VERTICAL RESEARCH PARTNERS®

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EE/MI

Q1 Distributor Survey – Nearing Normal

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Ticker	Rating	TP	Price
AYI	HOLD	$290	$265.00
ETN	BUY	$310	$317.26
HUBB	BUY	$383	$406.23
NVT	BUY	$70	$74.90
ROK	HOLD	$275	$288.52
SIE-DE	BUY	€210	€172.66
SU-FR	HOLD	€199	€209.40

Power Surge Drives Q1 Sales Growth – Q1 distributor sales were up 3.3% on roughly equal contributions from both volume (1.7%) and price (1.6%). The two-year growth stack saw modest sequential improvement to 9.7% from 9.1% in Q4. Pricing held steady sequentially overall though there does seem to be an emerging divergence with some distributors actively pushing price in support of margins while others appear to be ceding price to win share. By category, Power (T&D) led with solid 6.9% growth including volumes up 5.1%. Electrical Equipment sales improved sequentially to 2.7% growth, while Automation sales were softest, as distributors had anticipated.

Lead Times and Inventories Step Lower – Branch inventory levels came in at the lowest level reported since Q3 2015, pointing to potential replenishment dynamics through the year. Lead times took a step lower for the third consecutive quarter. Availability overall has improved but continued shortages of switchgear are still holding up project activity. Pockets of medium voltage electrical products are also still challenging as well as electrical fuses and other small circuity components (contributing also to the switchgear shortage). The definition of "normal" may well be a moving target influenced by dynamics in the post-COVID environment but the improvement in lead times and inventories over the past three quarters does point to a stabilization in underlying operating conditions.

Slight Sequential Acceleration Projected for Q2 – Distributors are expecting ~4% growth on average for Q2. Election related uncertainty may hold up the release of certain projects but backlogs remain broadly above pre-COVID levels and should support a steady pace of activity through the year. There are no signs of cancellations or push outs to date and quoting activity sounds healthy. Reshoring continues to drive industrial and general manufacturing activity, while construction has generally held in better than feared in the face of higher interest rates. Several distributors did highlight a change in posture around the EV ecosystem with non-Tesla participants starting to tap the brakes as underlying demand ramps more slowly than anticipated. Rates remain more of a focal point for distributors than the political news cycle.

Read to OEMs – The survey results and commentary are generally supportive of our Q1 estimates. We have HUBB organic sales modeled up 3.2%, about in line with the aggregate survey. Our HUBB estimate includes Electrical up 2% and Utility flat, compared to the survey results of Electrical up 2.7% and Power up 6.9% (regression implies +2.3%). We are modeling total ETN Electrical up 8.7% for Q1 (Americas +13%). Strength in project work, where equipment may at times bypass distribution and go direct to the customer/project and therefore not be captured in our survey, is especially relevant for ETN, and partially explains the delta between our estimates and the survey. Our NVT estimates for Enclosures up 4% and EFS up 5% are in range of the survey results. ROK has generally outperformed our survey in the post-COVID period likely reflecting excess channel fill. We have total core sales for ROK modeled down 12.5% this quarter as the company laps a 27.3% comp. The historical regression points to a 1.1% decline for ROK's North American business. Smoothing the quarterly volatility out with a four-quarter average shows ROK could now be reverting back to the tight historical correlation and could underperform the survey for another quarter or two. North America remains a pocket of relative strength for ROK, with recent cautious commentary centered more around the machine builder complex in Europe/China. The relatively flat automation result in our survey should be a good indication of actual end demand in the quarter suggesting the short cycle drawdown has largely run its course.

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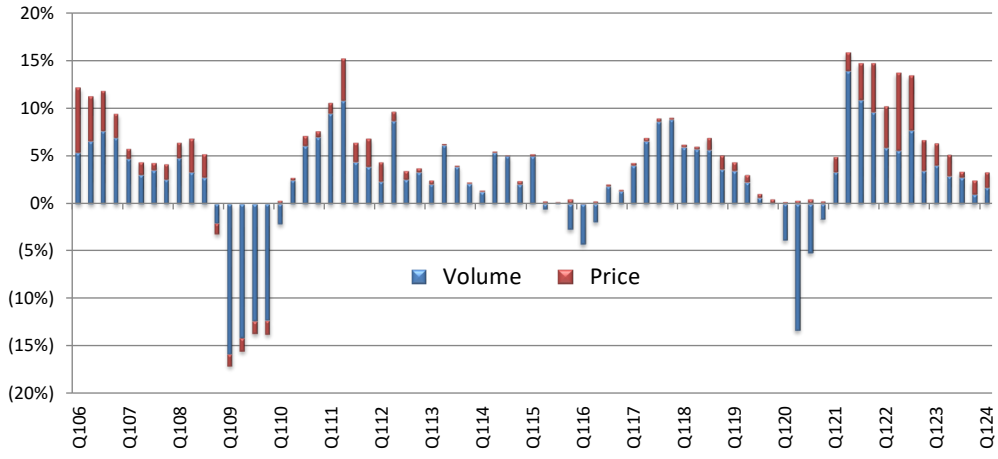
Key Highlights from Survey

- Q1 distributor sales grew 3.3% with roughly equal contributions from volume (1.7%) and price (1.6%)
- The two-year growth stack of 9.7% was a slight step up from the 9.1% in Q4
- Distributors are on average expecting sales up 4% in Q224, the same as the in-going expectation for Q1
- Power sales picked up to 6.9% as volumes surged (up 5.1%) and price held steady at 1.8%
- Electrical sales were also up sequentially, to 2.7% from 2.1% in Q4, with similar contributions from volumes (1.5%) and price (1.2%)
- Automation sales decelerated slightly more than distributors had forecasted, declining a modest 0.4% versus the prior year (projection was for 1.4% growth)

In this report, we present the results of our Q1 2024 proprietary North American Distributor Survey. We surveyed 39 distributor branch managers in total throughout North America capturing more than ~$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 39 distributors, 18 sold electrical equipment, 12 focused on T&D utility customers and 9 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 1.7%, Price up 1.6%



Source: Company Reports and Vertical Research Partners

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Figure 2: VRP Distributor Survey Results

Industry	Q119	Q219	Q319	Q419	Q120	Q220	Q320	Q420	Q121	Q221	Q321	Q421	Q122	Q222	Q322	Q422	Q123	Q223	Q323	Q423	Q124
All Distributors	**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%**	**5.1%**	**3.3%**	**2.4%**	**3.3%**
Volume	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%	2.9%	2.7%	0.9%	1.7%
Price	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%	2.2%	0.6%	1.5%	1.6%
Total Power	**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%**	**8.0%**	**4.0%**	**1.9%**	**6.9%**
Volume	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%	4.7%	3.2%	0.1%	5.1%
Price	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%	3.3%	0.8%	1.8%	1.8%
Total Automation	**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%**	**1.3%**	**3.0%**	**3.2%**	**(0.4%)**
Volume	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%	(0.9%)	2.3%	1.9%	(2.8%)
Price	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%	2.2%	0.7%	1.3%	2.4%
Total Electrical Equipment	**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%**	**5.5%**	**3.2%**	**2.1%**	**2.7%**
Volume	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%	4.1%	2.7%	0.9%	1.5%
Price	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%	1.4%	0.5%	1.2%	1.2%

Source: Company Reports and Vertical Research Partners

Q124 Distributor Anecdotes and Outlook

Below we summarize commentary and anecdotes from our distributor contacts. Looking forward, distributors are expecting sales up 4% on average for Q2 2024. This is coincidentally equal to the ingoing expectation for Q1, with distributors accurately anticipating the softer results in Automation this quarter, while Power proved more robust than the ingoing 4.7% estimate. There is some caution around release of projects given election year uncertainty but backlogs remain generally strong and comps ease through the year. This suggests we may have successfully managed through the slowdown after the post-COVID recovery period without sales ever turning negative. We have observed a similar result for our group's organic sales growth, which appears to have held positive through the down PMI cycle and now looks poised to potentially accelerate through the year.

Figure 3: Summary of Key Distributor Anecdotes

• *"Commodity deflation is suppressing margin"*
• *"We stocked up so lead times affect us less. We have what our customers are asking us for so just in time delivery is working well for us."*
• *"Slow January but good quote activity"*
• *"Manufacturing capacities improving, logistic challenges, price is flat to down and inventories are light."*
• *"All aspects of Q1 trends lead times/inventory levels at the branch level continue to attempt to rely on quick/instant gratification from manufacturers and suppliers. Expectation for Q2 indicates the same."*
• *"Our day to day SKUs are pretty much back to normal. It is high dollar capital type products - large gear and large drives - that are still long lead*
• *"Distribution is under pressure to lower inventory dollars and causing price erosion."*
• *Backlogs still generally strong, no major cancellations to speak of*
• *OEMs that over purchased now letting their inventory come down*
• *Customers shopping a lot more*
• *Interest rates more of a factor than the election, haven't slowed things as much as feared*
• *Price increases - "have gone from 90% of OEMs doing quarterly price increases to 5% now"*

Source: Company Reports and Vertical Research Partners

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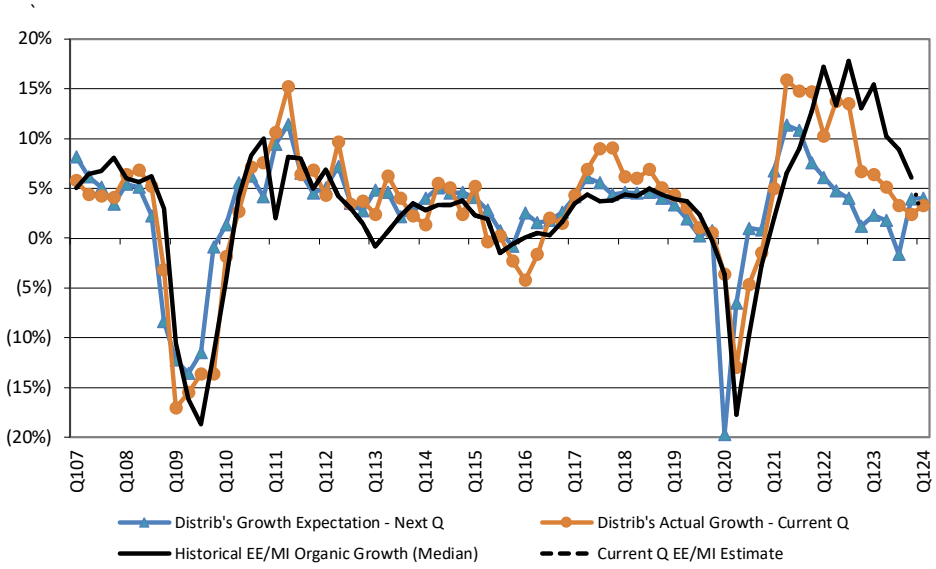
Figure 4: Distributors Expecting Q224 Up ~4%



Source: Company Reports and Vertical Research Partners

Q1 End-Market Review

Reshoring remains a key driver of activity broadly. One notable change in tone from recent quarters relates to the EV market where several distributors pointed to a decreased "sense of urgency" from non-Tesla auto OEMs and tier suppliers ("there are as many people making car chargers as there are EV drivers right now"). Ag equipment was also highlighted as softening of late. We heard some optimistic comments that the machine building market may have bottomed. Food & Beverage activity in the Midwest sounds subdued as producers look to drive returns on COVID-era investments. Data center remains strong with a solid pipeline, though grid integration/power availability is a key constraint. Petrochemical projects in the Gulf Coast, including LNG, are ongoing. Wastewater was also highlighted as a pocket of strength with support from the IRA. Multi-family is driving residential activity in certain regions. Commercial construction remains mixed by vertical and region, with some distributors noting the impact of interest rates on project activity while institutional markets like education and healthcare have shown resiliency. 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 2.7% in Q1 on relatively similar contributions from volume (1.5%) and price (1.2%). The two-year stack dipped below 10% for the first time since Q221. Price was stable sequentially while volumes picked up relative to the ~1% growth in Q4. The growth outlook for Q2 is relatively steady at ~3%.

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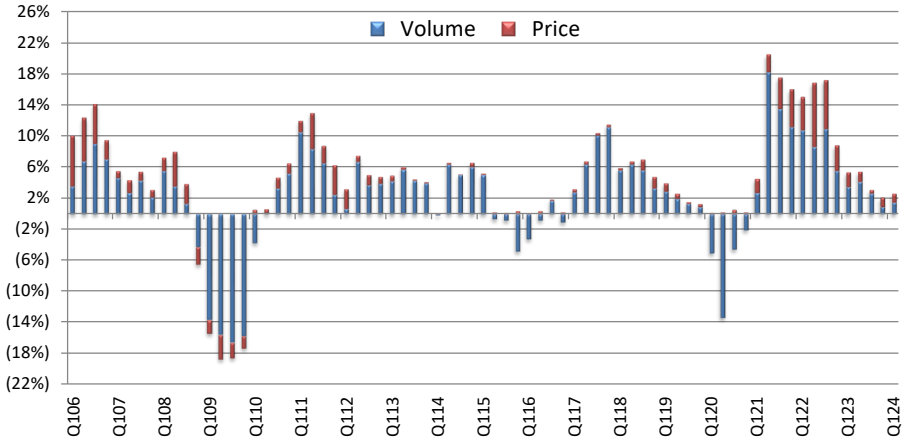
Figure 5: Electrical Volume up 1.5%, Price up 1.2%



Source: Company Reports and Vertical Research Partners

Automation

Automation sales were down slightly in Q1 with 2.4% of price offset by a 2.8% volume decline. 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. In recent quarters, several distributors have pointed to manufacturers finally filling backlogged orders, enabling some catch up. 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 decline 1.1% in its FQ2. We have total core sales for ROK modeled down 12.5%, consistent with the downside guidance provided during conference season and reflecting inventory liquidations in the channel. Smoothing the quarterly volatility out with a four-quarter average shows ROK has been over-performing the survey results for the past several years, and could now be reverting back to the tight historical correlation as channel dynamics normalize. North America remains a pocket of relative strength for ROK, with recent cautious commentary centered more around the machine builder complex in Europe/China. The relatively flat automation result in our survey should be a good indication of actual end demand in the quarter suggesting the short cycle drawdown has largely run its course.

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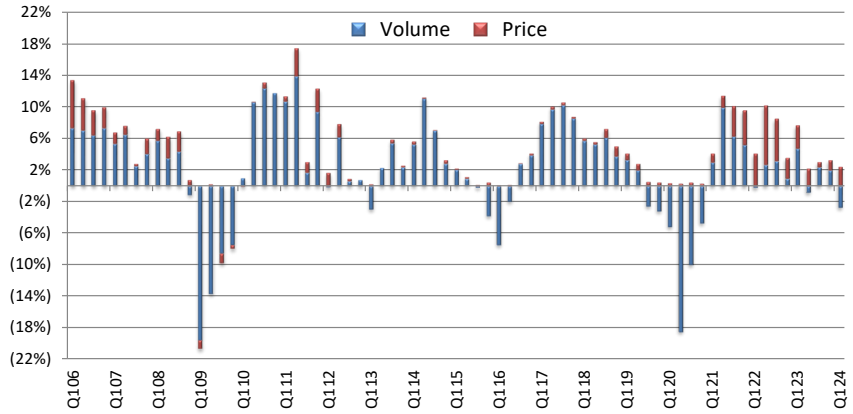
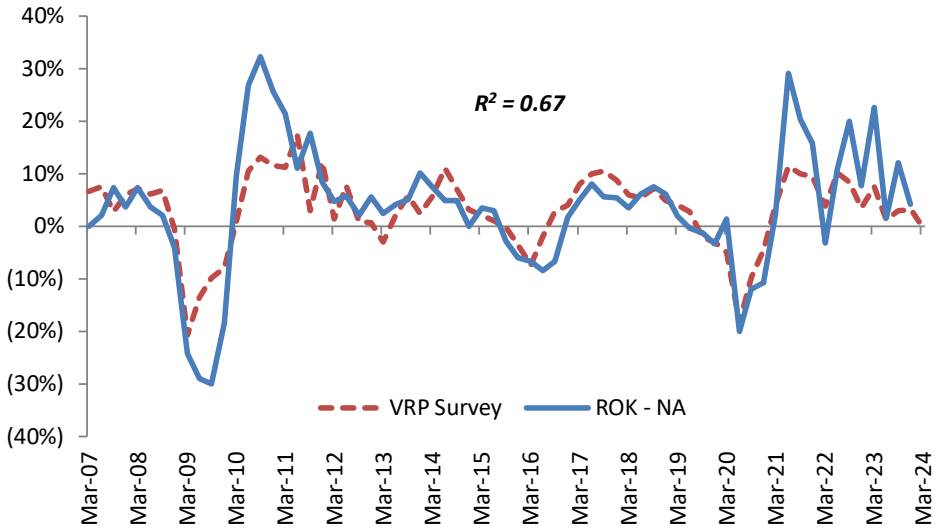
Figure 6: Automation Volume Down 2.8%, Price up 2.4%



Source: Company Reports and Vertical Research Partners

Figure 7: Survey Predicts ROK NA Sales Down ~1.1%



Source: Company Reports and Vertical Research Partners

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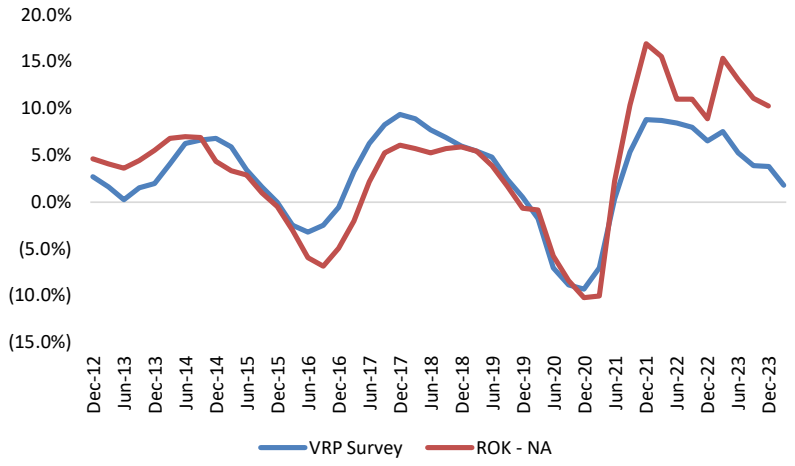
Figure 8: ROK N. America Organic Sales vs. VRP Survey (4Q Average)

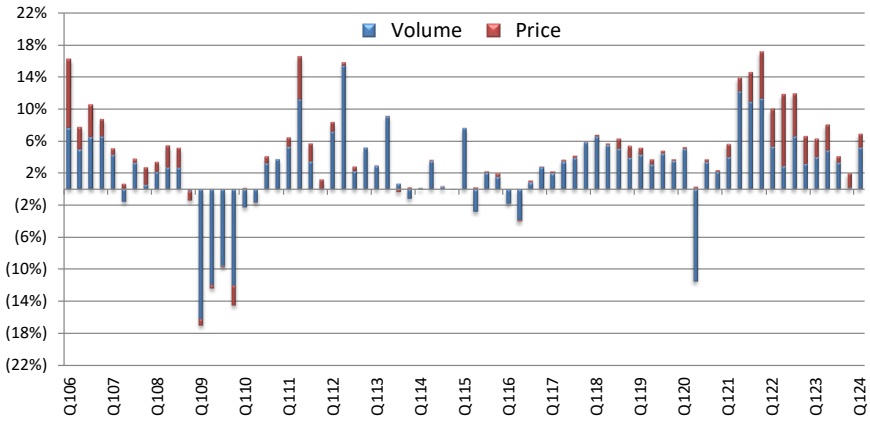


Source: Company Reports and Vertical Research Partners

Utility T&D

Power results reaccelerated in Q1 with 6.9% growth. Price of 1.8% was steady sequentially while volumes markedly picked up to 5.1% growth from the relatively flat result in Q4. The two-year growth stack surged to 13.2% after dipping below 10% for the first time since 2021 last quarter. Switchgear availability remains the primary issue reported by multiple distributors. We were beginning to see some moderation in absolute growth rates lapping a period of very strong comps (averaged 10% growth from Q121-Q323) but the pickup in Q1 offers some support for our ongoing positive bias on the US T&D outlook. 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 have also picked up on emerging demand around energy storage (link). For Q1 we are modeling HUBB's Utility Solutions segment flat organically against a 19.3% comp.

Figure 9: Power Volume up 5.1%, Price up 1.8%



Source: Company Reports and Vertical Research Partners

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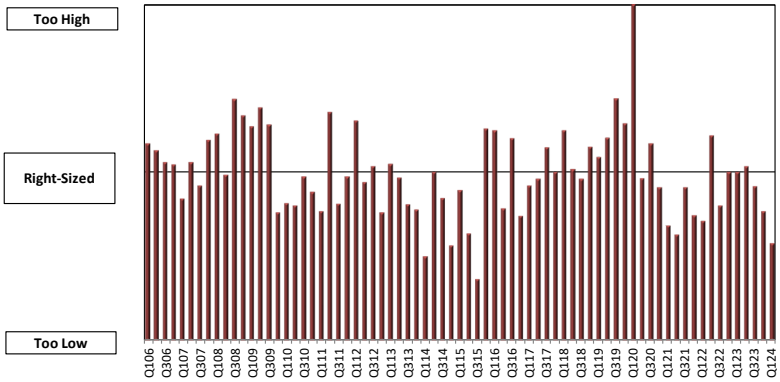
Inventories

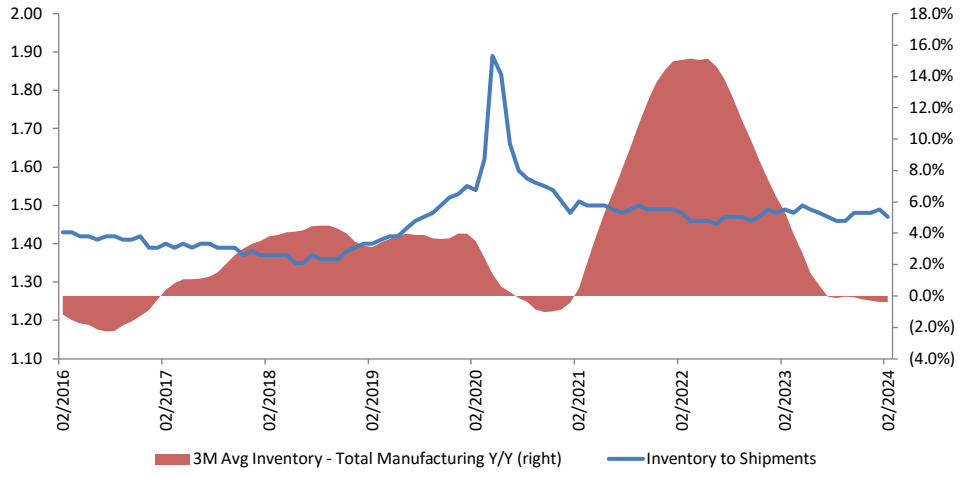
Our inventory index reading for Q1 showed branch level inventories declining for the third consecutive quarter to reach the lowest level in nearly a decade, suggesting we may see some replenishment dynamics playing out early in 2024. There is some discussion around what distributors consider "normal" with some making the strategic decision to hold higher stocks to be able to compete on availability. 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 roughly flattened out on a trailing 3-month basis but the inventory/sales ratio has moderated only slightly.

Figure 10: Inventories Looking Lean



Source: Company Reports and Vertical Research Partners

Figure 11: Manufacturing Inventory/Sales Through February 2024



Source: Census Bureau

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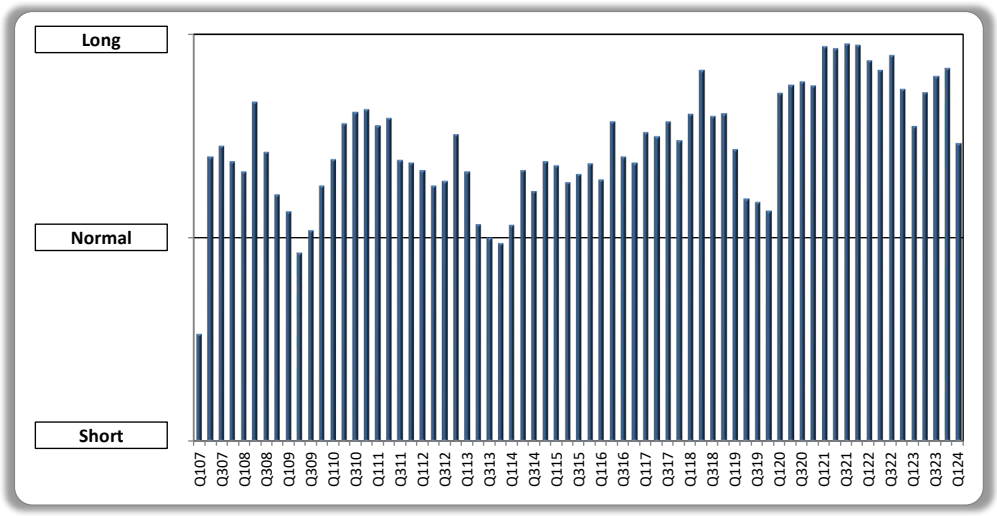
Lead Times

Lead times took a marked step toward lower in Q1 with multiple distributors reporting normal lead times across electrical, automation, and power equipment. We note that the baseline for "normal" is undoubtedly influenced to some degree by post-COVID dynamics, similar to the inventory dynamic noted above. Switchgear is the single biggest issue in terms of availability, though we also heard of some shortages of other medium-voltage electrical products. Electrical fuses and other small circuity components are believed to be contributing to the broader switchgear shortages, though absolute capacity constraints, large volume orders, and a generally increased demand pull (including a perceived crowding out from large data centers) are all contributing factors. Some distributors were dubious that planned capacity increases will be sufficient to meaningfully reduce lead times.

Figure 12: Lead Times Normalizing



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.

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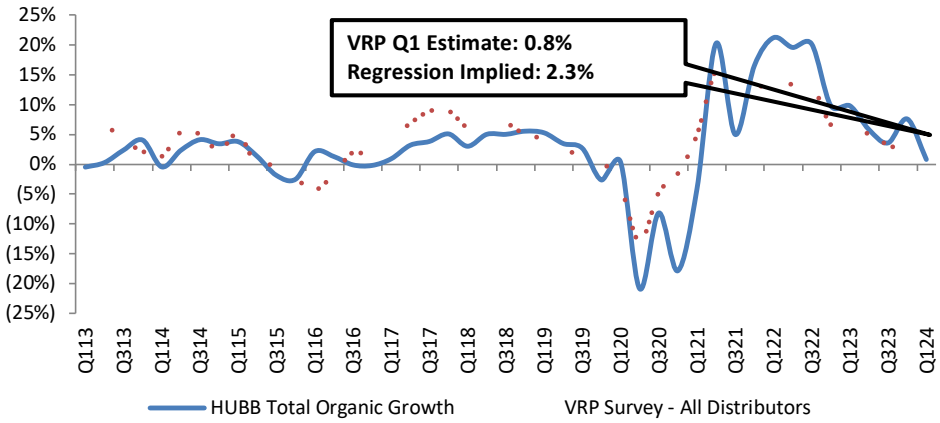
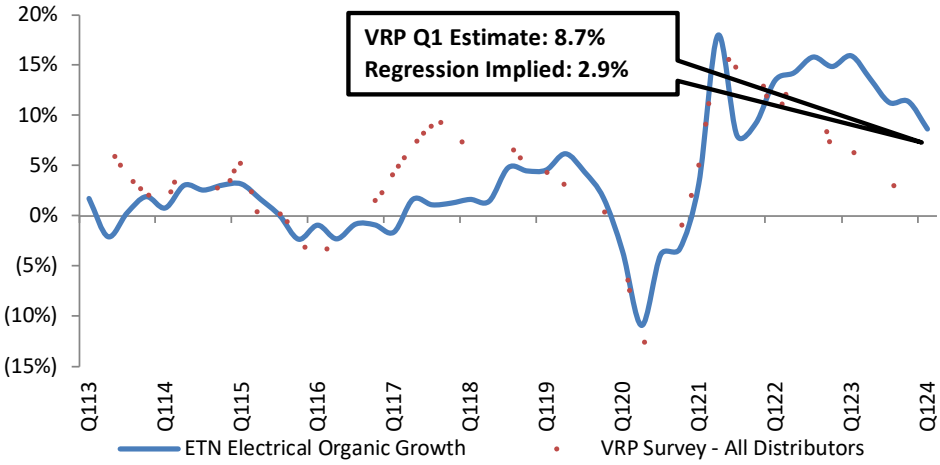
Figure 13: Survey Regression Implies HUBB Organic Sales Up 2.3%



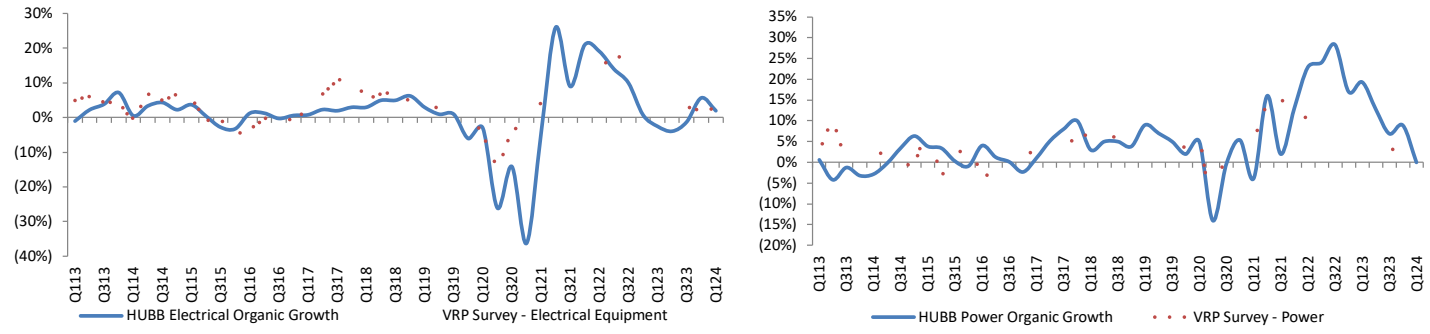
Source: Company Reports and Vertical Research Partners

Figure 14: Survey Regression Implies ETN Electrical Organic Sales Up 2.9%



Source: Company Reports and Vertical Research Partners

Figure 15: HUBB Electrical/Power Organic Growth vs. VRP Distributor Survey (HUBB Q1 VRP Estimate)



Source: Company Reports and Vertical Research Partners

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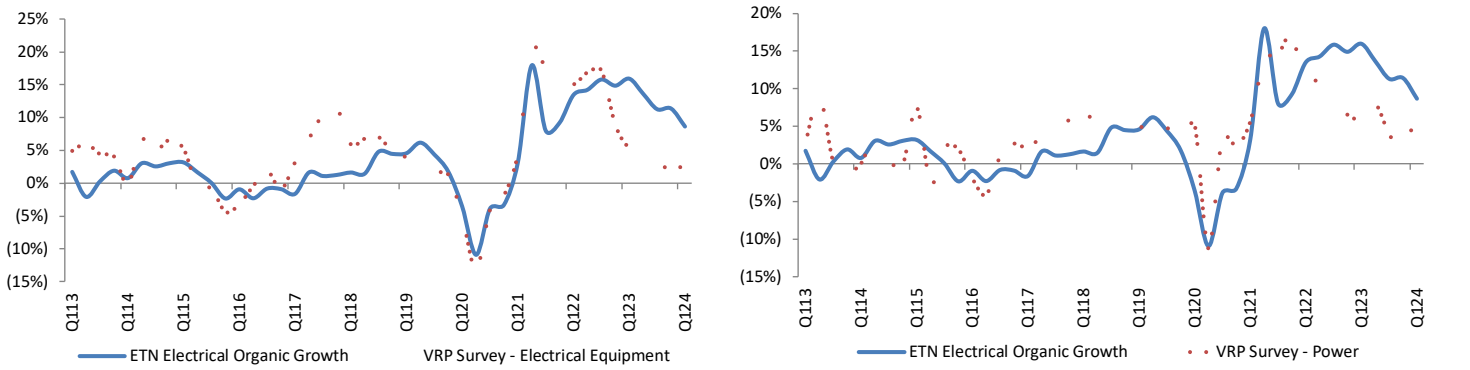
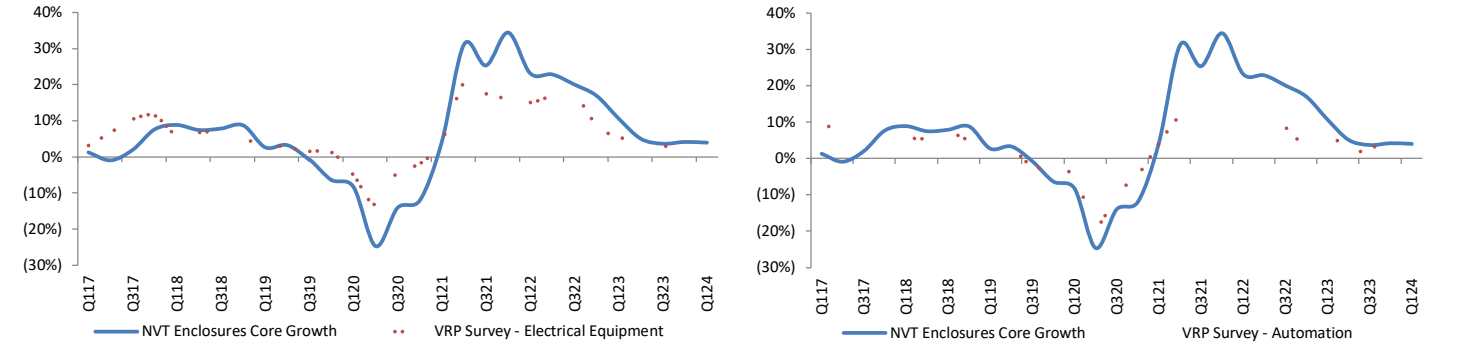
Figure 16: ETN Electrical Organic Growth vs. VRP Distributor Survey (ETN Q1 VRP Estimate)



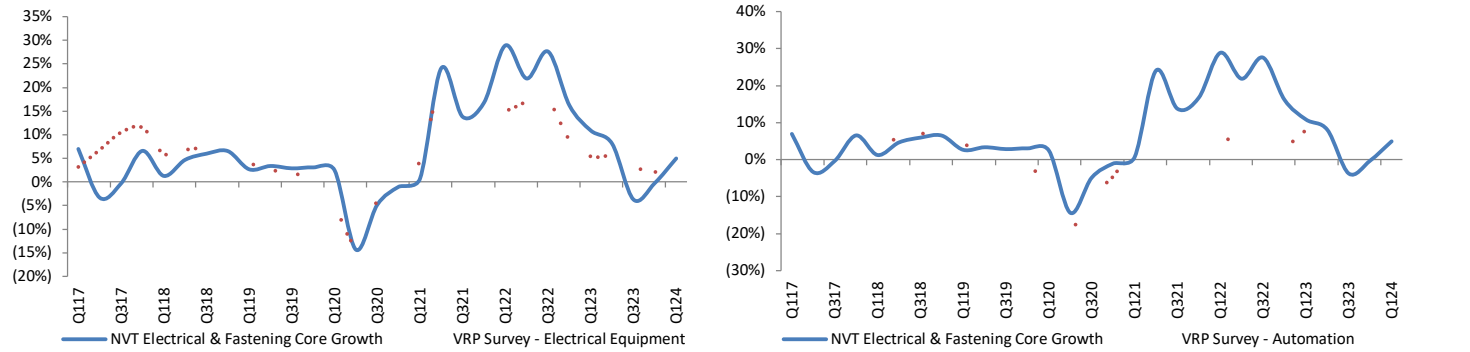
Source: Company Reports and Vertical Research Partners

Figure 17: NVT Enclosures Core Growth vs. VRP Distributor Survey (NVT Q1 VRP Estimate)



Source: Company Reports and Vertical Research Partners

Figure 18: NVT Electrical & Fastening Core Growth vs. VRP Distributor Survey (NVT Q1 VRP Estimate)



Source: Company Reports and Vertical Research Partners

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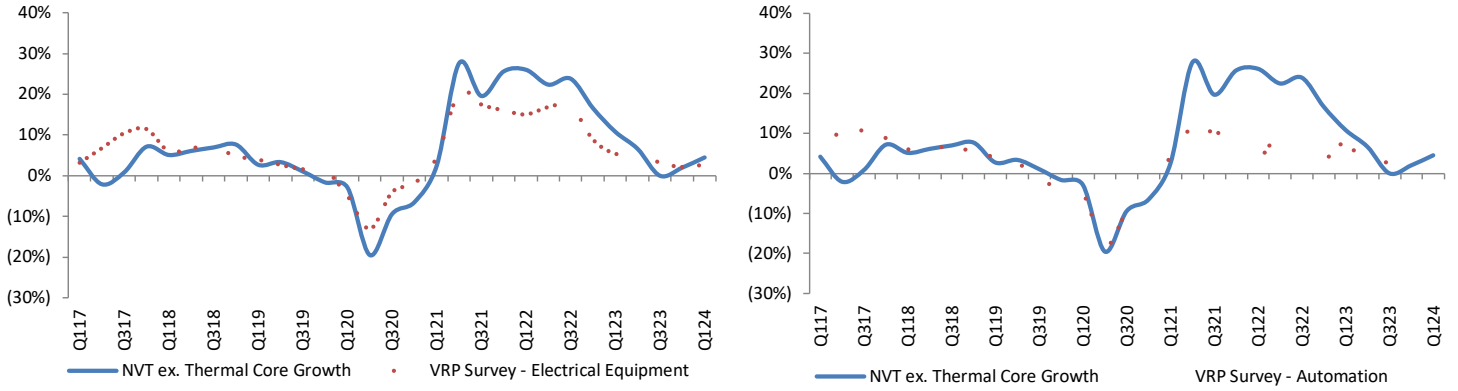
Figure 19: NVT ex. Thermal Core Growth vs. VRP Distributor Survey (NVT Q1 VRP Estimate)



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 2023 sales of approximately $62 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 Q124 revenue growth rate for the public distributor group is ~0.4% versus the same period last year, with negative revisions coming in since our Q4 survey when the estimate was ~2.4%. Our survey shows volumes up 1.7% and price up 1.6% for total revenue up 3.3%. 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 20: Public Distributors Q124 Consensus Growth Rates

		Q123 Rev Reported	Q124 Rev Consensus Est	Q124 Rev Growth Est (y/y)
Watsco	WSO	$1,551	$1,598	3.0%
W.W. Grainger	GWW	$4,091	$4,258	4.1%
MSC Industrial Direct	MSM	$962	$935	(2.7%)
Wesco	WCC	$5,522	$5,299	(4.0%)
Fastenal	FAST	$1,859	$1,895	1.9%
Applied Industrial	AIT	$1,132	$1,132	(0.0%)
Equally Weighted Average		**$2,519**	**$2,519**	**0.4%**
Equally Weighted Median		**$1,705**	**$1,746**	**1.0%**

Source: FactSet

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The estimated equally-weighted average/median calendar Q224 growth rate for the public distributor group is 3.2% with a median of 4%. Our survey respondents anticipate overall organic revenue to be up 4% next quarter.

Figure 21: Public Distributors Q224 Consensus Growth Rates

		Q223 Rev Reported	Q224 Rev Consensus Est	Q224 Rev Growth Est (y/y)
Watsco	WSO	$2,003	$2,189	9.3%
W.W. Grainger	GWW	$4,182	$4,388	4.9%
MSC Industrial Direct	MSM	$1,054	$1,022	(3.1%)
Wesco	WCC	$5,746	$5,757	0.2%
Fastenal	FAST	$1,883	$1,971	4.7%
Applied Industrial	AIT	$1,158	$1,197	3.4%
Equally Weighted Average		**$2,671**	**$2,754**	**3.2%**
Equally Weighted Median		**$1,943**	**$2,080**	**4.0%**

Source: FactSet

The consensus equally-weighted average 2024 growth rate for the public distributor group is 4.1% on average, down ~50bps from the 4.6% estimate as of our Q4 survey. The median implied 2024 growth rate is up 5.1%. The distributor consensus growth estimates include the benefit of any revenue related to small branch acquisitions/closures during the year

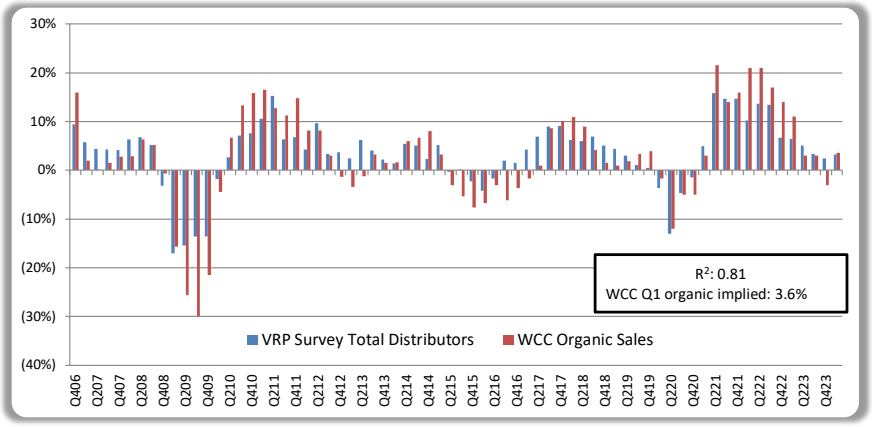
Figure 22: Public Distributors 2024 Consensus Growth Rates

		2023 Rev Reported	2024 Rev Consensus Est	2024 Rev Growth Est (y/y)
Watsco	WSO	$7,284	$7,730	6.1%
W.W. Grainger	GWW	$16,478	$17,479	6.1%
MSC Industrial Direct	MSM	$4,009	$4,036	0.7%
Wesco	WCC	$22,385	$22,679	1.3%
Fastenal	FAST	$7,347	$7,773	5.8%
Applied Industrial	AIT	$4,413	$4,607	4.4%
Equally Weighted Average		**$10,319**	**$10,717**	**4.1%**
Equally Weighted Median		**$7,315**	**$7,752**	**5.1%**

Source: FactSet

Our survey results have an R^2 of ~0.81 with WESCO's organic growth. WCC reports Q1 results on May 2nd. Our survey suggests total WCC organic sales up 3.6% based on historical correlations.

Figure 23: VRP Survey Predicts WCC Q1 Organic Sales Up 3.6%



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