factory. The firm reported that it shipped more than 100 units in the past month alone. These units are rapidly being sourced for clean-up operations and the manufacturer expects demand for handlers to grow even further as regional rebuilding efforts get underway.

## Rising Energy Vs. Farm Equipment Costs

For farm machinery manufacturers, the indirect, but significant negative impact will likely be seen due to the heavy use of energy in the farm commodity production process. In all likelihood, higher oil prices will increase shipping costs for virtually the entire supply chain, all the way from equipment manufacturers to producers.

"Based on USDA data, we estimate the cost of energy in a normal year is roughly 10% of a farmer's direct cost of corn production before including the indirect impact on fertilizer prices," says Bleustein.

"Given the sustained higher levels of energy prices, we believe the additional expense could lead to some crowding out of farmer capital spending in 2006."

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