

Industrials/Multi-Industry

Fluid Power Survey #165: Slow start to January, but bullish on '24

Industry Overview

Fluid Power Survey #165, week of January 26, 2024

This week, we surveyed 50 industrial distributors from North America, EMEA, and APAC focusing on fluid power products (hydraulics and pneumatics). Our demand indicator decelerated but our outlook indicator improved from last survey, similar to last survey. Demand decelerated to 52.0 from 60.0 last survey while outlook improved to 82.0 from 77.6 prior. While data is noisy week-to-week, outlook has been on a general downward trend since 2H22. A positive inflection over the last few weeks would be consistent with our 4Q distributor channel checks. The slowing demand but improving outlook is consistent with our conversation with Applied Industrial Technologies (AIT). It suggested a softer January on weather and customer conservatism at the beginning of the year, but was constructive on exiting CY2Q24 with growth and bullish on F25. We note our distributor channel checks in (early) January did not capture the soft start to the year. We also note that our international results were particularly noisy this week given only two respondents in EMEA and three in APAC.

Our key global outlook indicator rose to 82.0 from 77.6 prior. This was driven by improvements in North America and EMEA. APAC outlook decelerated. Outlook remains bullish in all three regions. Our demand outlook indicator has a meaningful positive correlation with ISM Manufacturing PMI (80% correlation) and ISM Manufacturing New Orders (72% correlation). We look at the relationship from July 2017 through January 2024. Outlook has been trending more positively the last two surveys after decelerating since the beginning of summer '22.

Demand decelerates as outlook improves (again)

Our global demand indicator decelerated relative to last survey, with the reading coming in at 52.0 versus 60.0 prior. This was driven by deceleration in all three regions. Our key global outlook indicator rose to 82.0 from 77.6 prior. Our outlook indicator continues to improve, which we view as a positive read across for Buy-rated Parker Hannifin (PH), which is more strongly correlated with outlook than current demand.

Distributors still perceive inventories as “too low”

A reading greater than 50 indicates that more distributors perceive inventory levels are too low, whereas a reading below 50 indicates more distributors perceive inventory levels are too high. This week's indicator reading fell to 59.0 from 60.2 last survey. This suggests that inventory is perceived as higher than last survey, but still too low.

Pricing improves, in line with distributor commentary

Distributor pricing improved to 82.0 from 76.0 last survey. We heard from AIT that there have been more supplier price increases than expected. The company's framework is that pricing seems to be “higher-for-longer,” with more supplier price increases than it expected. This is in line with HON commentary, which we interpreted as more bullish on price into YE23. We view this as a tailwind for our coverage in 2024.

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Andrew Obin
Research Analyst
BofAS
+1 646 855 1817
andrew.obin@bofa.com

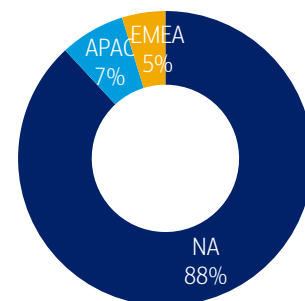
David Ridley-Lane, CFA
Research Analyst
BofAS
+1 646 855 2907
david.ridleylane@bofa.com

Sabrina Abrams
Research Analyst
BofAS
+1 646 556 3520
sabrina.abrams@bofa.com

Devin Leonard
Research Analyst
BofAS
+1 646 855 3698
devin.leonard@bofa.com

Exhibit 1: Distributor regional breakout

88% of distributors surveyed are North America-based



Source: BofA Global Research
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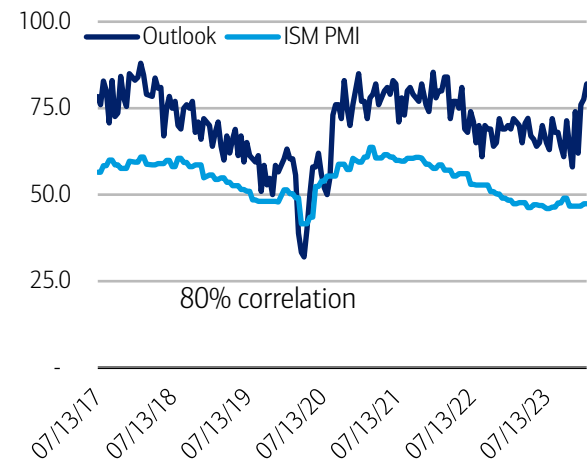
Survey Results

Outlook: strong leading indicator for PMI/new orders

Our demand outlook indicator has a meaningful positive correlation with ISM Manufacturing PMI (80% correlation) and ISM Manufacturing New Orders (72% correlation). We look at the relationship from July 2017 through January 2024. Our demand results are somewhat positively correlated with PMI and New Orders, albeit to a lower extent than our outlook indicator.

Exhibit 2: Strong correlation between outlook indicator and demand

We find an 80% correlation between outlook indicator and PMI

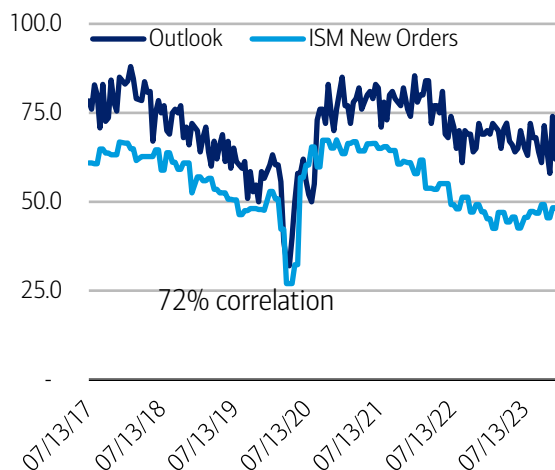


Source: BofA Global Research, Bloomberg

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Exhibit 3: Strong correlation between outlook indicator and New Orders

We find a 72% correlation between outlook indicator and New Orders

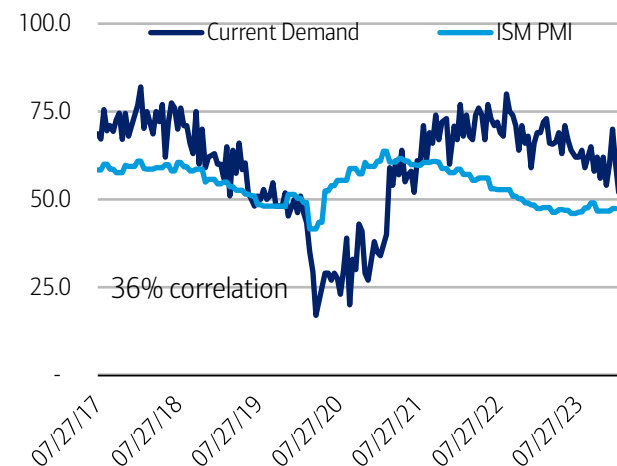


Source: BofA Global Research, Bloomberg

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Exhibit 4: Demand indicator and PMI somewhat correlated

We find a 36% correlation between demand indicator and PMI

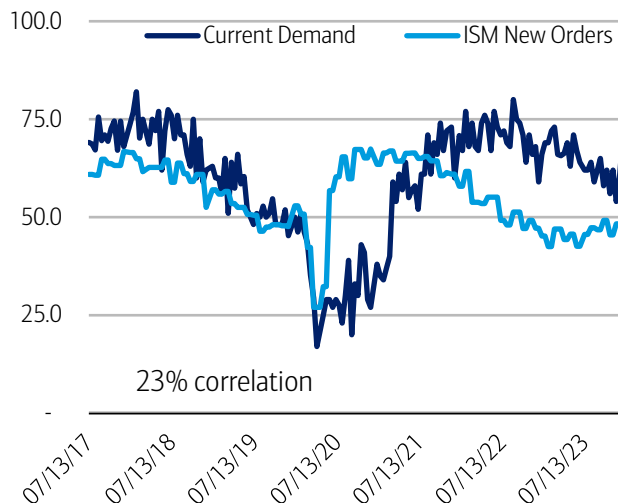


Source: BofA Global Research, Bloomberg

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Exhibit 5: Demand indicator and New Orders somewhat correlated

We find a 23% correlation between demand indicator and New Orders



Source: BofA Global Research, Bloomberg

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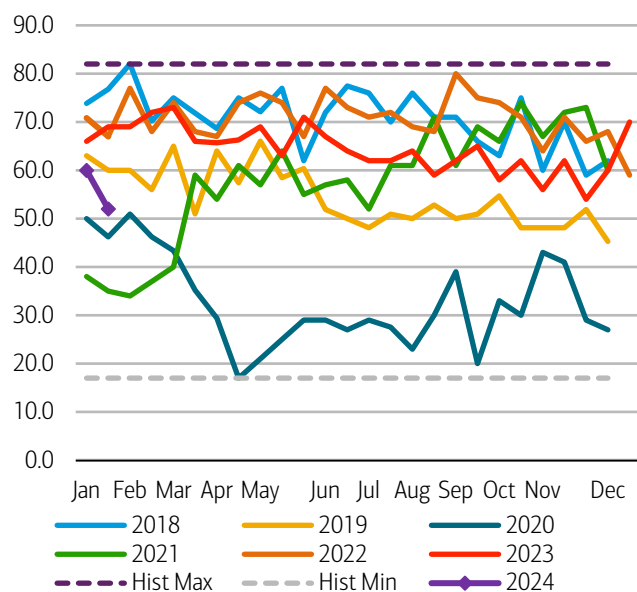
We analyze the data using our global demand indicator, which measures sentiment week-to-week through demand trends, pricing, and inventory levels. An indicator value greater than 50 marks improving sentiment, while below 50 marks deteriorating sentiment. To calculate the indicator value, we assign a value of +1 to responses of “better” demand, “too low” inventory levels, and “improving” pricing. “Same”, “normal”, and “flat” are assigned a value of 0, and “worse”, “too high”, and “declining” are assigned -1. We divide the sum of these values by the number of survey respondents, multiply by 50, and add 50 to get a value relative to our 50.0 baseline.

Question 1: Compared to the same time a year ago, is demand for fluid power products the same, better, or worse?

This week’s current demand indicator decelerated versus last survey, with the indicator reading coming in at 52.0 versus 60.0 prior. This was driven by deceleration in North America, EMEA, and APAC. We note that the data may be noisy week to week due to the small sample size. EMEA results are particularly noisy given we only had two respondents this week.

Exhibit 6: Current demand for fluid power products on stack basis (2018-2024)

Global demand decelerated to 52.0 versus 60.0 prior

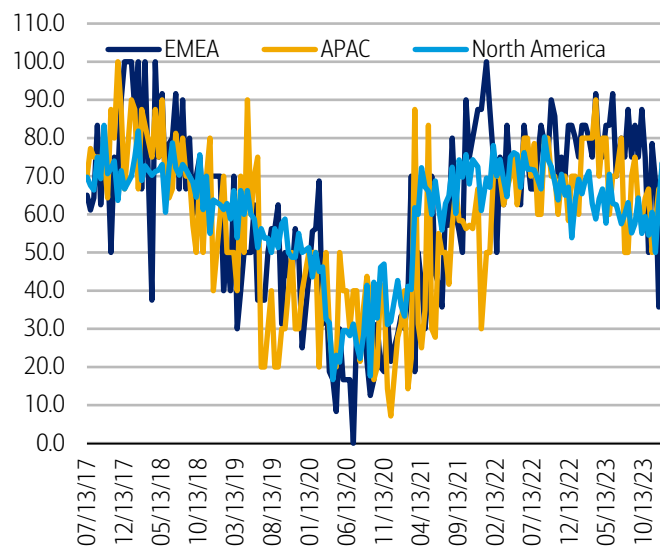


Source: BofA Global Research

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Exhibit 7: Demand decelerated in NA, EMEA, and APAC

Demand remains bullish on an absolute basis in NA and APAC regions



Source: BofA Global Research

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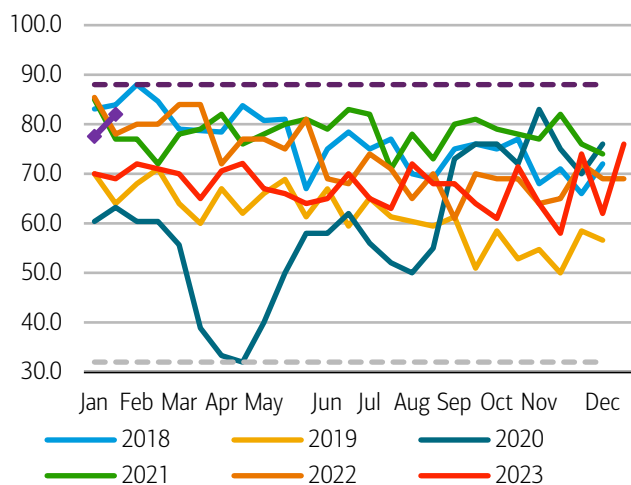
Disclaimer: The indicator identified as a Global Demand Indicator above is intended to be an indicative metric only and may not be used for reference purposes or as a measure of performance for any financial instrument or contract, or otherwise relied upon by third parties for any other purpose, without the prior written consent of BofA Global Research. This indicator was not created to act as a benchmark.

Question 2: What are your expectations for demand for fluid power products over the next 12 months?

Demand outlook improved versus last survey, with the indicator reading coming in at 82.0 versus 77.6 prior. This was driven by improvements in EMEA and NA, while APAC demand decelerated slightly. Outlook remains bullish in all 3 regions. Again, we note that the data may be noisy week to week due to the small sample size. Again, we also note EMEA particularly noisy given we only had two respondents this week.

Exhibit 8: Demand outlook for fluid power products on stack basis (2018-2024)

Global outlook improved to 82.0 versus 77.6 prior

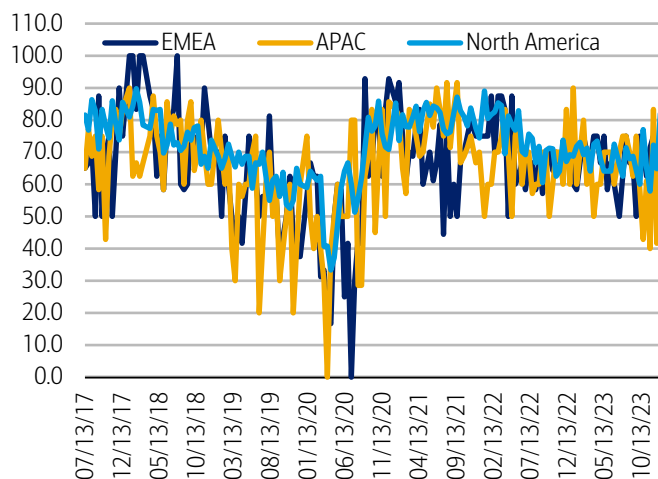


Source: BofA Global Research

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Exhibit 9: Demand outlook improved in EMEA and APAC

NA demand decelerated slightly, but outlook is positive in all three regions



Source: BofA Global Research

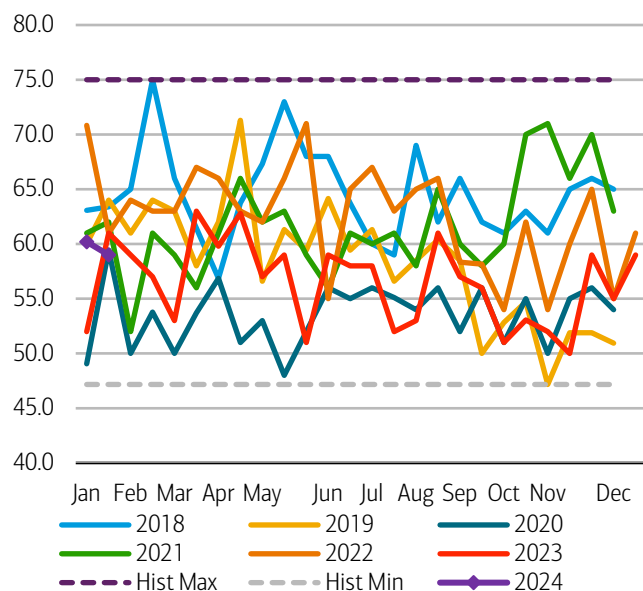
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Question 3: How would you describe current inventory levels of fluid power products?

A reading greater than 50 indicates that more distributors perceive inventory levels are too low, whereas a reading below 50 indicates more distributors perceive inventory levels are too high. This week's indicator reading decelerated to 59.0 from 60.2 last survey. This suggests that inventory is perceived as slightly lower than last survey. Again, we note EMEA particularly noisy given we only had two respondents this week.

Exhibit 10: Inventory level indicator reading on stack basis (2018-2024)

Global inventory reading fell to 59.0 from 60.2 prior

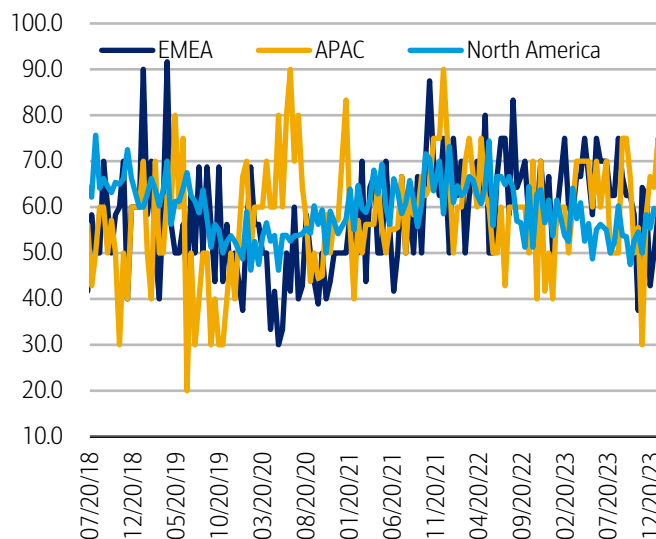


Source: BofA Global Research

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Exhibit 11: Inventories are perceived as too low in NA, at the breakeven in EMEA, and too high in APAC

Inventories are still perceived as too low in NA



Source: BofA Global Research

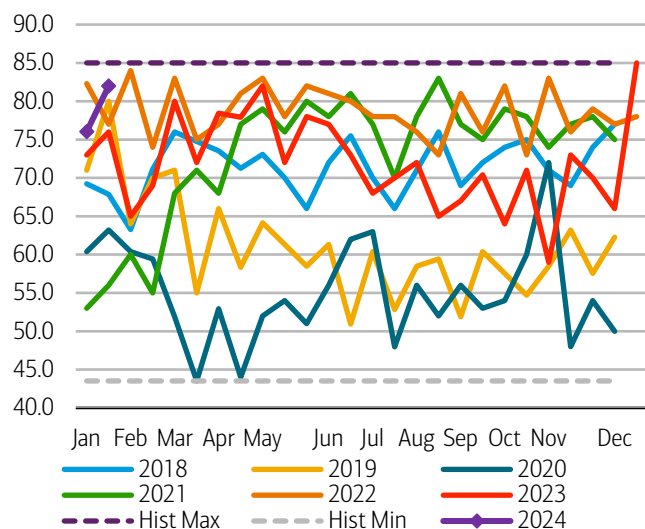
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Question 4: How would you describe current pricing in the market for fluid power products?

Distributor pricing rose relative to last survey, with the indicator coming in at 82.0 versus 76.0 prior. Pricing power improved in all three regions. Again, we note EMEA particularly noisy given we only had two respondents this week.

Exhibit 12: Pricing power indicator on stack basis (2018-2024)

Global pricing reading rose to 82.0 versus 76.0 prior

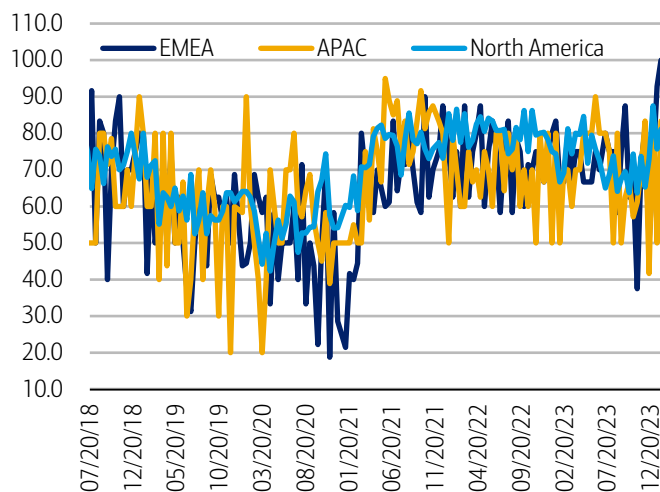


Source: BofA Global Research

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Exhibit 13: Pricing power accelerated in all three regions

Pricing power is positive overall in all three regions



Source: BofA Global Research

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Question 5: What was the most positive or negative market surprise this quarter?

Exhibit 14: Fluid power distributor comments

Comments on pricing

Commentary	Country
Just a slow start to the year, but not sure it was a surprise.	US
Slow turnover due to some logistics issues	India

Source: BofA Global Research

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Price objective basis & risk

Parker Hannifin Corporation (PH, B-1-7, \$471.59)

We base our \$525 price objective on a 14x EV/EBITDA multiple applied to our CY25E estimate. Our 14x target multiple is at a discount to the 16x multi-industrial peer average on 2024E and 17x Aerospace Suppliers peer average on 2024E. Parker has historically traded at a discount, but we believe it should start to close the gap with high quality peers AME and ITW.

Downside risks are: 1) industrial short-cycle destocking worse than expected, 2) Meggitt integration, and 3) the ability to offset material inflation through pricing. Upside risks: 1) Aerospace recovery has more upside given more exposure from Meggitt, and 2) Multiple expansion as the company closes the performance gap.

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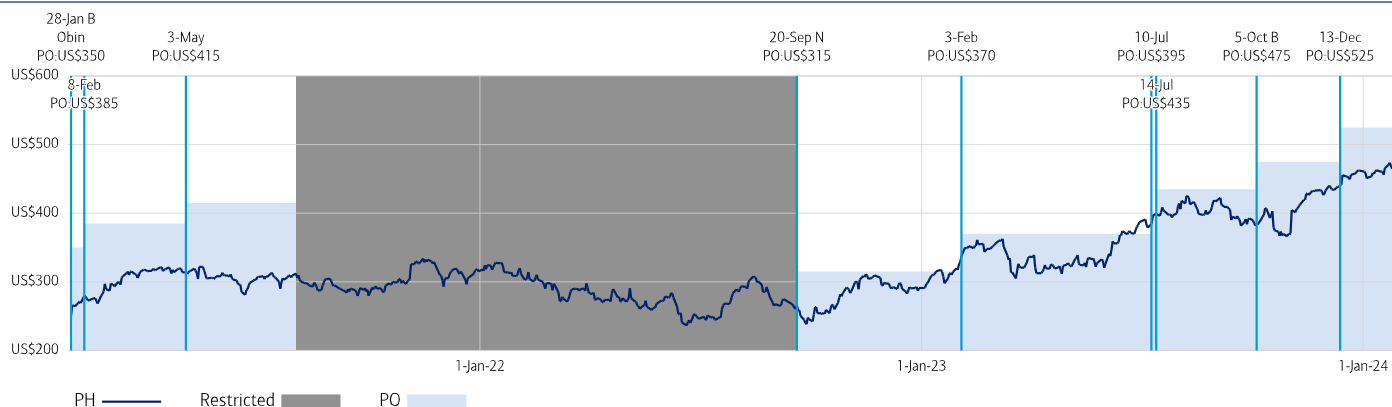
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	Eaton Corp PLC	ETN	ETN US	Andrew Obin
	Emerson Electric Co	EMR	EMR US	Andrew Obin
	Flowserve	FLS	FLS US	Andrew Obin
	General Electric Company	GE	GE US	Andrew Obin
	Honeywell International Inc.	HON	HON US	Andrew Obin
	ITT Inc.	ITT	ITT US	Andrew Obin
	Montrose Environmental Group, Inc.	MEG	MEG US	Andrew Obin
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Parker Hannifin (PH) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

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Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	45	50.56%	Buy	25	55.56%
Hold	26	29.21%	Hold	13	50.00%
Sell	18	20.22%	Sell	7	38.89%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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