VERTICAL RESEARCH PARTNERS®

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EE/MI

Q1 Distributor Survey – Steady Sailing Despite Cross Currents

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Ticker	Rating	TP	Price
ABB	HOLD	$29	$34.45
AYI	HOLD	$180	$159.48
ETN	BUY	$185	$162.22
HUBB	BUY	$262	$226.77
NVT	BUY	$51	$42.90
SIE-DE	BUY	€190	€144.82
SU-FR	HOLD	€155	€147.68

Sales Steady Sequentially – Q1 distributor sales were up 6.4% on 4.0% volume growth and 2.4% of price, a touch below the 6.7% result in Q4. The two-year growth stack of 16.6% in Q1 continues to slow from the ~30% level in Q2/3 2022. Pricing is moderating from the record levels seen in 2022, but remains solid at 2.4%. Automation sales were the strongest among distributor categories for the first time since Q318, with leading contributions from both volume (up 4.7%) and price (up 2.9%). Electrical Equipment sales decelerated to a still solid 5.4%, the lowest among product categories after leading throughout 2022 (two-year stack continues to lead). Power remains steady with sales up 6.3%, only a slight deceleration versus the 6.6% reported in Q4.

A Familiar Story – April 13th results from public electrical distributor Fastenal (FAST) were in focus recently as the company pointed to softening exiting March. We did not pick up on any notable slowing towards the end of the quarter from our individual distributor contacts, with several actually pointing to a record March and continued momentum in April. Signs of a slowdown related to higher interest rates do continue to creep in around the edges but the underlying demand pulse continues to be relatively robust. “Not much has changed” was a common refrain. Backlogs generally remain at record levels. We have not picked up on any real signs of widespread cancellations outside of some anecdotal one-offs. MRO activity sounds like it remains solid. Stimulus around infrastructure, energy efficiency/storage, and EVs appear to be in early stages and could provide a boost to results if interest rates begin to take a larger bite out of project activity. Overall the tone sounded more like a natural deceleration in growth after a strong post-pandemic recovery period rather than a broader and more meaningful downturn.

Adapting in the Post-COVID World – Lead times and inventories both appeared to trend positively in Q1 though we suspect to some degree this reflects distributors becoming accustomed to the “new normal.” We may be years away from returning to pre-pandemic service levels and some distributors express doubt that we ever will. As we have heard numerous times in recent quarters, “switchgear remains in shambles” (lead times 100+ weeks in some cases). While we picked up on specific shortages of a critical ETN breaker that is used widely in commercial construction projects and is running over a year out, we continue to hear about availability issues with nearly all of the major OEMs including ABB, ROK, SIE and SU. Price pressure is picking up again, and we heard chatter of pending increases from ROK and ETN.

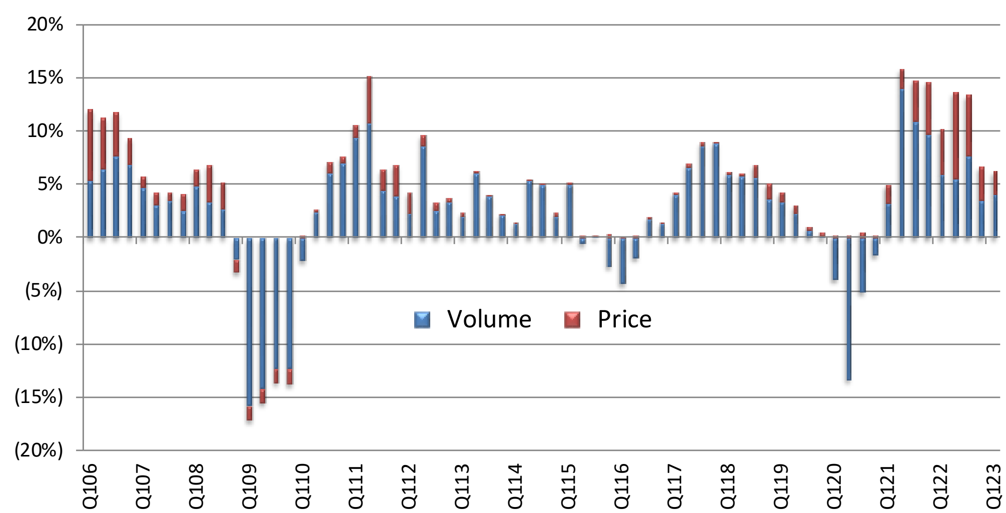
Read to OEMs – Overall, our estimates appear fairly well dialed. We have HUBB organic sales modeled up 7.1% including Electrical up 2% and Utility up 11%, compared to the survey results of Electrical up 5.4% and Power up 6.4% (regression implies +5.5%). We are modeling total ETN Electrical up 8% for Q1 (Americas +11%) versus the 6.4% reading in the survey and the 4.9% implied by the survey regression. Our NVT estimates for Enclosures up 8% and EFS up 6% appear well supported by the survey results. Our survey points to 9.5% organic growth for ROK’s US business, while we are modeling core sales up 18% for ROK overall. Given ROK’s published long lead times (link), it is the only one in this group where the gap between our survey and model is large enough to make us question our forecast. That said, ROK North America is lapping a relatively easy comp (down 3.2%) and has outperformed the survey in recent quarters.

Key Highlights from Survey

- Q1 distributor sales grew 6.4% led by volume growth of 4.0% with price contributing 2.4%
- The two-year growth stack of 16.6% remains solid though continues to moderate from the near 30% level seen in Q2/3 2022
- Distributors are on average expecting sales growth of 2.3% in Q223; our average current estimate for peers ETN, HUBB, NVT, ROK and SU is for 8.8% organic growth in Q2
- Among distributor categories, Electrical Equipment showed the greatest sequential deceleration after posting the strongest results in the previous four quarters; volumes were still up a solid 3.5% with price adding 1.9%
- Power results were relatively stable with 6.3% growth versus 6.6% in Q4, with volume up 3.9% and price up 2.4%
- Automation sales led among distributor categories for the first time since Q318, accelerating to 7.6% growth on volumes up 4.7% and price up 2.9%

In this report, we present the results of our Q1 2023 proprietary North American Distributor Survey. We surveyed 50 distributor branch managers in total throughout North America capturing ~$900 million in revenues. Although the sample revenue represented by our coverage universe is a relatively small proportion of our group's total revenue, the true power of the survey revolves around the directional growth and anecdotal commentary about end market conditions, which are salient indicators for our entire group. Companies such as Eaton, Hubbell, Rockwell, nVent, Schneider (Square D) and ABB are well represented in the survey because they sell primarily through distribution. Of the 50 distributors, 18 sold electrical equipment, 17 focused on T&D utility customers and 15 sold automation equipment. Based on this sample composition, it is not surprising to see Eaton, Hubbell, nVent, Schneider and ABB the most widely represented firms in our survey.

Figure 1: Distributors Report Volume Up 4.0%, Price up 2.4%



Source: Company Reports and Vertical Research Partners

Figure 2: VRP Distributor Survey Results

Industry	Q118	Q218	Q318	Q418	Q119	Q219	Q319	Q419	Q120	Q220	Q320	Q420	Q121	Q221	Q321	Q421	Q122	Q222	Q322	Q422	Q123
All Distributors	**6.2%**	**6.0%**	**6.9%**	**5.0%**	**4.3%**	**3.0%**	**1.0%**	**0.5%**	**(3.7%)**	**(13.0%)**	**(4.7%)**	**(1.5%)**	**5.0%**	**15.8%**	**14.7%**	**14.7%**	**10.2%**	**13.7%**	**13.5%**	**6.7%**	**6.4%**
Volume	5.9%	5.7%	5.6%	3.6%	3.4%	2.3%	0.6%	0.1%	(3.9%)	(13.3%)	(5.2%)	(1.7%)	3.3%	13.9%	10.8%	9.6%	5.8%	5.5%	7.7%	3.5%	4.0%
Price	0.3%	0.3%	1.3%	1.5%	0.9%	0.7%	0.4%	0.4%	0.2%	0.3%	0.5%	0.2%	1.7%	1.9%	3.9%	5.1%	4.4%	8.2%	5.8%	3.2%	2.4%
Total Power	**6.7%**	**5.7%**	**6.3%**	**5.4%**	**5.2%**	**3.7%**	**4.8%**	**3.7%**	**5.2%**	**(11.2%)**	**3.7%**	**2.3%**	**5.6%**	**13.9%**	**14.6%**	**17.1%**	**10.0%**	**11.8%**	**11.9%**	**6.6%**	**6.3%**
Volume	6.5%	5.4%	5.0%	3.8%	4.2%	3.0%	4.4%	3.4%	5.0%	(11.5%)	3.3%	2.1%	3.9%	12.1%	10.8%	11.2%	5.2%	2.8%	6.5%	3.1%	3.9%
Price	0.3%	0.3%	1.3%	1.6%	1.0%	0.7%	0.4%	0.3%	0.2%	0.3%	0.3%	0.2%	1.7%	1.7%	3.8%	5.9%	4.8%	9.0%	5.4%	3.5%	2.4%
Total Automation	**6.0%**	**5.5%**	**7.2%**	**5.0%**	**4.1%**	**2.8%**	**(2.1%)**	**(2.9%)**	**(4.9%)**	**(18.2%)**	**(9.6%)**	**(4.5%)**	**4.1%**	**11.4%**	**10.1%**	**9.6%**	**3.8%**	**10.2%**	**8.5%**	**3.6%**	**7.6%**
Volume	5.7%	5.2%	6.1%	3.7%	3.3%	2.0%	(2.6%)	(3.3%)	(5.3%)	(18.5%)	(10.0%)	(4.8%)	2.9%	9.9%	6.2%	5.2%	(0.3%)	2.7%	3.1%	0.9%	4.7%
Price	0.3%	0.3%	1.1%	1.3%	0.8%	0.8%	0.5%	0.4%	0.3%	0.3%	0.4%	0.3%	1.2%	1.5%	3.9%	4.4%	4.1%	7.5%	5.4%	2.7%	2.9%
Total Electrical Equipment	**5.9%**	**6.8%**	**7.0%**	**4.8%**	**3.9%**	**2.7%**	**1.6%**	**1.3%**	**(5.0%)**	**(13.2%)**	**(4.1%)**	**(1.9%)**	**4.5%**	**20.5%**	**17.5%**	**16.1%**	**15.1%**	**16.9%**	**17.2%**	**8.9%**	**5.4%**
Volume	5.6%	6.4%	5.6%	3.3%	2.9%	2.0%	1.3%	0.9%	(5.1%)	(13.4%)	(4.6%)	(2.1%)	2.7%	18.2%	13.5%	11.2%	10.8%	8.6%	10.9%	5.6%	3.5%
Price	0.4%	0.4%	1.4%	1.5%	1.0%	0.7%	0.3%	0.4%	0.1%	0.2%	0.5%	0.2%	1.8%	2.3%	4.0%	4.9%	4.3%	8.3%	6.3%	3.3%	1.9%

Source: Company Reports and Vertical Research Partners

Q123 Distributor Anecdotes and Outlook

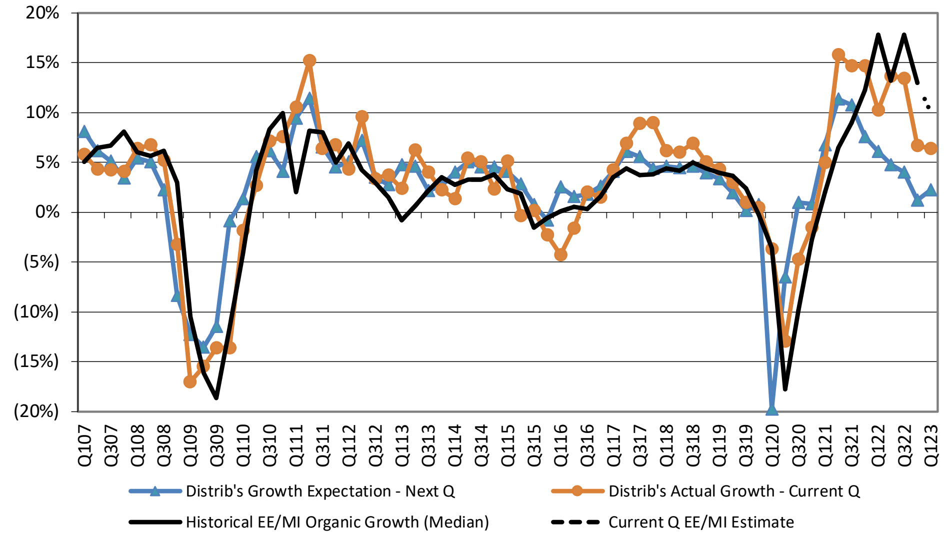
Below we summarize commentary and anecdotes from our distributor contacts. Looking forward, distributors are expecting 2.3% growth on average for Q2 2023. This marks the first time distributor forward expectations have shown sequential improvement since we exited the peak of the pandemic period. However, they have consistently and uncharacteristically underestimated forward sales through this period. This disconnect could be tied to confusing volumes with revenues in an inflationary environment. The long-expected slowdown appears to be manifesting somewhat as we lap a period of exceptionally strong comps and with macro forces including interest rates starting to impact project economics. Expectations for Q2 are most robust for Electrical Equipment and Power, both expected up ~2.7-2.8%, with Automation expected to see slight growth of 1.3%.

Figure 3: Summary of Key Distributor Anecdotes

• *"Nothing's really changed, still scrambling for material, offering alternates where we can find them"; "Status quo"*
• *" We had a strong Q1 but that was back log falling out of the system"*
• *"Quotation and day to day activity has slowed some"*
• *"The high interest rates are starting to negatively effect our sales to the OEM market as their sales are slowed"*
• *"Things are starting to slow down"*
• *"Interest rates are slowing down things but probably not as fast as the Fed wants"*
• *"Luckily haven't had cancellations yet"*
• *Charging, energy storage like a "tidal wave you see but it hasn't broken yet"*
• *"ROK and ETN still have a long way to go before they get to where they need to be"*
• *Utilities investing in backing up power*
• *"We're on the verge of them (the Fed) breaking the economy"*
• *"Some manufacturers have improved, most have gotten worse. As business stays strong they're farther behind."*
• *Still having huge huge lead times, stuff on order over a year old (14 months)*
• *"Being lied to so often don't know what's true and what's not"*
• *"Still a lot of 'living with it so I don't go back to the end of the line' "*
• *Overall lighting is strong, keeps expanding to different types and size modules, becoming more intelligent*
• *"Switchgear in shambles"*
• *EV charging activity percolating (including municipal - buses)*
• *" Thing gets pushed out a few months out of nowhere, planning for April and ends up starting June or July"*
• *"Battling to keep our heads above the water" but "optimistic"*

Source: Company Reports and Vertical Research Partners

Figure 4: Distributors Expecting Q223 Up ~2.3%



Source: Company Reports and Vertical Research Partners

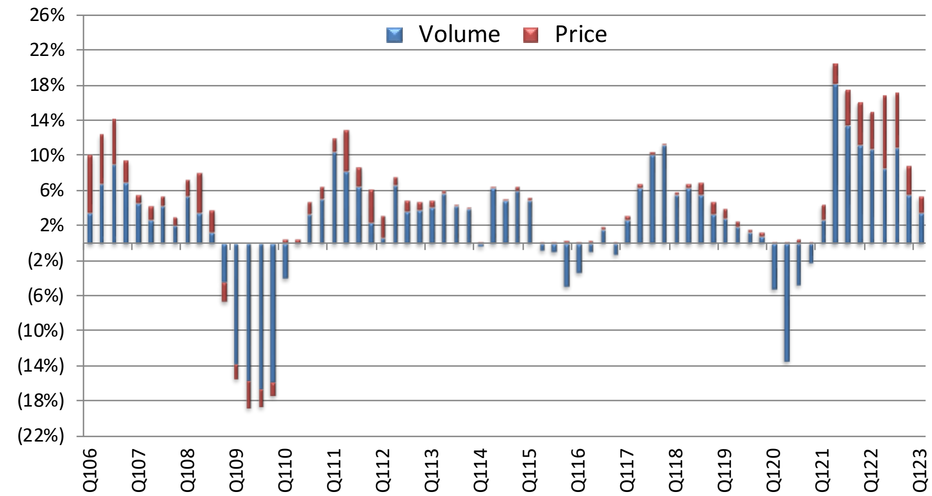
Q1 End-Market Review

Distributors continued to notice some softness emerging in commercial construction related to higher interest rates. Infrastructure remains a pocket of strength as government stimulus is beginning to manifest. The infrastructure bill sounds like an obvious multiyear tailwind (heard of specific project activity in the Boston area) and the Inflation Reduction Act (essentially a climate stimulus) appears to be driving some EV activity in certain parts of the country. For the second straight quarter we heard about percolating charging related demand. Last quarter's analogy was "smoke but no fire yet", this quarter it is more like "a tidal wave that you can see but hasn't broken". Energy storage is also an emerging demand driver. MRO activity appeared to be broadly robust across a variety of industries. Several distributors pointed to slower sales at OE customers themselves trickling down to slower orders. Institutional verticals including healthcare and education are less interest rate sensitive and continue to make steady investments. We would note that our polling methodologies of end markets can result in real-time sentiment (i.e. current month's pulse), versus what actually occurred in the quarter and view these reads as more directional indicators of activity.

Electrical Equipment

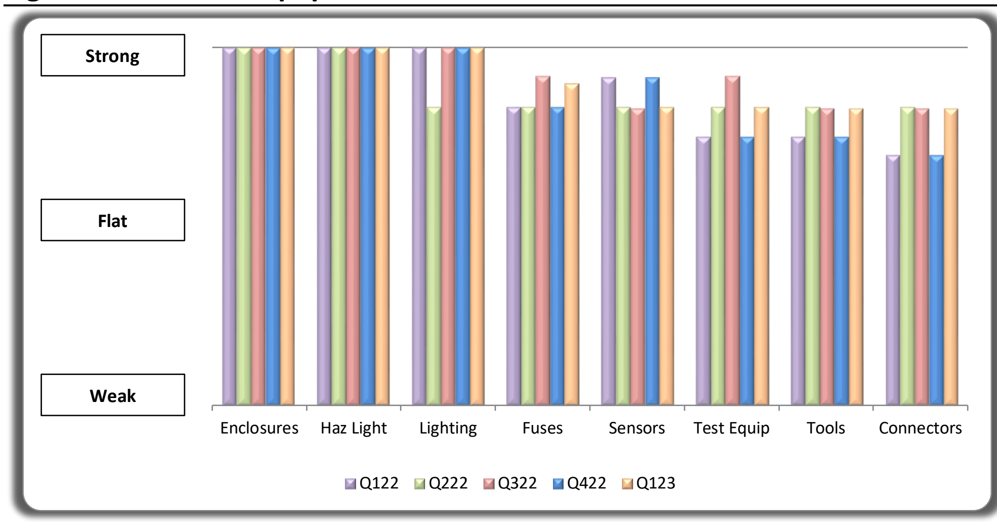
Electrical Equipment sales grew 5.4% in Q1 on 3.5% volume growth and 1.9% of price. The two-year growth stack remained solid at 20.5%. A deceleration was inevitable after an extended period of record growth coming out of the pandemic. Electrical Equipment had led on growth among product categories in every quarter of 2022. Demand remains broadly strong across product categories even as absolute growth rates moderate in the face of strong comps. Specifically we picked up on continued broad strength in Lighting and Enclosures.

Figure 5: Electrical Equipment Volumes up 3.5%, Price up 1.9%



Source: Company Reports and Vertical Research Partners

Figure 6: Electrical Equipment Product Demand

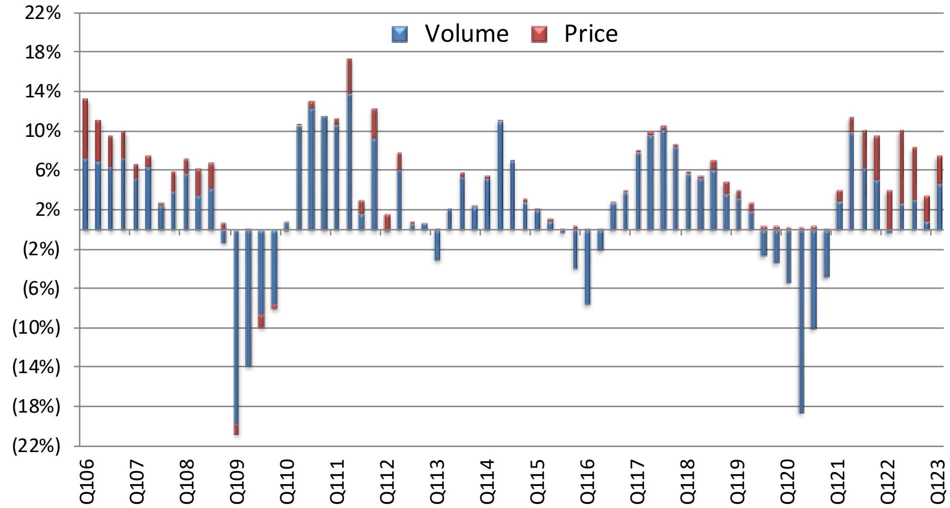


Source: Company Reports and Vertical Research Partners

Automation

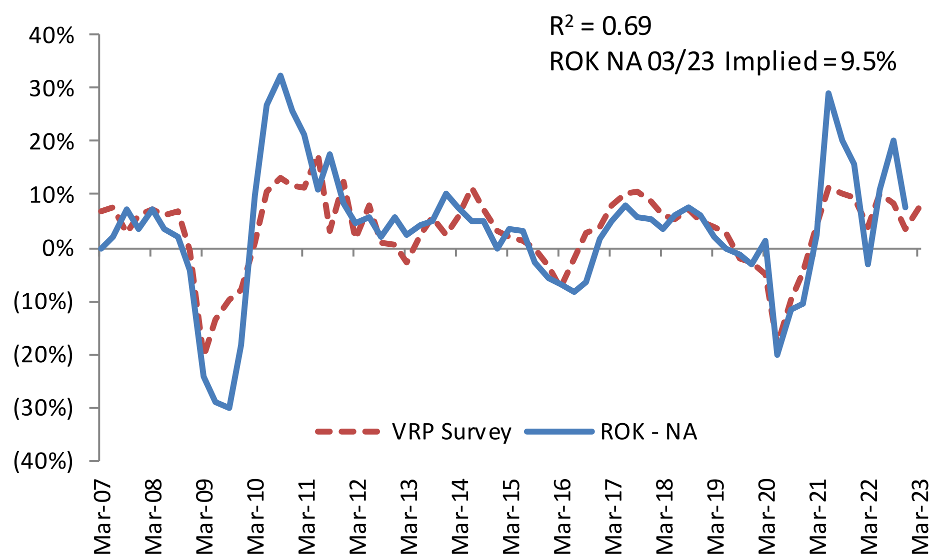
Automation sales grew 7.6% in Q1 with both volume and price growth leading among distributor categories, up 4.7% and 2.9% respectively. The 2- year growth stack of 11.4% decelerated slightly from the 13.1% in Q4. Automation has generally lagged Electrical and Power since turning negative back in H219 as a general industrial recession seemed likely. While there appears to be significant pent-up demand, the post-COVID recovery has been limited by the supply chain crunch which has disproportionately impacted automation given a relatively higher intensity of electronic components. The historical correlation between our survey and ROK's North American sales is high (the US & Canada represent ~60% of total ROK sales) and implies ROK NA should grow ~9.5% in its FQ2. We are modeling total ROK organic sales up 18% for its FQ2 led by 21% growth in Intelligent Devices. We are modeling 16% growth in Software & Control and 15% growth in Lifecycle Services. Note that ROK's North America business is facing a relatively easy comp (-3.2%).

Figure 7: Automation Volume Up 4.7%, Price up 2.9%



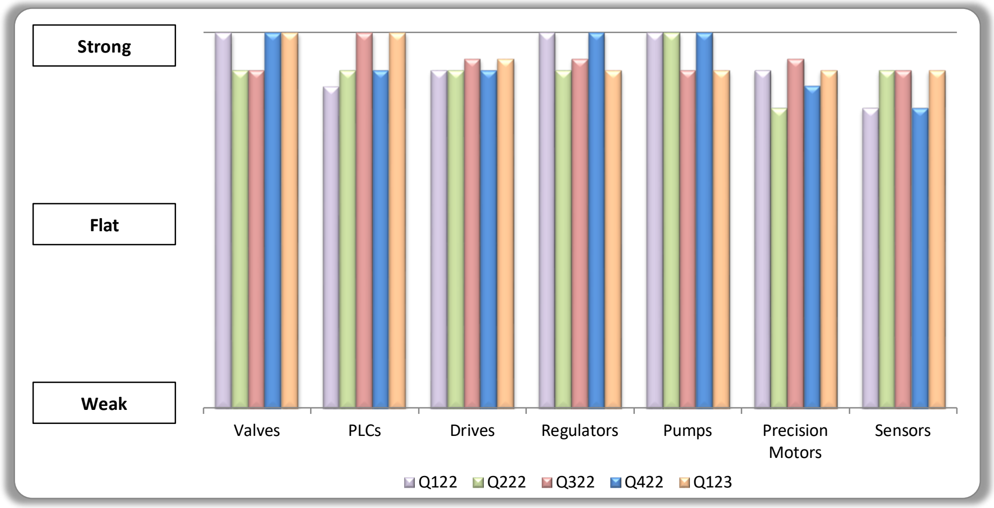
Source: Company Reports and Vertical Research Partners

Figure 8: Automation Regression - Survey Predicts ROK NA Sales up ~9.5%



Source: Company Reports and Vertical Research Partners

Figure 9: Automation Product Demand

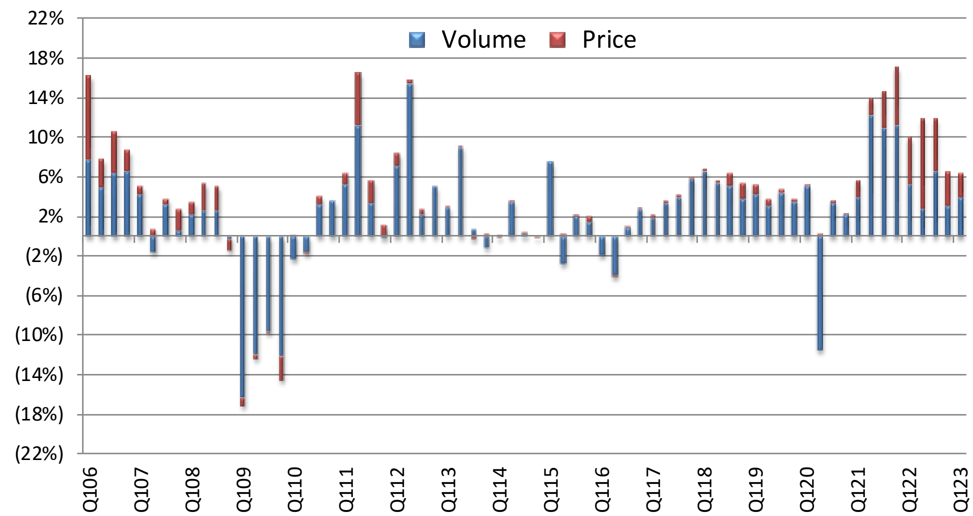


Source: Company Reports and Vertical Research Partners

Utility T&D

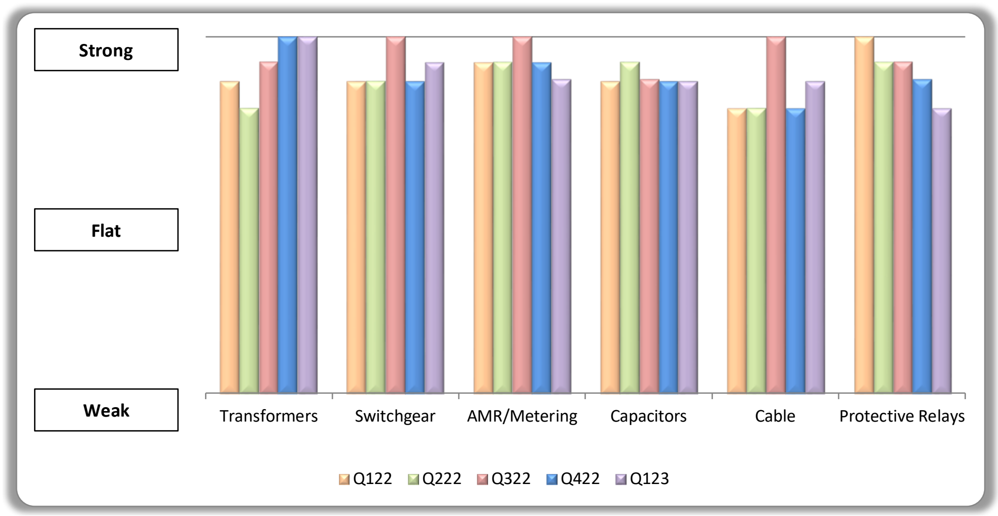
Power results remained solid in Q1, up 6.3% on 3.9% volume growth and 2.4% of price. The two year growth stack was solid at 16.3%. Switchgear demand remains strong but availability remains an issue reported by multiple distributors. We are beginning to see some moderation in absolute growth rates as we lap a period of very strong comps but we still maintain an overall positive bias on the US T&D outlook as we think there is a real, multiyear investment cycle underway. Aside from the decline in the peak COVID impact (Q220), distributors have reported growth in Power in every quarter since Q316. Natural disasters (i.e. hurricanes and wild fires) and national security concerns have kicked off investment in grid modernization and hardening, a key priority of several major US utilities. Increased deployment of renewable energy capacity spurred by state policies is also driving demand for grid hardening. We also picked up on emerging demand around energy storage. See our latest T&D update note for more detail: T&D Trends and Spending Priorities. For Q1 we are modeling HUBB's Utility Solutions segment up 11% organically on 2% volume growth and 9% of price.

Figure 10: Power Volume up 3.9%, Price up 2.4%



Source: Company Reports and Vertical Research Partners

Figure 11: Power Equipment Product Demand

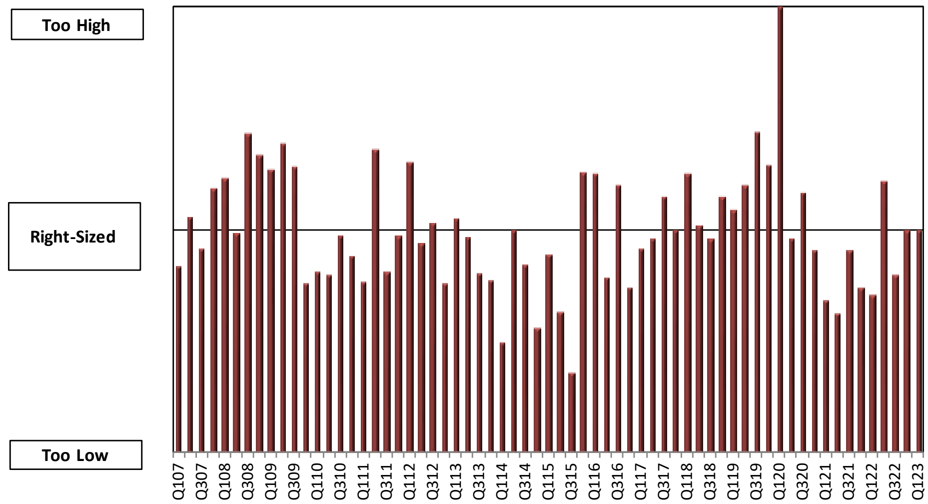


Source: Company Reports and Vertical Research Partners

Inventories Right Sized

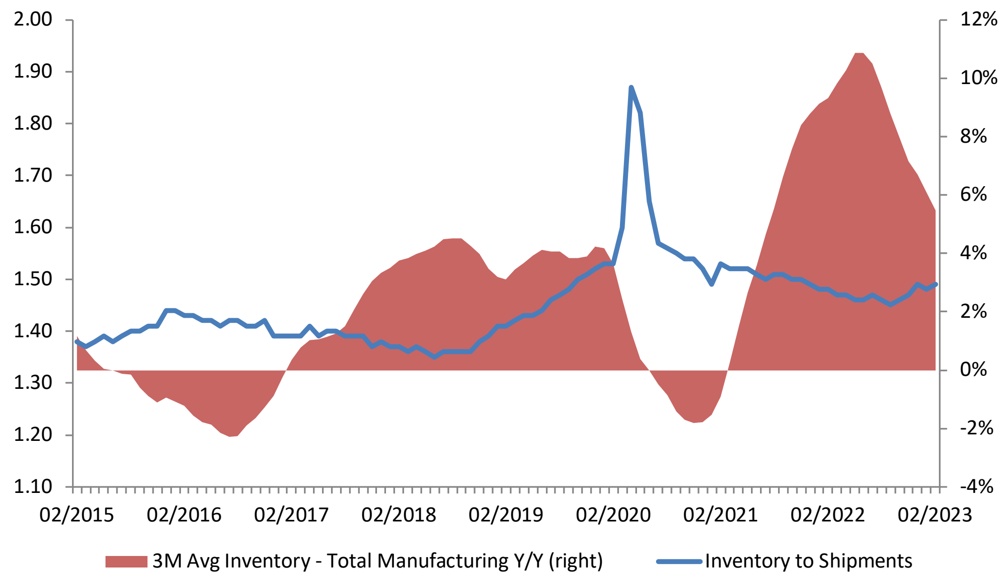
Our inventory index reading for Q1 was about right-sized for the second straight quarter. While inventories averaged out to a "normal" level, the picture is not uniform as we continue to see variations in inventories on hand across distributors. Similar to the discussion on lead times below, we suspect the inventory right-sizing we are seeing reflects distributors adapting to the post-COVID dynamics around supply chains and customer demand rather than a return to historically "normal" inventory levels. Inventories have seen some significant swings after a record level spike in Q120 as things came to a quick halt with the COVID outbreak. Inventories previously were trending higher for about a year, which may have been partially tied to tariff pre-buys. Absolute manufacturing inventories reported by the US Census Bureau have declined but the inventory/sales ratio has ticked slightly higher.

Figure 12: Inventories Stabilizing Around Normal Levels



Source: Company Reports and Vertical Research Partners

Figure 13: Manufacturing Inventory/Sales Through February 2023

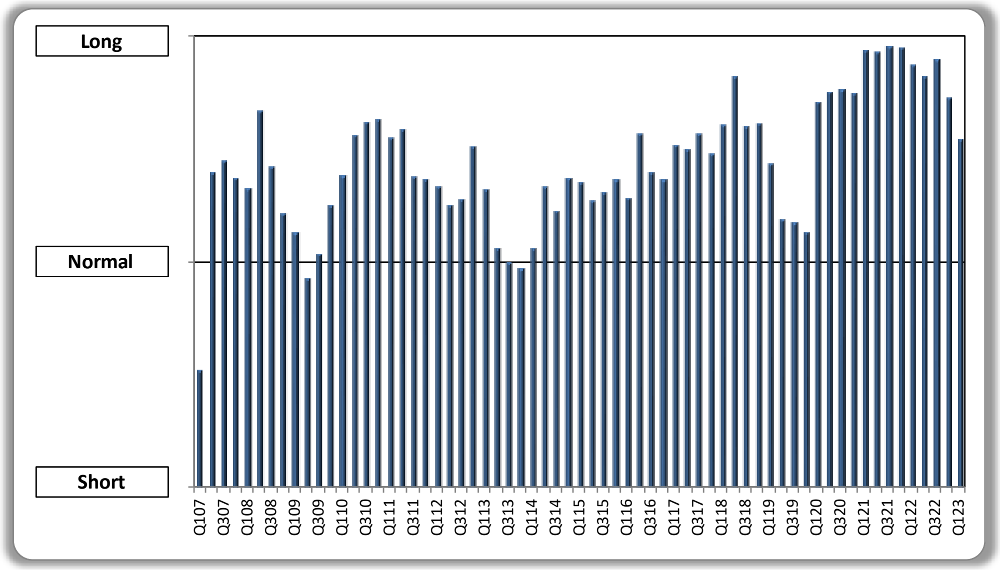


Source: US Census Bureau

Lead Times Take Another Leg Lower

Our lead time index for Q1 showed continued signs of easing supply chain conditions. Overall the index remains relatively elevated as shortages still persist across a number of products and components. Given continued frustrations around select product availability, the apparent moderation in lead times likely reflects some distributors becoming accustomed to the "new normal." We may be years away from returning to pre-pandemic service levels and some distributors express doubt that we ever will. Switchgear lead times remain eye-popping (100+ weeks in some cases) and PLCs continue to be very tight. We continue to hear about availability issues with nearly all of the major OEMs including ABB, ETN, ROK, SIE and SU.

Figure 14: Lead Times Take Another Leg Lower

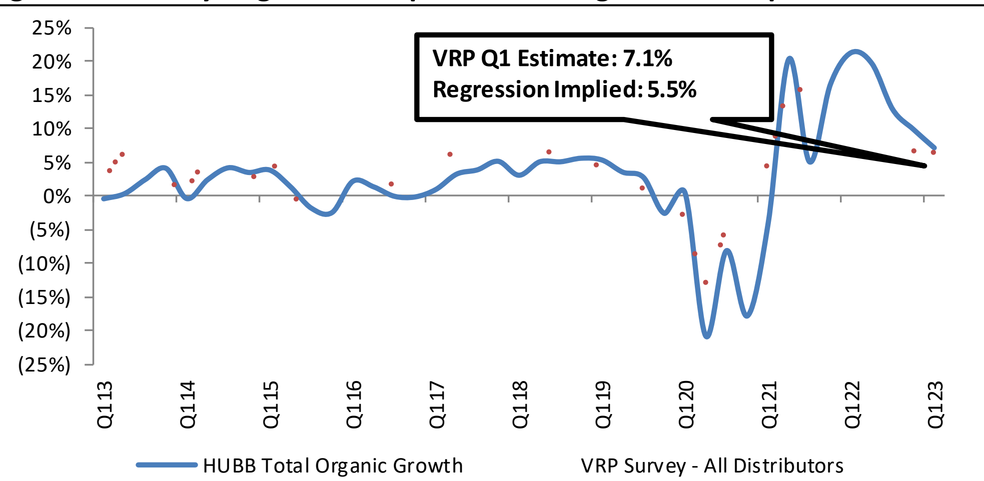


Source: Company Reports and Vertical Research Partners

HUBB, ETN, NVT versus VRP Survey Results

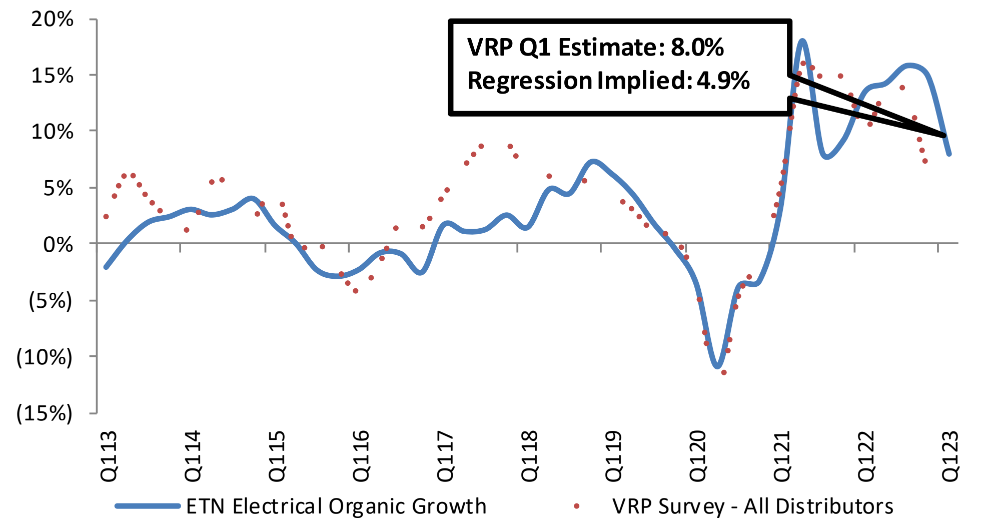
Our survey does not typically yield the very high mathematical correlations (R^2) on ETN, NVT and HUBB, like we see on ROK and WCC. However, the relationship between our survey results and company performance is visually clear. In addition, we see evidence that the survey often leads some elements of business for these companies. For example, there have been several quarters where our Power survey results actually lead directional turns in HUBB Power by a quarter or two. Mathematically, this reduces the R^2 because the data series are moving in different directions, but the signal from the survey is valuable.

Figure 15: Survey Regression Implies HUBB Organic Sales Up 5.%



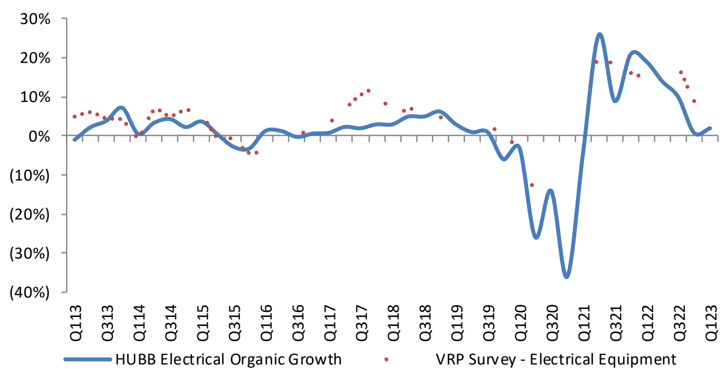
Source: Company Reports and Vertical Research Partners

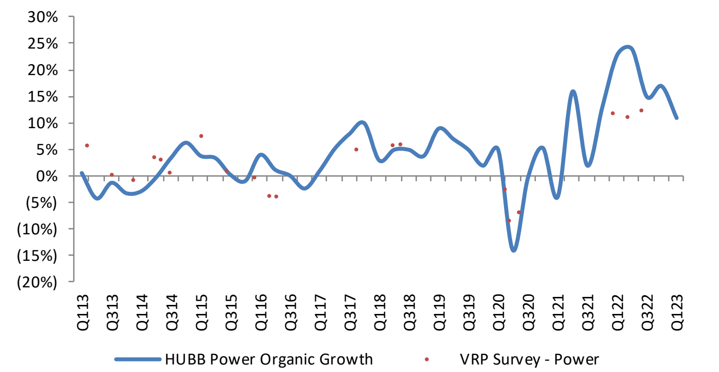
Figure 16: Survey Regression Implies ETN Electrical Organic Sales Up 4.9%



Source: Company Reports and Vertical Research Partners

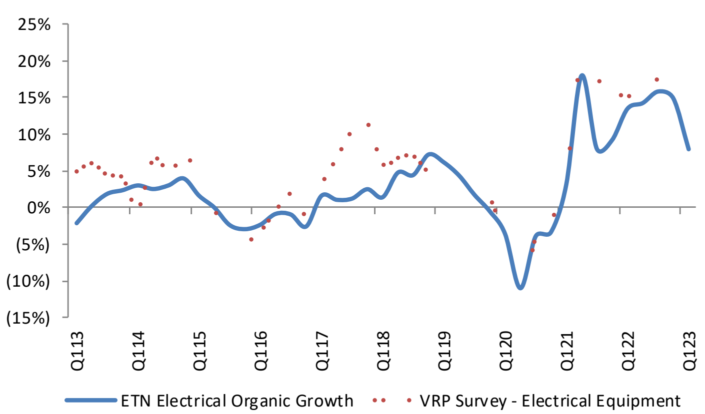
Figure 17: HUBB Power/Electrical Organic Growth vs. VRP Distributor Survey (HUBB Q1 VRP Estimate)

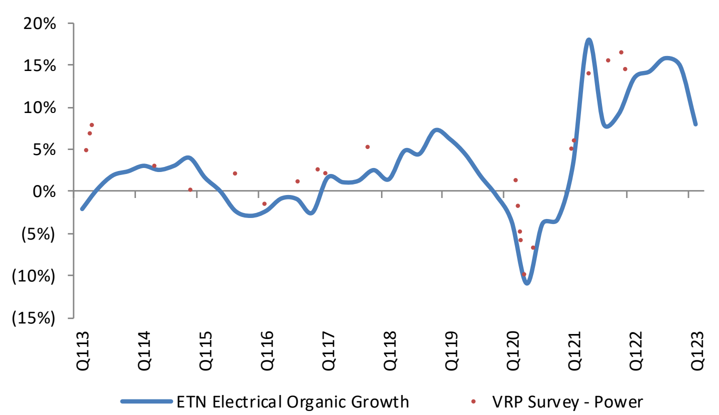




Source: Company Reports and Vertical Research Partners

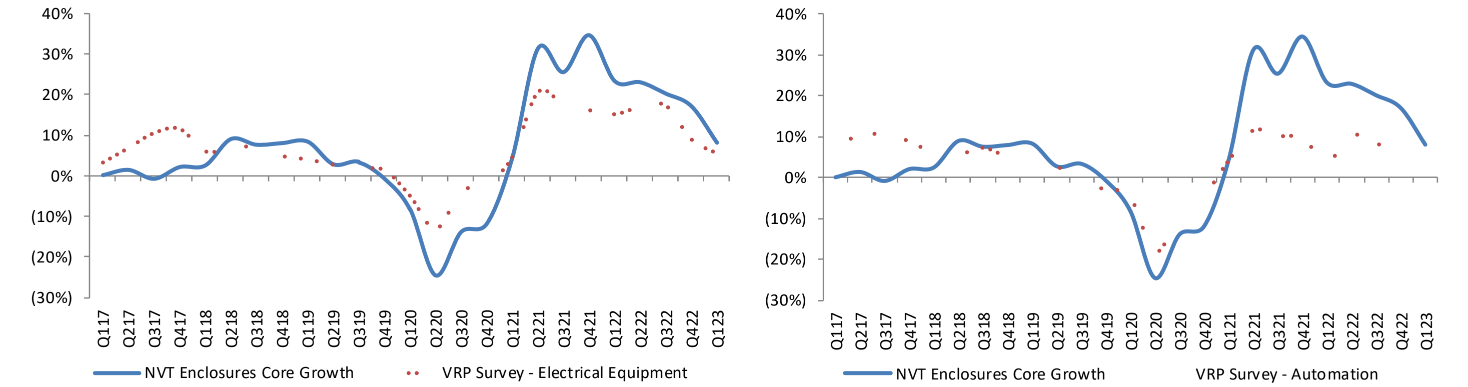
Figure 18: ETN Electrical Organic Growth vs. VRP Distributor Survey (ETN Q1 VRP Estimate)





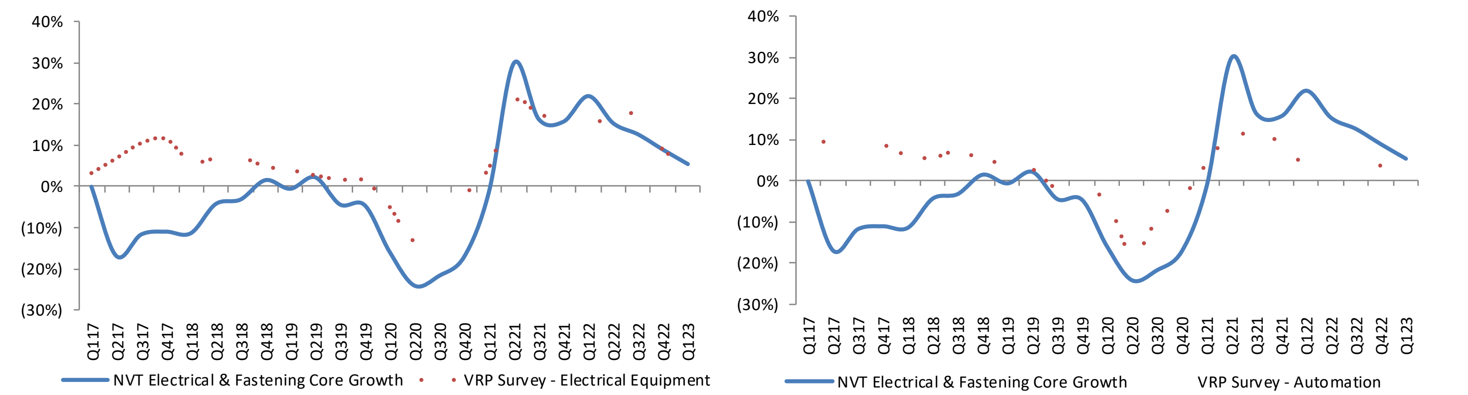
Source: Company Reports and Vertical Research Partners

Figure 19: NVT Enclosures Core Growth vs. VRP Distributor Survey (NVT Q1 VRP Estimate)



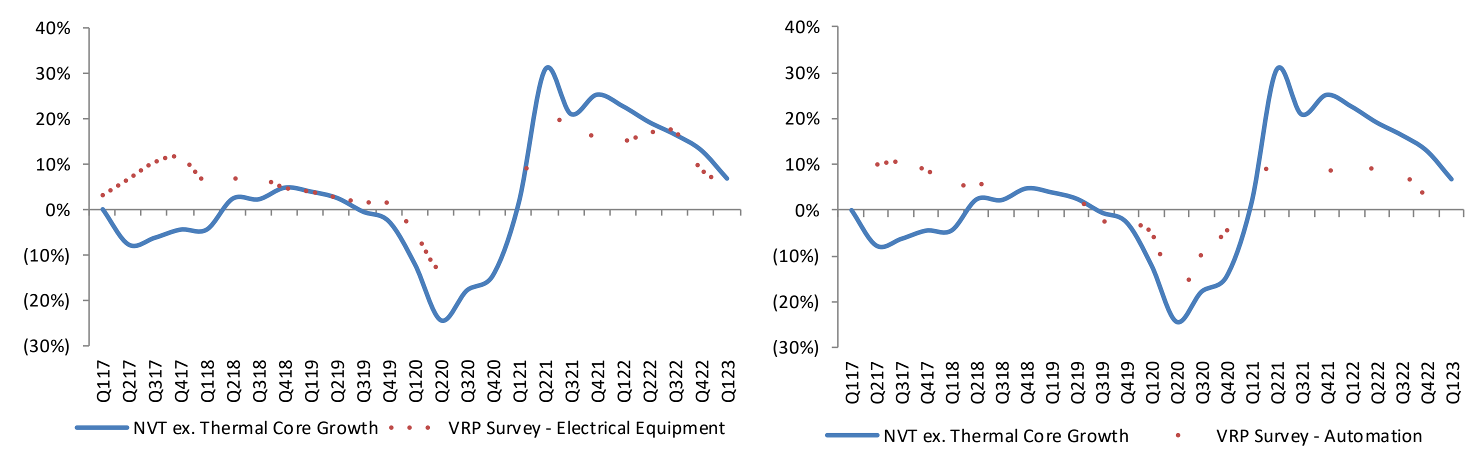
Source: Company Reports and Vertical Research Partners

Figure 20: NVT Electrical & Fastening Core Growth vs. VRP Distributor Survey (NVT Q1 VRP Estimate)



Source: Company Reports and Vertical Research Partners

Figure 21: NVT ex. Thermal Core Growth vs. VRP Distributor Survey (NVT Q1 VRP Estimate)



Source: Company Reports and Vertical Research Partners

Public Distributor Growth Rates and Commentary

Our efforts to forecast sales growth for our coverage list have focused on the distribution channel, and our primary analytical technique has been our quarterly survey of individual branch and regional sales managers. In an attempt to better frame the surveyed growth estimates, we calculated the consensus growth rates for selected publicly traded distributors. The selected public distributors account for 2022 sales of approximately $58 billion. As a reasonability check, the implied growth rates for these companies should generally fall in line with our survey estimates. We would note that we would expect the benefit of price to reasonably be in-line with what our distributor contacts would report. However, we expect there to be divergences in volume – many of the public distributors listed below are much larger and continue to aggressively seek share gains from smaller private distributors thereby leading to volumes above what our survey would indicate. New store openings can also skew public company growth rates higher than our survey results might indicate.

The estimated equally-weighted average/median calendar Q123 revenue growth rate for the public distributor group is ~9.4% versus the same period last year with a median of 10.9%. Our survey shows volumes up 4.0% and with price up 2.4% for total revenue up 6.4%. USD denominated coverage will see F/X headwinds in the near term. Note distributor consensus growth estimates include the benefit of any small scale branch acquisitions/closings during the year, but we are excluding significant transactions.

Figure 22: Public Distributors Q123 Consensus Growth Rates

		2022/1C Q122 Rev Reported	2023/1C Q123 Rev Consensus Est	Q123 Rev Growth Est (y/y)
Watsco	WSO	$1,524	$1,525	0.1%
W.W. Grainger	GWW	$3,647	$4,078	11.8%
MSC Industrial Direct	MSM	$863	$962	11.5%
Wesco	WCC	$4,932	$5,440	10.3%
Fastenal	FAST	$1,704	$1,859	9.1%
Applied Industrial	AIT	$981	$1,116	13.8%
Equally Weighted Average		**$2,275**	**$2,497**	**9.4%**
Equally Weighted Median		**$1,614**	**$1,692**	**10.9%**

Source: FactSet

The estimated equally-weighted average calendar Q223 growth rate for the public distributor group is 6.2% on average with a median growth rate of 6.3%. Our survey respondents anticipate overall organic revenue to be up 2.3% next quarter. The distributor consensus growth estimates include the benefit of any small scale branch acquisitions/closures during the year.

Figure 23: Public Distributors Q223 Consensus Growth Rates

		Q222 Rev Reported	Q223 Rev Consensus Est	Q223 Rev Growth Est (y/y)
Watsco	WSO	$2,134	$2,200	3.1%
W.W. Grainger	GWW	$3,837	$4,180	8.9%
MSC Industrial Direct	MSM	$959	$1,016	6.0%
Wesco	WCC	$5,484	$5,907	7.7%
Fastenal	FAST	$1,779	$1,894	6.5%
Applied Industrial	AIT	$1,061	$1,114	4.9%
Equally Weighted Average		**$2,542**	**$2,718**	**6.2%**
Equally Weighted Median		**$1,956**	**$2,047**	**6.3%**

Source: FactSet

The estimated equally-weighted average 2023 growth rate for the public distributor group is 7.5% on average. The median implied 2023 growth rate is up 6.7%. The distributor consensus growth estimates include the benefit of any revenue related to small branch acquisitions/closures during the year.

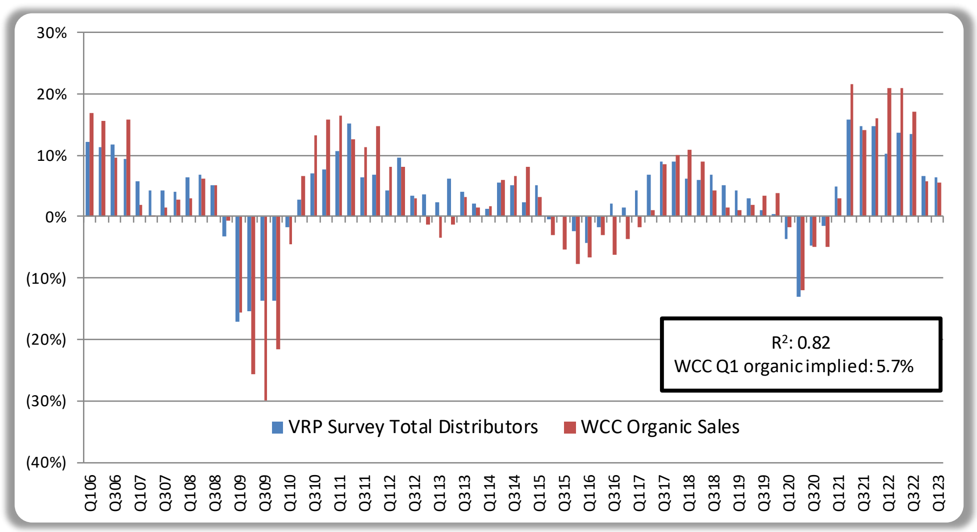
Figure 24: Public Distributors 2023 Consensus Growth Rates

		2022 Rev Reported	2023 Rev Consensus Est	2023 Rev Growth Est (y/y)
Watsco	WSO	$7,274	$7,500	3.1%
W.W. Grainger	GWW	$15,228	$16,485	8.3%
MSC Industrial Direct	MSM	$3,692	$3,921	6.2%
Wesco	WCC	$21,420	$22,975	7.3%
Fastenal	FAST	$6,981	$7,370	5.6%
Applied Industrial	AIT	$3,811	$4,362	14.5%
Equally Weighted Average		**$9,734**	**$10,436**	**7.5%**
Equally Weighted Median		**$7,127**	**$7,435**	**6.7%**

Source: FactSet

Our survey results have an R^2 of ~0.82 with WESCO's organic growth. WCC reports Q1 results on May 4th. Our survey suggests total WCC organic sales up 5.7% based on historical correlations.

Figure 25: VRP Survey Predicts WCC Q1 Organic Sales Up 5.7%



Source: Company Reports and Vertical Research Partners

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