

Industrial Distribution

Final Results: 2Q18 Distribution Survey

Second-quarter survey upticks further: Is this as good as it gets? 2Q18 revenue growth of +5.9% accelerated sequentially, exceeded last quarter's forecast, and was uniformly positive across product categories. Looking forward, however, 3Q18 growth is seen moderating and the 2018 forecast was maintained, with tariff/trade-related uncertainty weighing on the psychology of many participants (plus ongoing freight/labor pressures). Consequently, we believe 2Q18 could represent a high water mark for the survey, with potential mean reversion from here consistent with elevated later-cycle risks for distributor stocks overall.

- **41st quarterly survey** with ~500 respondents and \$100+ billion in aggregate revenue.
- **Final 2Q18 results** indicate overall y/y revenue growth was +5.9%, accelerating +20bps sequentially, amid a strong rebound in building products (following weather-impacted 1Q results) and broad-based strength elsewhere (all individual product categories grew mid-single-digits or better).
- **Pricing again improved overall** (+2.7%), reaching the highest levels seen since 2011. Pricing gains were led by Building Products (most notably in HVAC and Roofing), while Industrial Supply pricing came in slightly below the overall survey in aggregate.
- **Looking forward**, the third-quarter forecast is for a slight moderation in near-term trends (+5.2%), while the updated 2018 outlook is for +5.1% growth – unchanged vs. positive revisions each of the prior two quarters.
- **Key themes – Industrial Distribution.**
 - **Industrial Supply.** Our contacts indicate demand remains strong at present, but concern is building around tariff/trade-related uncertainty and interest rate risk. Pricing also continues to march higher, although some distributors indicated price/cost is still lagging, placing downward pressure on gross margins. Higher freight and labor costs are also issues in the channel, further pressuring operating margins.
 - **Electrical & Datacomm.** Within industrial end markets, growth was more balanced across both OEM and MRO this quarter, while construction activity remains healthy overall with steady backlogs (both in res/non-res). Datacomm growth accelerated for the second consecutive quarter amid a continued recovery in large project activity. While feedback is generally positive on current demand trends, several distributors questioned whether a slowdown may be looming, with current demand potentially “as good as it gets.”
- **Key themes – Building Products Distribution.** Within HVAC, mid-year tariff-related price increases are sticking, with pricing surging sequentially and demand generally in line to above expectations. Re-roofing trends were resilient, with a notable uptick in shingle pricing sequentially and generally solid demand. Lastly, Pool & Spa/Landscape Supplies distributors noted favorable mix shifts towards higher margin products and continued price inflation, while LBM distributors bemoaned continued volatility in lumber pricing.
- **Please join us for our 10 a.m. CDT conference call today** with accompanying detailed slides. Contact your Baird representative for details.

INDUSTRY UPDATE

Prices as of 07/06/2018

Ticker	Price	Mkt Cap (mil)	Rating	Risk
AXE	\$65.30	\$2,227	N	H
BECN	\$41.86	\$2,846	O	H
BMCH	\$21.30	\$1,442	N	H
DNOW	\$13.78	\$1,488	N	H
FAST	\$48.21	\$13,880	N	L
FBM	\$15.85	\$680	N	S
GMS	\$26.39	\$1,114	N	H
GWW	\$298.93	\$16,860	N	L
HDS	\$43.29	\$8,017	N	H
MRC	\$22.28	\$2,061	N	H
MSM	\$83.73	\$4,739	N	A
POOL	\$155.16	\$6,501	N	H
SITE	\$83.41	\$3,553	N	H
WCC	\$58.10	\$2,766	N	H
WSO	\$178.76	\$6,131	N	A

Baird covered companies

**Please refer to Appendix
- Important Disclosures
and Analyst Certification**

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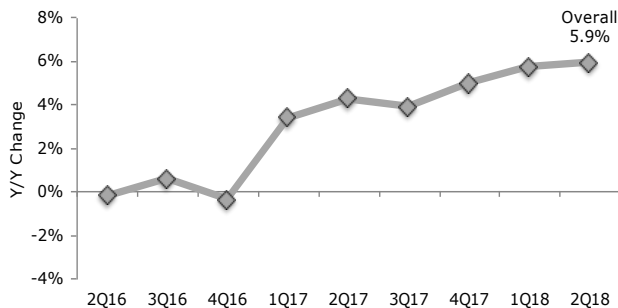
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~500 respondents, ~\$100 billion annual revenue

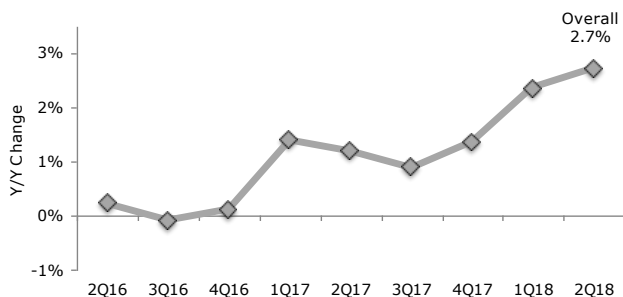
- Please see top of page 2 for a more detailed respondent profile

Revenue



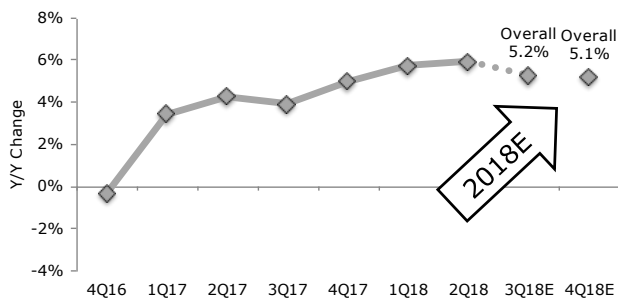
- On average, respondents indicated aggregate revenue growth (excluding acquisitions) in the second quarter was +5.9% y/y – exceeding the +5.0% forecast and accelerating sequentially for the fifth time in the last six quarters.
- Strength was broad-based, with mid-single-digit or better revenue growth seen across all major product categories.
- Relative strength: Industrial/Energy PVF and Hoses & Accessories
- Relative weakness: Lumber/Building Materials and Safety

Pricing



- Overall pricing strengthened further in the second quarter (+2.7%), reflecting a mix of traditional annual pricing actions as well as some initial tariff-related increases.
- Outsized pricing gains were seen in several building products categories, while industrial pricing was in line to below the overall survey average.
- Relative strength: HVAC and Plumbing
- Relative weakness: Safety and Datacomm

Outlook



- On average, respondents expect 3Q18 revenue growth to moderate to +5.2%.
- Looking out further, respondents also provided an updated 2018 revenue outlook of +5.1%. This is unchanged vs. last quarter's forecast, despite better-than-expected current-quarter results.
- Highest 2018 outlook: Roofing and Industrial/Energy PVF
- Lowest 2018 outlook: Waterworks Products and Datacomm

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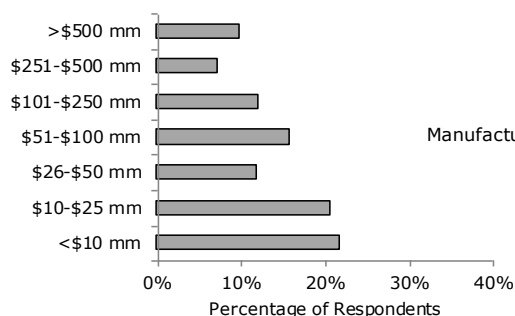
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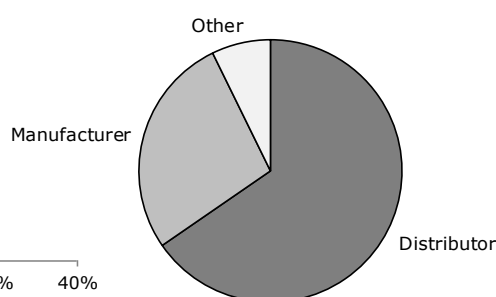
Source: Baird Analysis

Respondent Profile

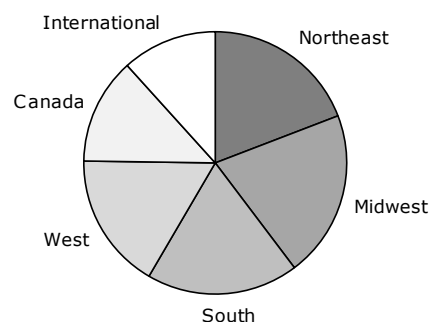
Annual Revenue Mix



Business Mix



Geographic Mix



Survey Results by Product Category

	2Q18 Revenue Growth	2Q18 Pricing	3Q18 Forecast	2018 Forecast
Overall	5.9%	2.7%	5.2%	5.1%
Industrial/Energy PVF	12.7%	3.4%	9.1%	11.4%
Hoses & Accessories	10.4%	3.9%	7.6%	5.7%
Plumbing	10.3%	4.4%	8.8%	9.8%
Roofing	9.2%	3.8%	10.6%	11.6%
Pool & Spa	9.0%	4.1%	8.6%	7.5%
General Industrial (MRO)	7.2%	2.4%	6.3%	5.4%
HVAC	6.8%	5.0%	5.4%	6.4%
OEM Fasteners	6.6%	2.9%	6.5%	5.6%
Datacomm	6.4%	1.6%	4.7%	3.0%
Facilities Maintenance/Jan-San (MRO)	6.3%	1.9%	5.7%	5.2%
Electrical	6.3%	2.2%	6.1%	5.5%
Mechanical/Power Transmission	5.9%	3.0%	4.0%	6.2%
Metalworking/Cutting Tools	5.9%	2.6%	4.9%	4.1%
Waterworks Products	5.7%	3.8%	6.0%	2.2%
Safety	4.5%	1.1%	3.7%	3.2%
Lumber & Building Materials	4.0%	3.6%	3.8%	3.2%

Source: Baird Analysis

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