

Industrial Distribution

Final Results: 1Q18 Distribution Survey

First-quarter survey shows continued strong momentum. 1Q18 growth of +5.7% accelerated +80bps sequentially and the updated 2018 outlook came in at +5.1%, revised 60bps higher vs. last quarter's forecast. We like the backdrop for select Industrial Distributors (**FAST** and **GWW**) given sustained later-cycle strength and increased conviction around pricing realization (with steel tariffs likely additive), while we continue to hold a favorable view of Building Products Distributors overall, with **SITE** and **BECN** our top ideas.

- **40th quarterly survey** with 500+ respondents and \$100+ billion in aggregate revenue.
- **Final 1Q18 results** indicate overall y/y revenue growth was +5.7%, accelerating +80bps sequentially, amid continued strong industrial trends and a sharp improvement in electrical and datacomm, while more normal winter weather weighed on building products (ex-HVAC).
- **Pricing improved overall** (+2.3%), including broad-based steady gains within Industrial Supply, and a sharp uptick in both Building Products and Electrical & Datacomm pricing.
- **Looking forward**, the second-quarter forecast is for solid near-term trends (+5.0%), while the updated 2018 outlook is for +5.1% growth – revised +60bps vs. last quarter's forecast and also nicely above the 2017 forecast at this time last year (+3.7%).
- **Key themes – Industrial Distribution.**
 - **Industrial Supply.** Feedback from our contacts indicates demand remains strong, with momentum seen continuing through the remainder of 2018. This is coupled with increased inflationary pressures in the channel, with customers largely accepting new year price increases and steel tariffs potentially adding additional inflationary pressures. As one contact put it: "Customers are at a point now where they're more concerned with keeping up with demand, so they're too busy to worry about 2-3% price increases." Competitively, FAST's "in market" sales strategy appears to be paying dividends, and while Amazon remains a topic of heavy discussion, we are increasingly hearing suppliers are hesitant to view Amazon as a true strategic partner.
 - **Electrical & Datacomm.** Within industrial, growth was more balanced across both OEM and MRO this quarter, while construction activity is seen continuing overall (both in res/non-res). Following a flattish 4Q, Datacomm growth rebounded sharply amid early signs of a recovery in large project activity.
- **Key themes – Building Products Distribution.** Within HVAC, annual price increases appear to be sticking, while more normal winter weather boosted demand for furnaces and heat pumps. The 2018 outlook remains very strong, with an additional mid-year tariff-related price increase also a possibility. Re-roofing trends were negatively impacted by weather, though the outlook for 2018 remains solid, including a potentially more favorable pricing backdrop. Lastly, feedback continues to skew positive within Pool & Spa/Landscape Supplies amid a continued favorable macro environment, while lumber price volatility and weather dampened demand for LBM distributors.
- **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 04/06/2018

Ticker	Price	Mkt Cap (mil)	Rating	Risk
AXE	\$74.70	\$2,540	N	H
BECN	\$53.39	\$3,695	O	H
BMCH	\$19.85	\$1,342	O	H
DNOW	\$10.85	\$1,172	N	H
FAST	\$53.65	\$15,430	O	L
FBM	\$14.60	\$626	N	S
GMS	\$32.63	\$1,377	O	H
GWW	\$286.67	\$16,340	O	L
HDS	\$38.05	\$7,073	N	H
MRC	\$17.26	\$1,636	N	H
MSM	\$92.00	\$5,198	N	A
POOL	\$146.12	\$6,093	O	H
SITE	\$77.40	\$3,290	O	H
WCC	\$62.05	\$2,947	N	H
WSO	\$185.88	\$6,878	O	A

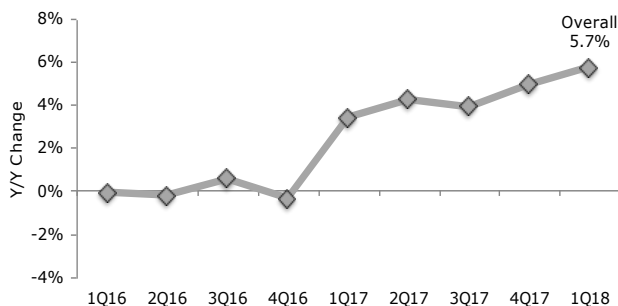
Baird covered companies

**Please refer to Appendix
- Important Disclosures
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500 respondents, \$100+ billion annual revenue

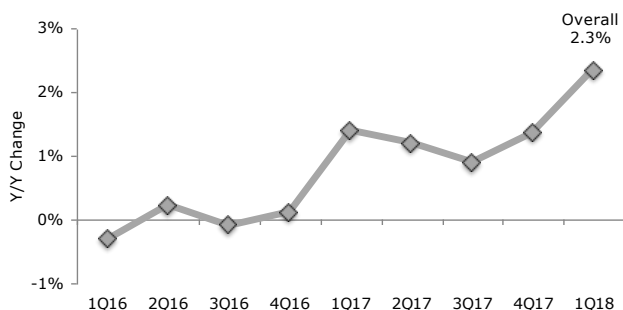
- Please see top of page 2 for a more detailed respondent profile

Revenue



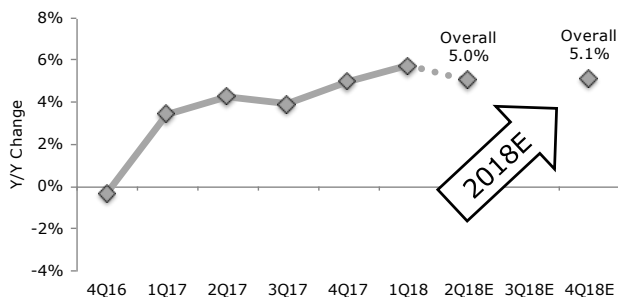
- On average, respondents indicated aggregate revenue growth (excluding acquisitions) in the first quarter was +5.7% y/y – reflecting the highest rate of growth seen in the survey since mid-2012.
- Growth again improved sequentially, reflecting sustained industrial strength and better electrical/datacomm trends, partially offset by mixed weather dynamics in building products.
- Relative strength: Plumbing and Gases & Cylinder Rental
- Relative weakness: Lumber/Building Materials and Roofing

Pricing



- Overall pricing was noticeably stronger in the first quarter (+2.3%), shifting higher vs. the +1% pricing seen throughout 2017 – and marking the highest pricing in the survey since 2011.
- Stronger pricing was broad-based across industrial and building products categories alike.
- Relative strength: Industrial/Energy PVF and Waterworks Products
- Relative weakness: Datacomm and Roofing

Outlook



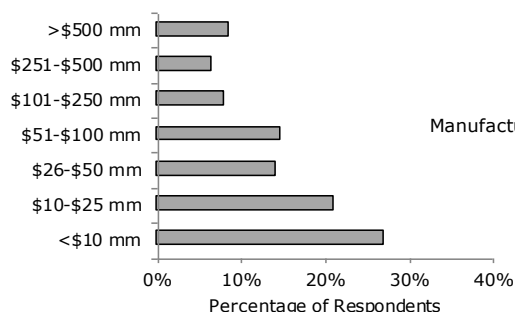
- On average, respondents expect 2Q18 revenue growth to moderate slightly to +5.0%.
- Looking out further, respondents also provided an updated 2018 revenue outlook of +5.1%. This is +60bps vs. last quarter's +4.5% outlook, the second successive increase of a similar magnitude.
- Highest 2018 outlook: Pool & Spa and Roofing
- Lowest 2018 outlook: Facilities MRO and Waterworks Products

Source: Baird Analysis

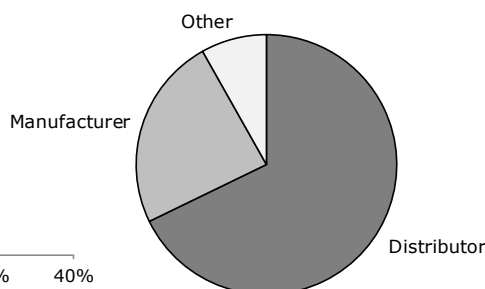
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Respondent Profile

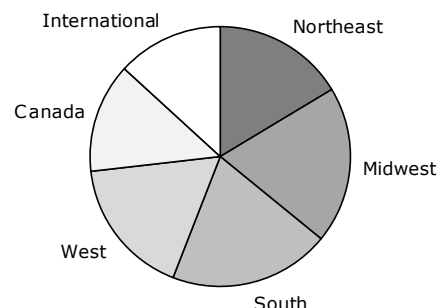
Annual Revenue Mix



Business Mix



Geographic Mix



Survey Results by Product Category

	1Q18 Revenue Growth	1Q18 Pricing	2Q18 Forecast	2018 Forecast
Overall	5.7%	2.3%	5.0%	5.1%
Pool & Spa	6.8%	3.4%	8.6%	9.0%
Roofing	3.8%	1.3%	8.0%	8.5%
Industrial/Energy PVF	6.2%	4.7%	7.8%	8.4%
Plumbing	8.3%	1.6%	3.9%	8.2%
HVAC	7.0%	1.5%	4.6%	7.8%
Lumber & Building Materials	3.0%	1.6%	5.4%	6.6%
Hoses & Accessories	7.2%	2.0%	6.9%	5.8%
Welding Hardgoods	3.8%	1.6%	5.6%	5.5%
Gases & Cylinder Rental	7.6%	3.3%	6.6%	5.2%
Electrical	5.8%	2.7%	4.1%	5.2%
OEM Fasteners	6.8%	2.4%	4.3%	5.0%
Metalworking/Cutting Tools	4.7%	2.6%	4.7%	4.9%
Safety	6.4%	1.5%	5.6%	4.9%
Datacomm	4.4%	1.1%	3.5%	4.0%
Mechanical/Power Transmission	6.8%	2.5%	5.0%	3.7%
General Industrial (MRO)	5.5%	2.8%	4.7%	3.6%
Waterworks Products	5.3%	4.6%	4.1%	3.0%
Facilities Maintenance/Jan-San (MRO)	4.9%	2.2%	3.4%	2.9%

Source: Baird Analysis

Please refer to Appendix – Important Disclosures and Analyst Certification

Valuation & Risks

Beacon Roofing Supply, Inc. (BECN)

Valuation

Our \$70 price target is based on 15x C2019E EPS, matching the long-term NTM average on a consistent "cash" EPS presentation. Our corresponding EV/EBITDA target (11x) is below WSO and POOL (15x and 19x), but with more favorable industry dynamics/predictable results, BECN could close the valuation gap.

Risks

Underlying replacement trends for residential and nonresidential roofing, new construction, pricing, storm activity, and Allied integration.

Fastenal Company (FAST)

Valuation

Our \$57 price target is based on 13.5x EV/2019E EBITDA/20x 2019E EPS, conservatively below historical averages (~16x and ~30x, respectively) due to secular changes in growth and margins.

Risks

Economic sensitivity, pricing power, relatively high valuation, secular gross margin pressures, success of vending and on-site initiatives, and ability to sustain historical growth.

Grainger, W.W., Inc. (GWW)

Valuation

Our \$317 price target is based on approximately 10.5x EV/2019E EBITDA, equal to the average NTM valuation over the past five years, as we believe deep-seated negative sentiment should unwind as GWW executes on strategic initiatives in an improving market.

Risks

Risks include macroeconomic conditions, ability to expand margins, pricing power, benefits from product expansion, sales force additions, and global sourcing.

SiteOne Landscape Supply, Inc. (SITE)

Valuation

Our \$85 price target is based on 33x 2019E EPS vs. the 26-36x historical NTM range. This premium also represents the assumption of future acquisitions that are not included in our estimates, which we estimate would lower our target PE multiple by approximately 3-4x.

Risks

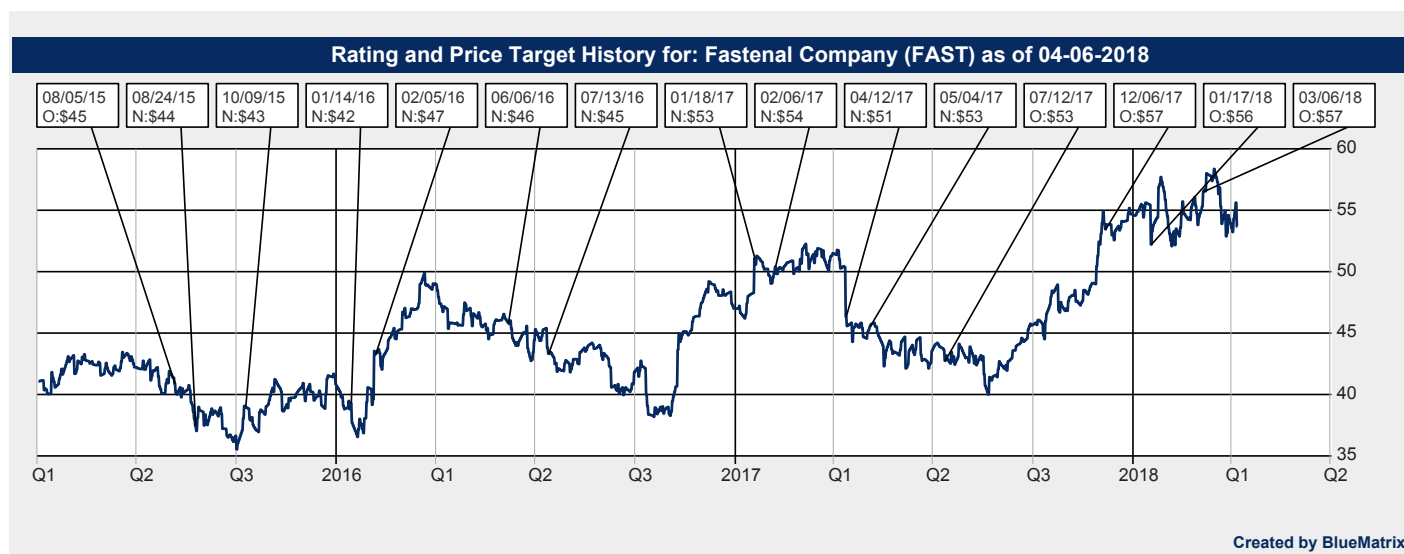
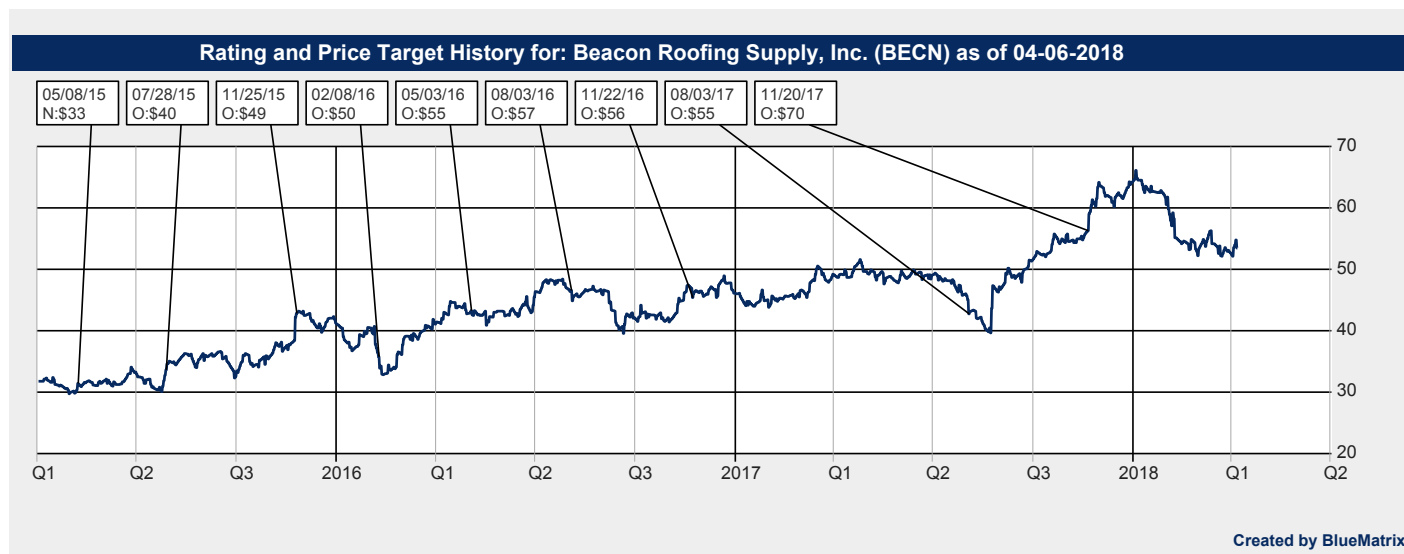
Key risks include premium target valuation, high initial expectations with limited track record, success of strategic initiatives, M&A challenges, cyclicity, and relatively high leverage, among other factors.

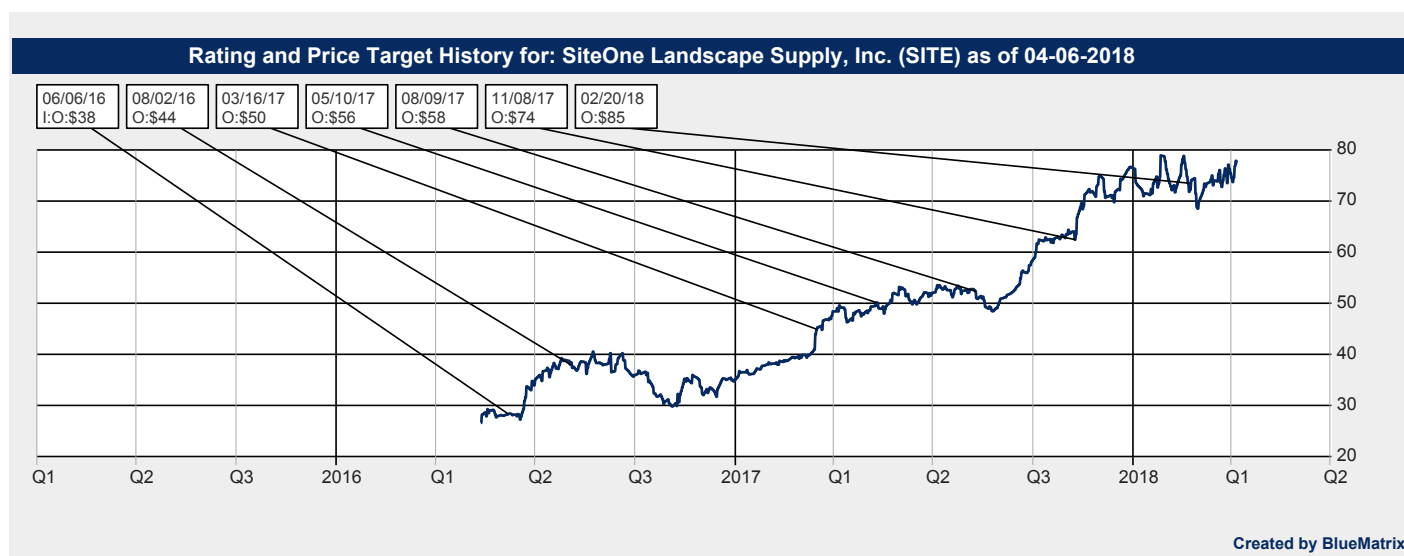
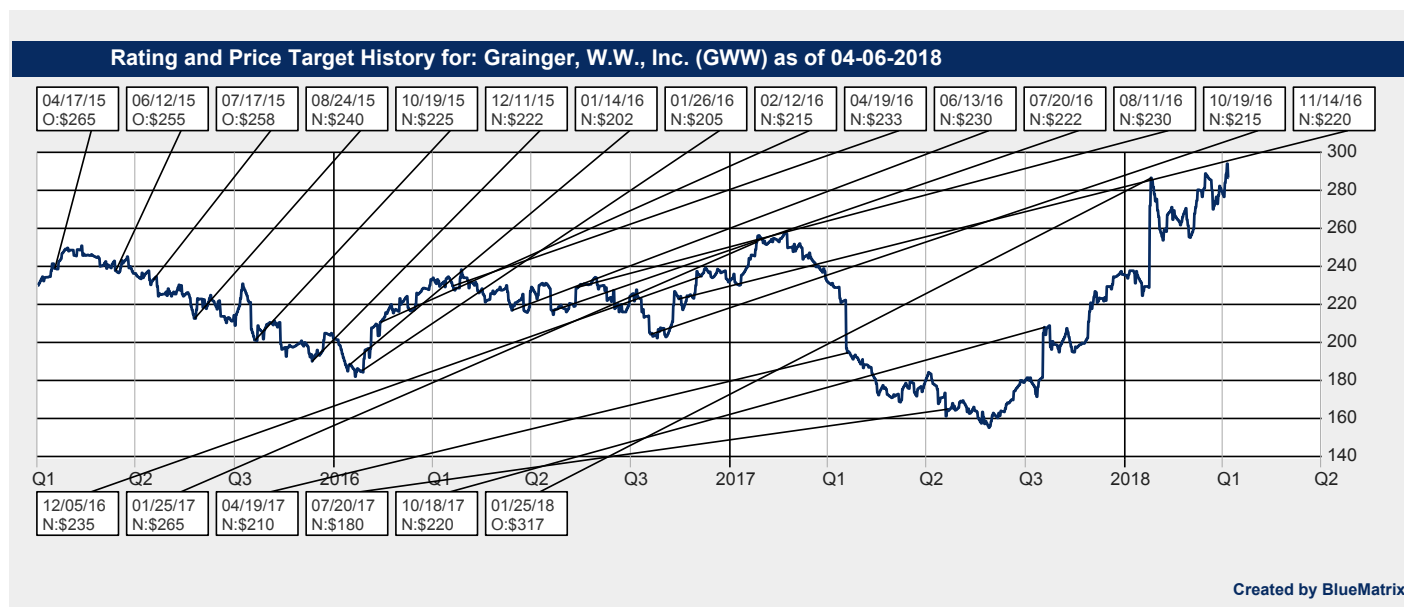
Appendix - Important Disclosures and Analyst Certification

Covered Companies Mentioned

All stock prices below are the 04/06/2018 closing price.

Beacon Roofing Supply, Inc. (BECN - \$53.39 - Outperform)
 Fastenal Company (FAST - \$53.65 - Outperform)
 Grainger, W.W., Inc. (GWW - \$286.67 - Outperform)
 SiteOne Landscape Supply, Inc. (SITE - \$77.40 - Outperform)
 (See recent research reports for more information)





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