

THE FPDA MOTION & CONTROL NETWORK



Review of Industrial Economy & Industrial Distribution Trends

September 16, 2014

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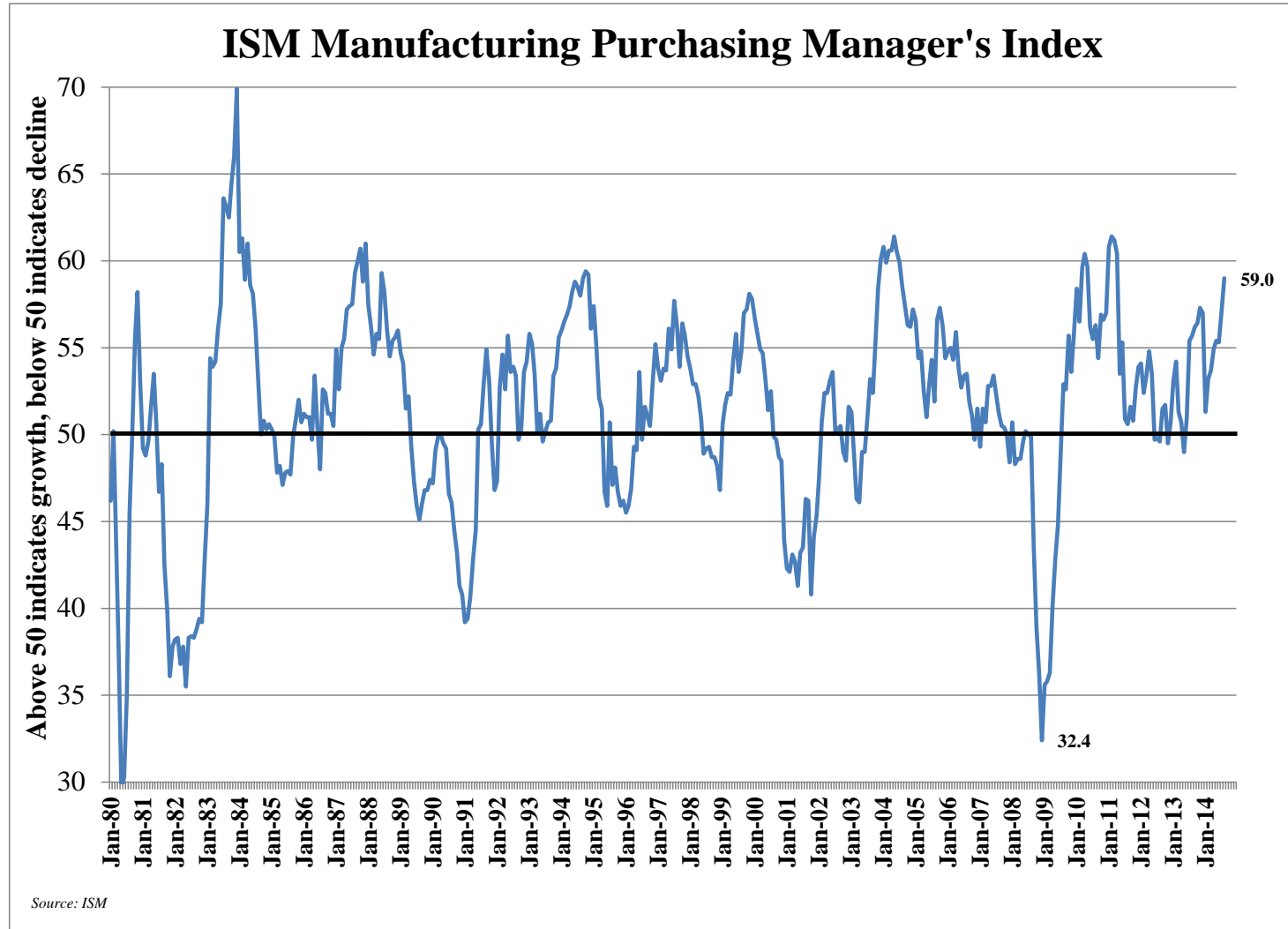
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RESEARCH COMPANY

Agenda

- ▶ **Overview of Current Industrial Trends**
 - ▶ Key Industrial Macro Indicators
 - ▶ Review of Recent Results
 - ▶ End Market Review & Initial 2015 Outlook
- ▶ **Industrial Distribution Trends**
 - ▶ Competitive Dynamics
 - ▶ Key Initiatives

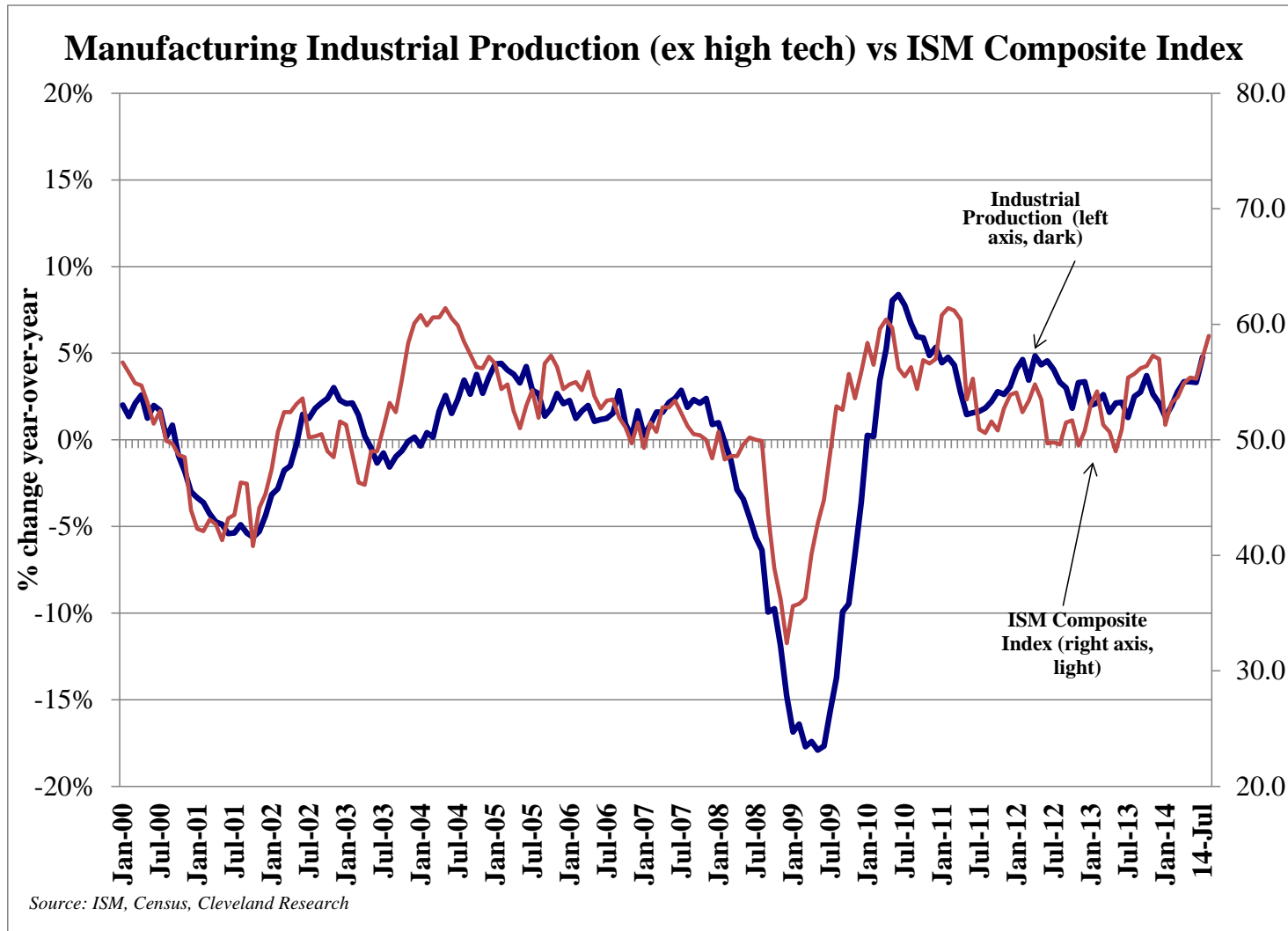
Industrial Economic Overview

ISM Strengthening – August Reading 59.0

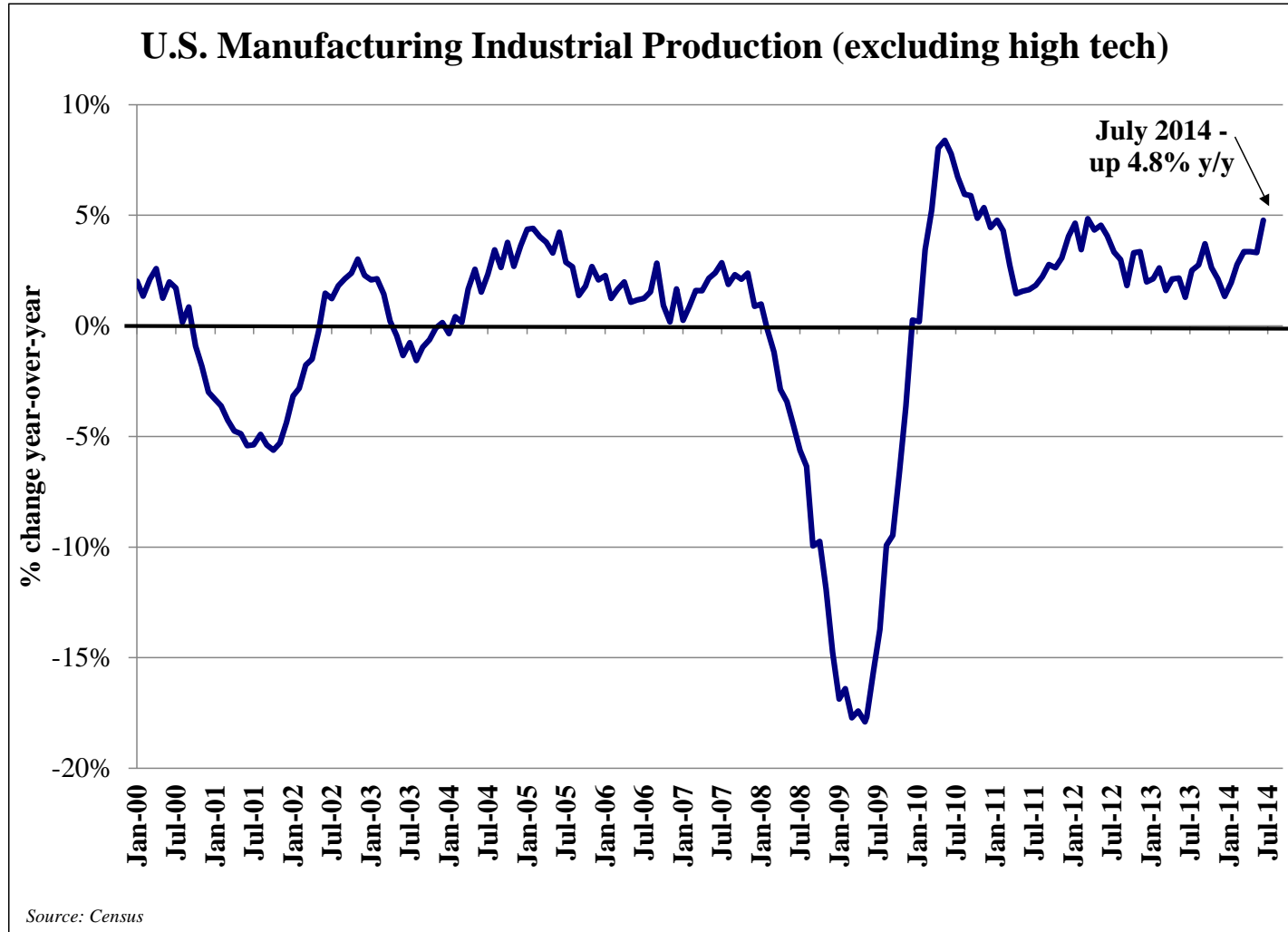


ISM Leads Industrial Production by 3-6 months

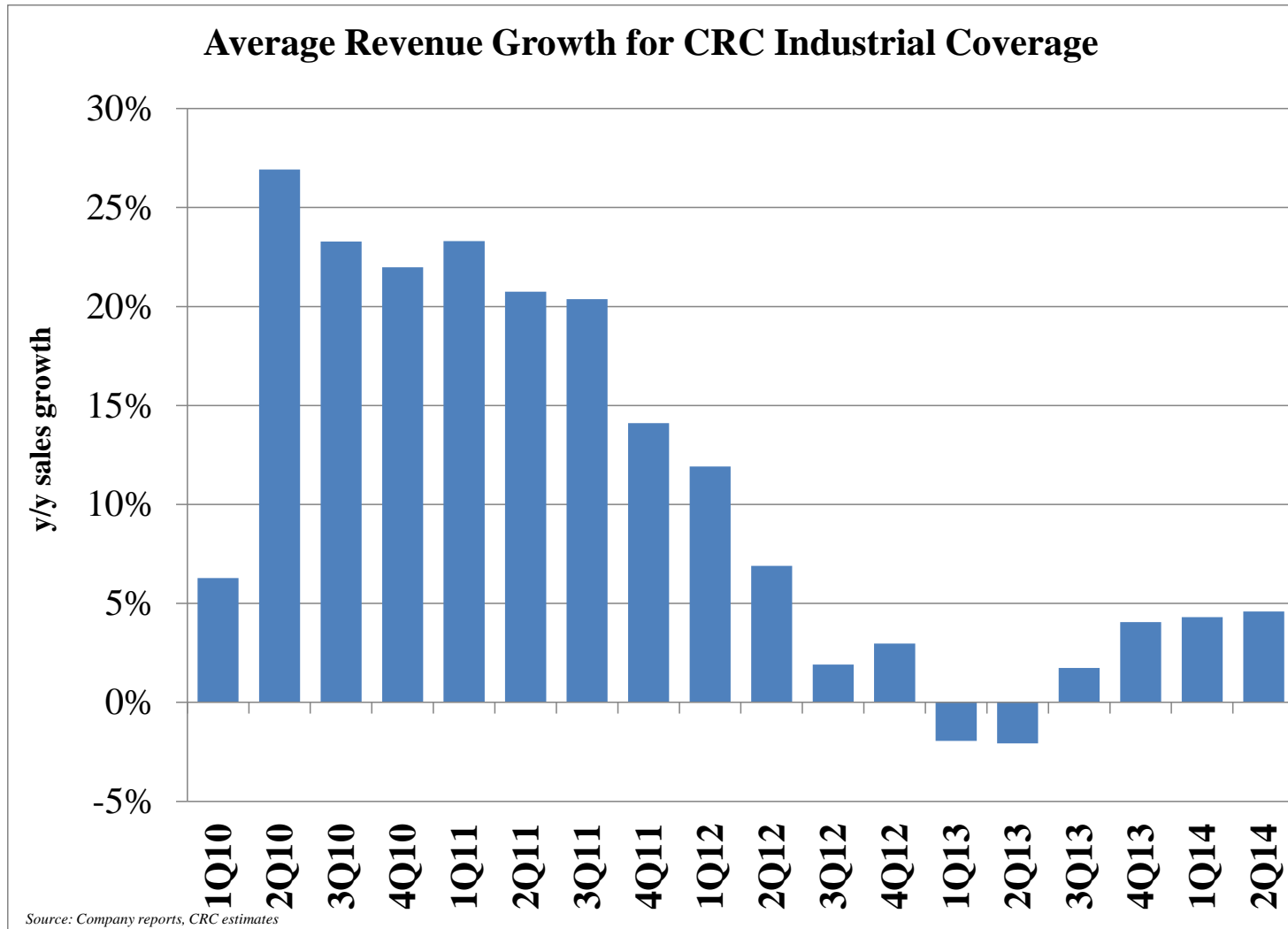
Reading of 55 Translates to ~4-5% Growth



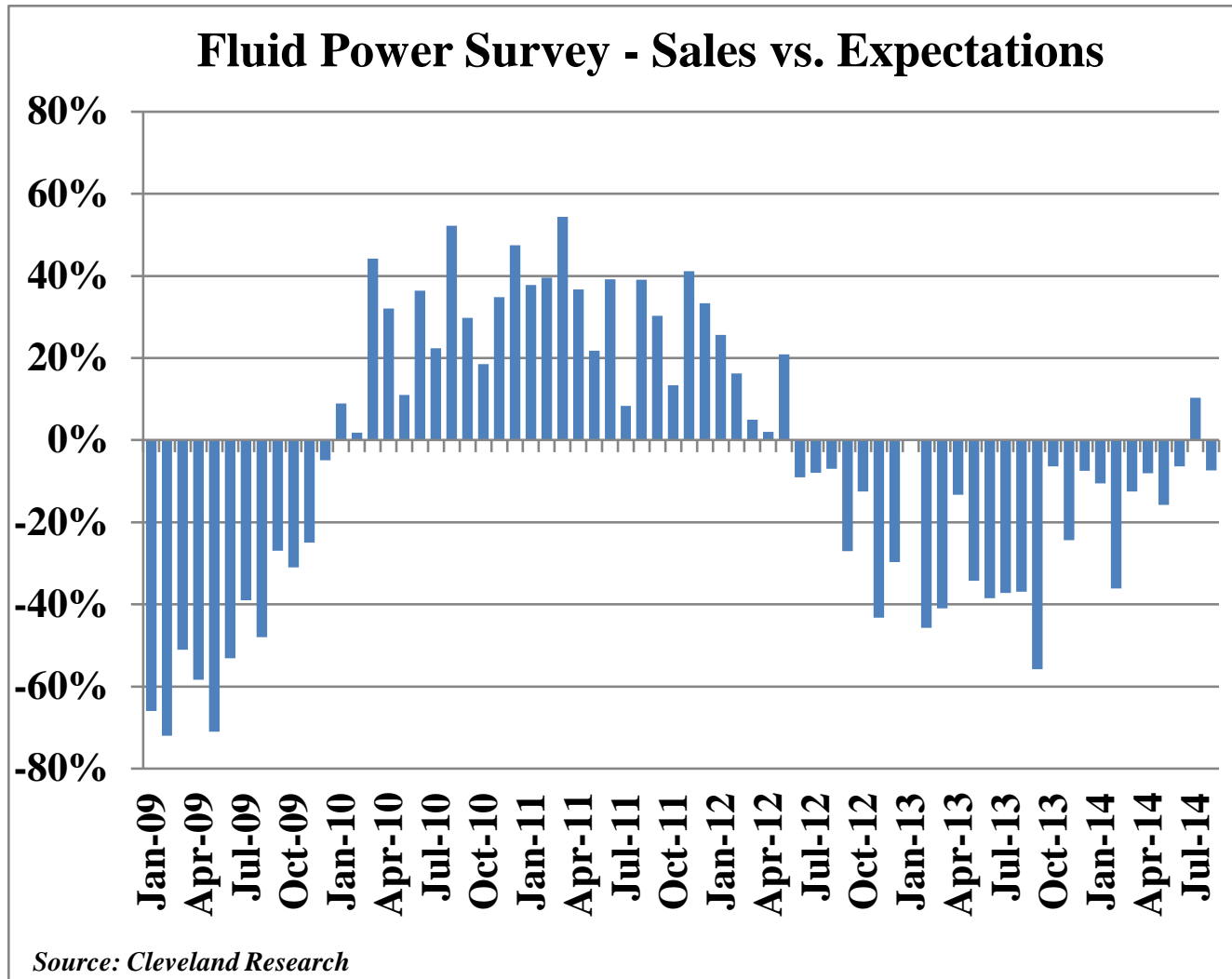
Manufacturing Industrial Production: Up 4.8% in July



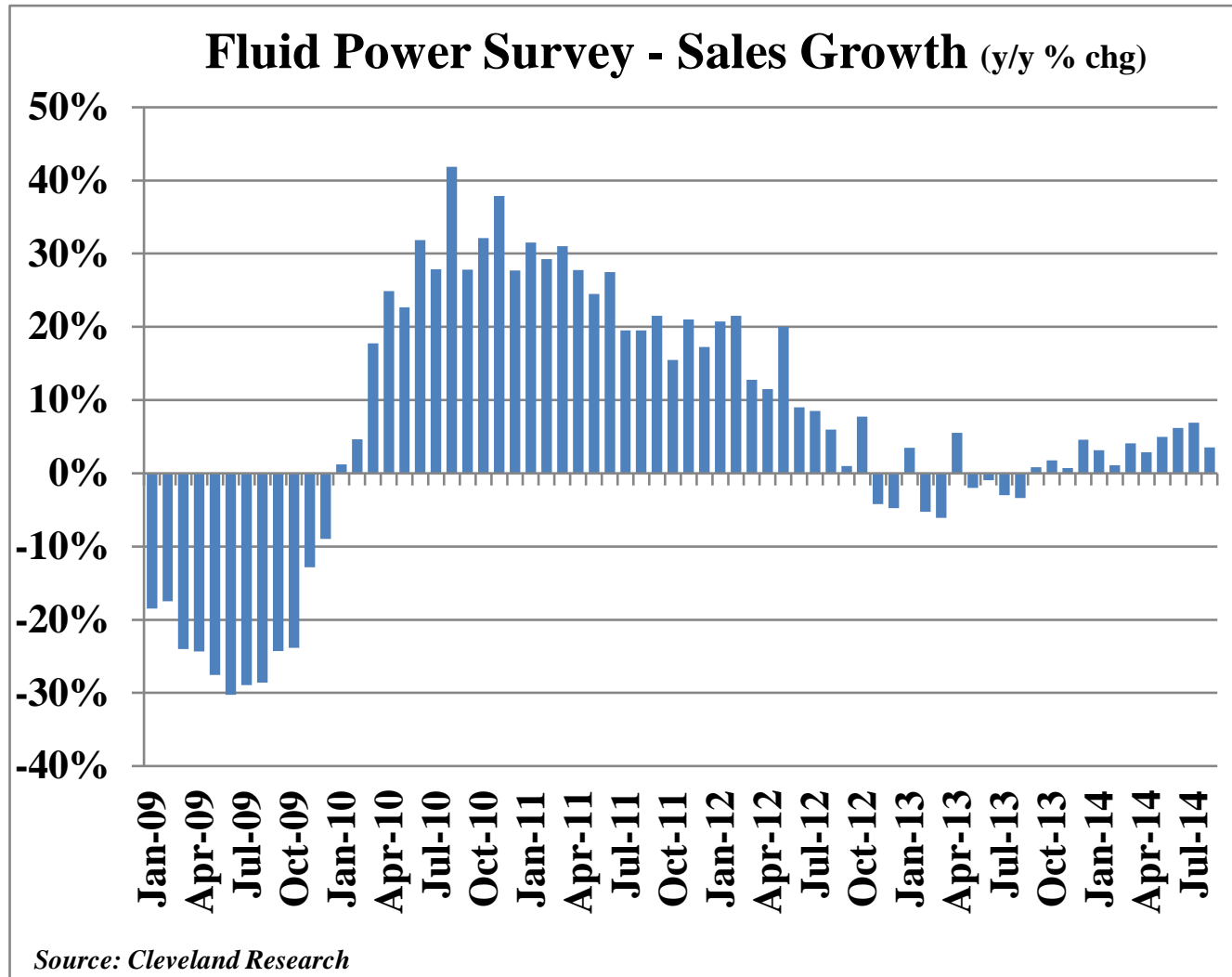
Industrial Composite Growth Index: Stronger Growth in 2H14 vs 1H14



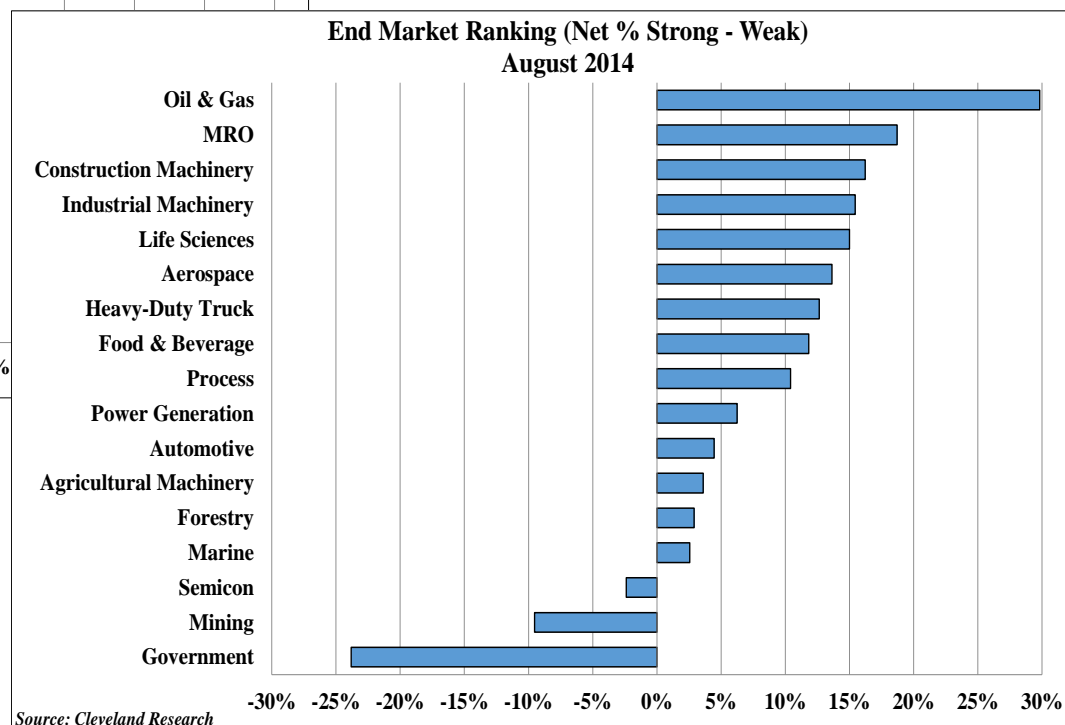
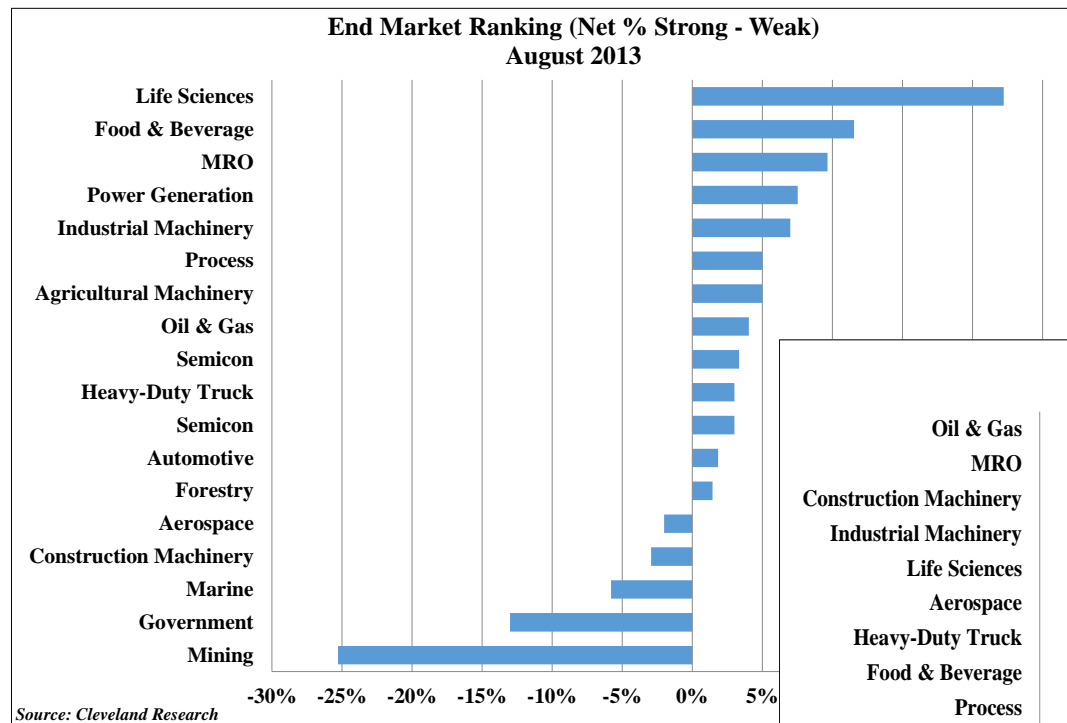
Sales vs Expectations Improve from 2013



Sales running up 5-6% (July +7%, Aug +4%) so far in 3Q following 5% growth in 2Q



End Market Trends – Today vs. Year Ago

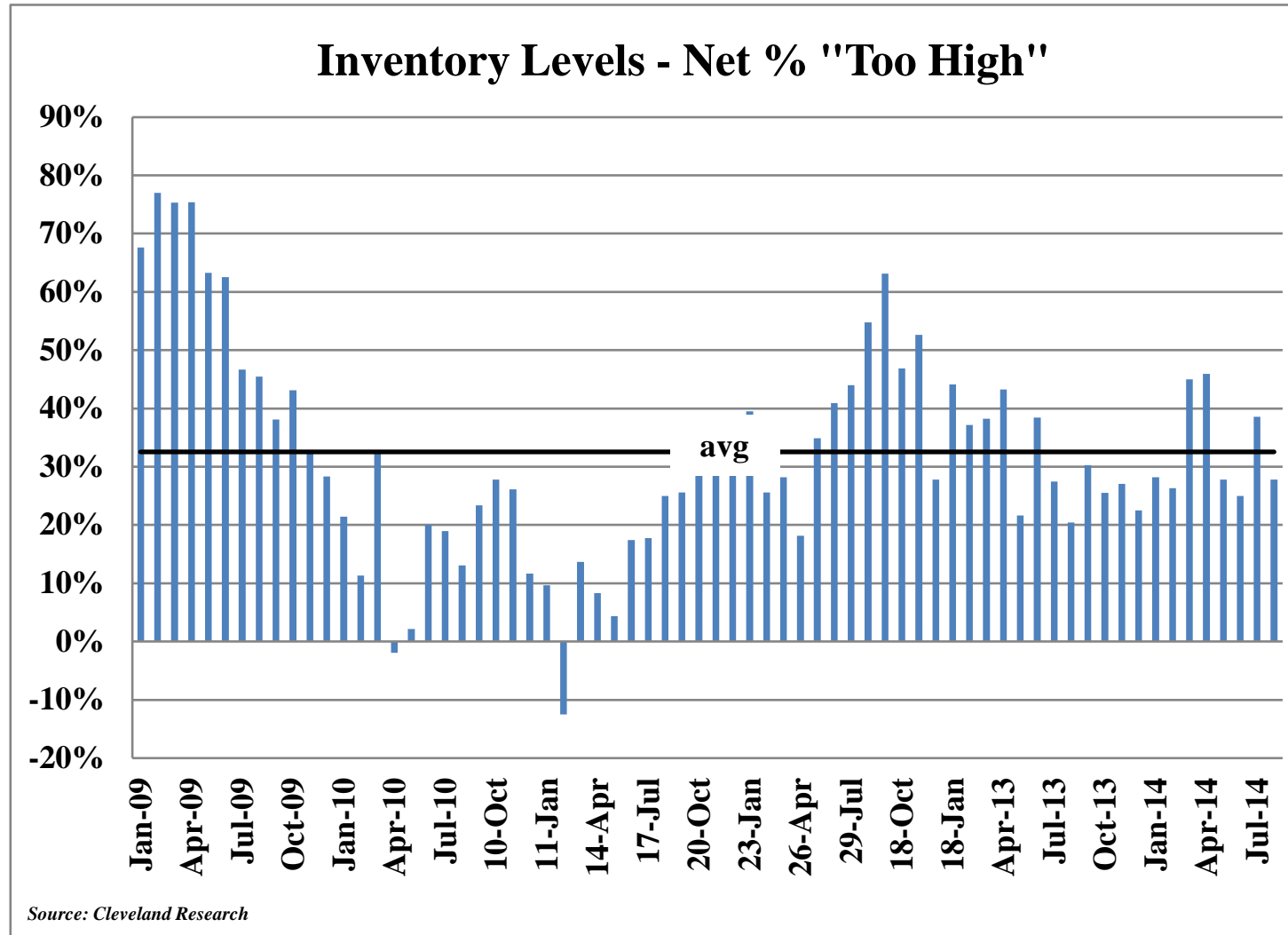


End Market Momentum

ISM Manufacturing End Market Momentum														
Major End Market	Jul-13	Aug-13	Sep-13	Oct-13	Nov-13	Dec-13	Jan-14	Feb-14	Mar-14	Apr-14	May-14	Jun-14	Jul-14	Aug-14
Apparel, leather and allied products	↓	↔	↓	↓	↓	↑	↓	↓	↓	↑	↑	↑	↑	↑
Chemical products	↑	↑	↓	↓	↑	↓	↓	↑	↑	↑	↑	↓	↑	↑
Computer and electronic products	↑	↑	↑	↑	↑	↑	↓	↔	↑	↑	↑	↑	↑	↑
Electrical equipment, appliances, components	↑	↑	↑	↑	↑	↓	↑	↑	↓	↑	↑	↑	↑	↑
Fabricated metal products	↑	↑	↑	↑	↑	↑	↑	↑	↑	↑	↑	↑	↑	↑
Food, beverage and tobacco products	↑	↑	↑	↑	↑	↑	↑	↑	↑	↑	↑	↑	↑	↑
Furniture and related products	↑	↑	↑	↑	↑	↑	↑	↑	↑	↑	↑	↑	↑	↑
Machinery	↓	↑	↑	↑	↓	↓	↑	↑	↑	↑	↑	↑	↑	↑
Miscellaneous manufacturing	↓	↓	↓	↓	↑	↑	↓	↓	↓	↑	↑	↑	↑	↑
Nonmetallic mineral products	↑	↑	↓	↑	↑	↓	↓	↑	↑	↓	↑	↑	↑	↑
Paper products	↑	↑	↑	↑	↑	↑	↓	↑	↑	↑	↑	↑	↑	↑
Petroleum and coal products	↔	↔	↑	↑	↑	↔	↓	↓	↑	↑	↑	↑	↑	↑
Plastics and rubber products	↓	↑	↑	↑	↑	↑	↑	↑	↑	↑	↑	↓	↑	↑
Primary metals	↑	↑	↓	↓	↑	↑	↑	↑	↑	↑	↑	↑	↑	↑
Printing, related support activities	↑	↑	↑	↑	↑	↑	↑	↑	↑	↑	↑	↑	↑	↑
Textile mills	↑	↑	↓	↑	↑	↑	↑	↑	↑	↑	↔	↓	↑	↓
Transportation equipment	↑	↑	↑	↑	↑	↑	↑	↑	↑	↑	↑	↑	↑	↑
Wood product	↑	↑	↔	↑	↓	↑	↑	↑	↓	↑	↑	↑	↓	↑
Statistics	Jul-13	Aug-13	Sep-13	Oct-13	Nov-13	Dec-13	Jan-14	Feb-14	Mar-14	Apr-14	May-14	Jun-14	Jul-14	Aug-14
% Better	72%	83%	61%	78%	83%	72%	61%	78%	78%	94%	94%	83%	94%	94%
Unchanged	6%	11%	6%	0%	0%	6%	0%	6%	0%	0%	6%	0%	0%	0%
% Worse	22%	6%	33%	22%	17%	22%	39%	17%	22%	6%	0%	17%	6%	6%
Net % of Industries Improving	50%	78%	28%	56%	67%	50%	22%	61%	56%	89%	94%	67%	89%	89%
PMI	55.4	55.7	56.2	56.4	57.3	57.0	51.3	53.2	53.7	54.9	55.4	55.3	57.1	59.0

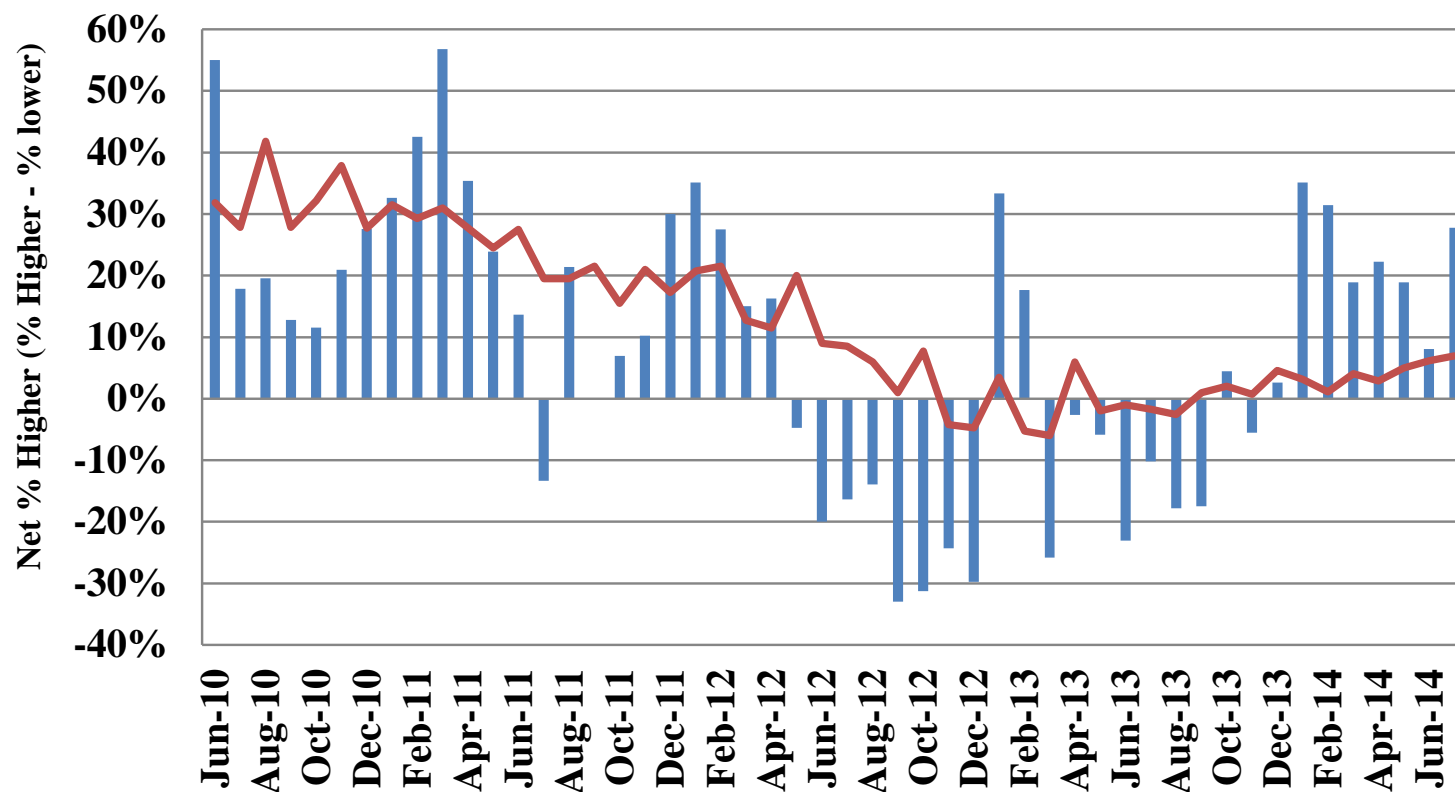
Source: Institute for Supply Management

Inventory Sentiment Below L-T Average



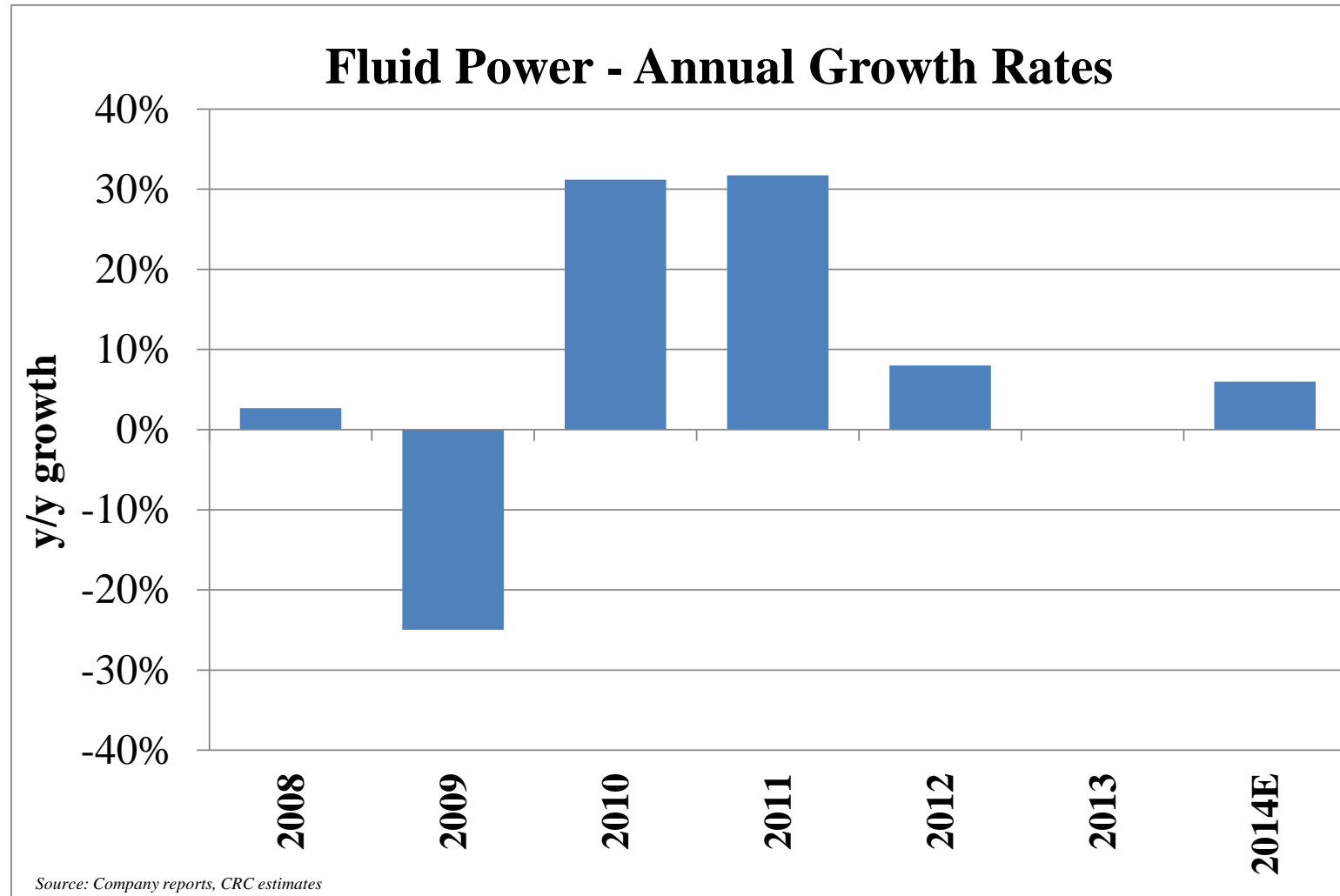
Backlogs – Steady Improvement in 2014

Backlog versus Prior Month vs Sales Growth



Source: Cleveland Research

2014 Expected up 5-6%, Helped by Stronger Finish
(1H up 4-5%; 2H estimated up 6-7%)

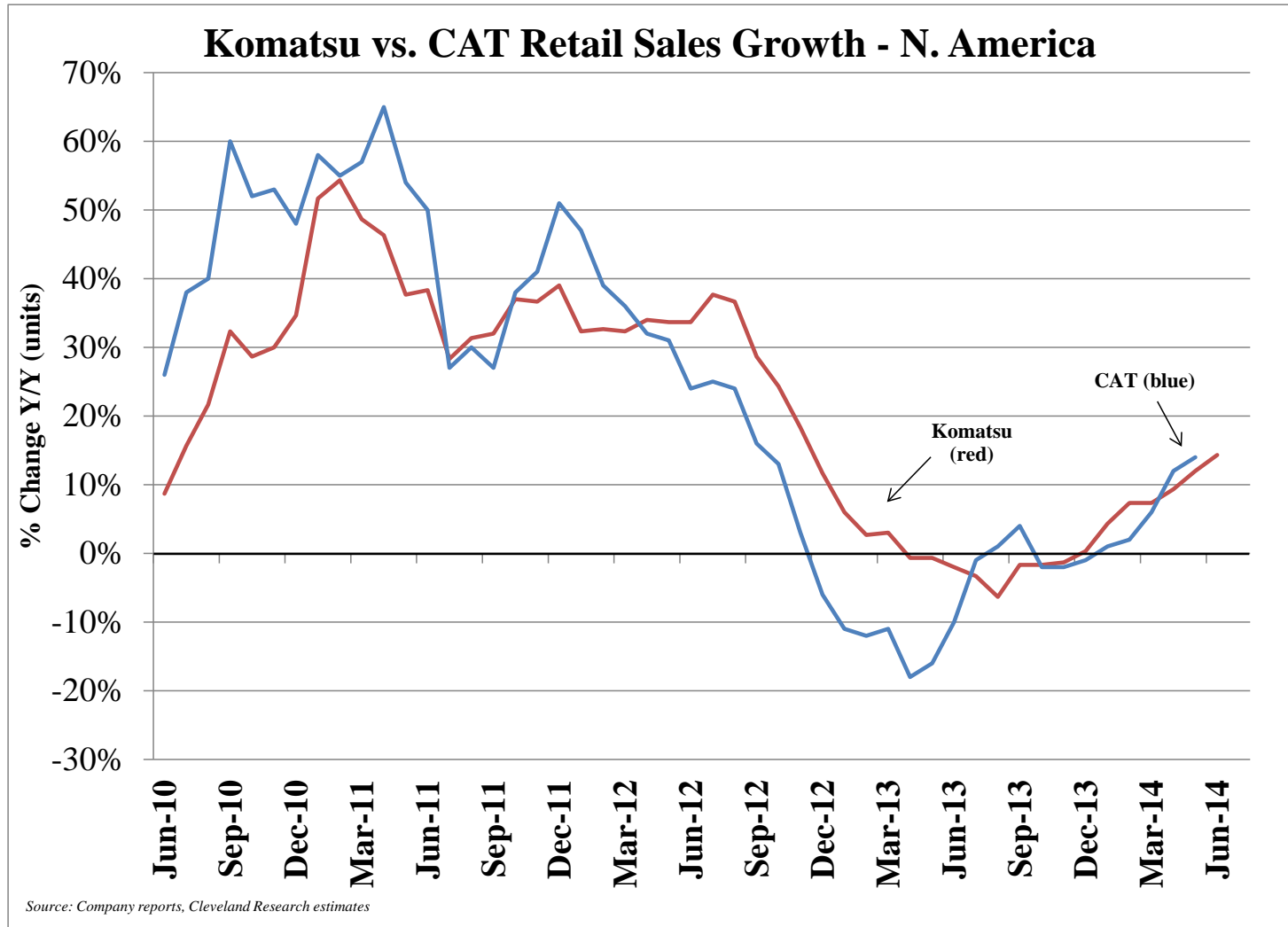




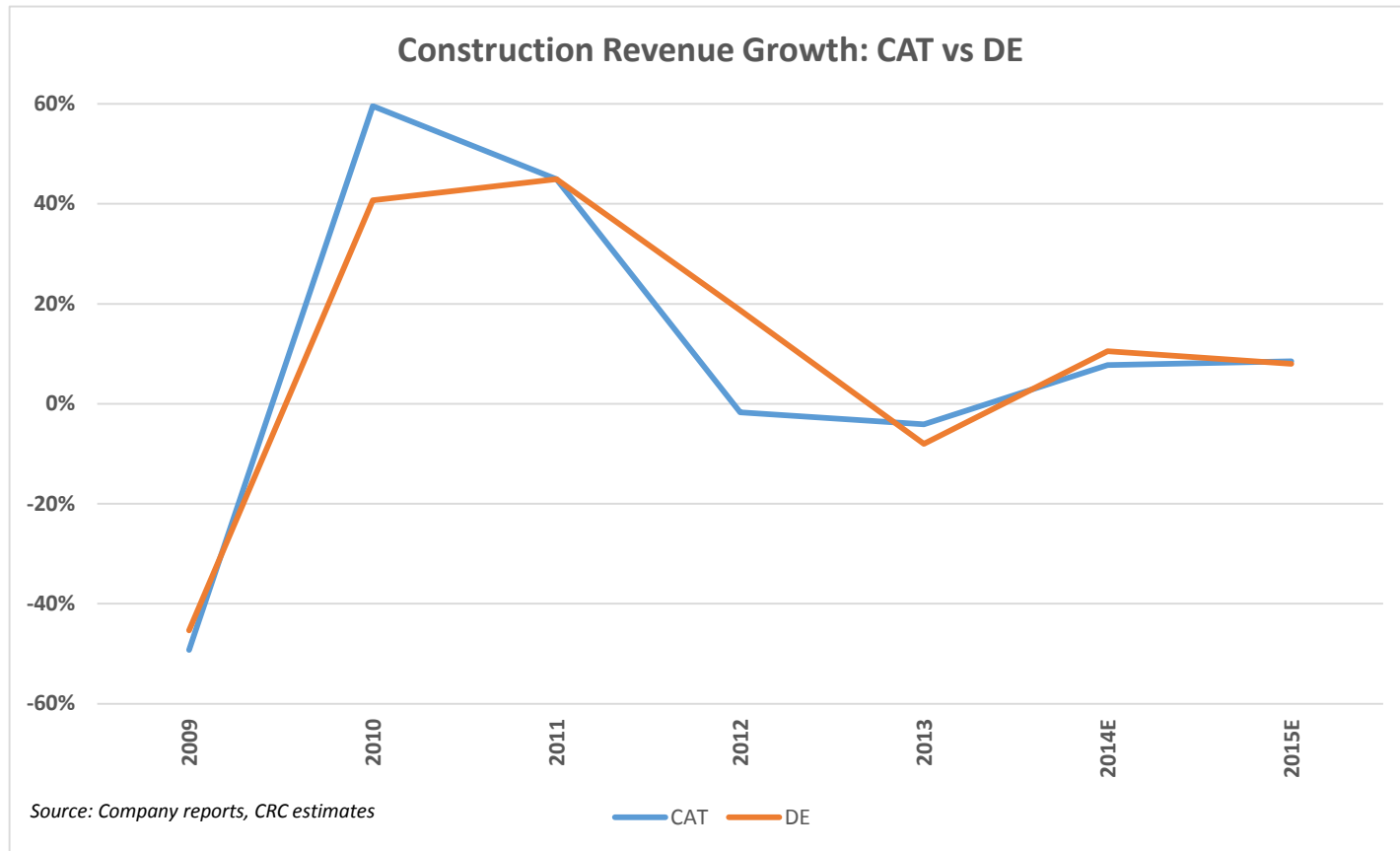
End Market Review / 2015 Outlook



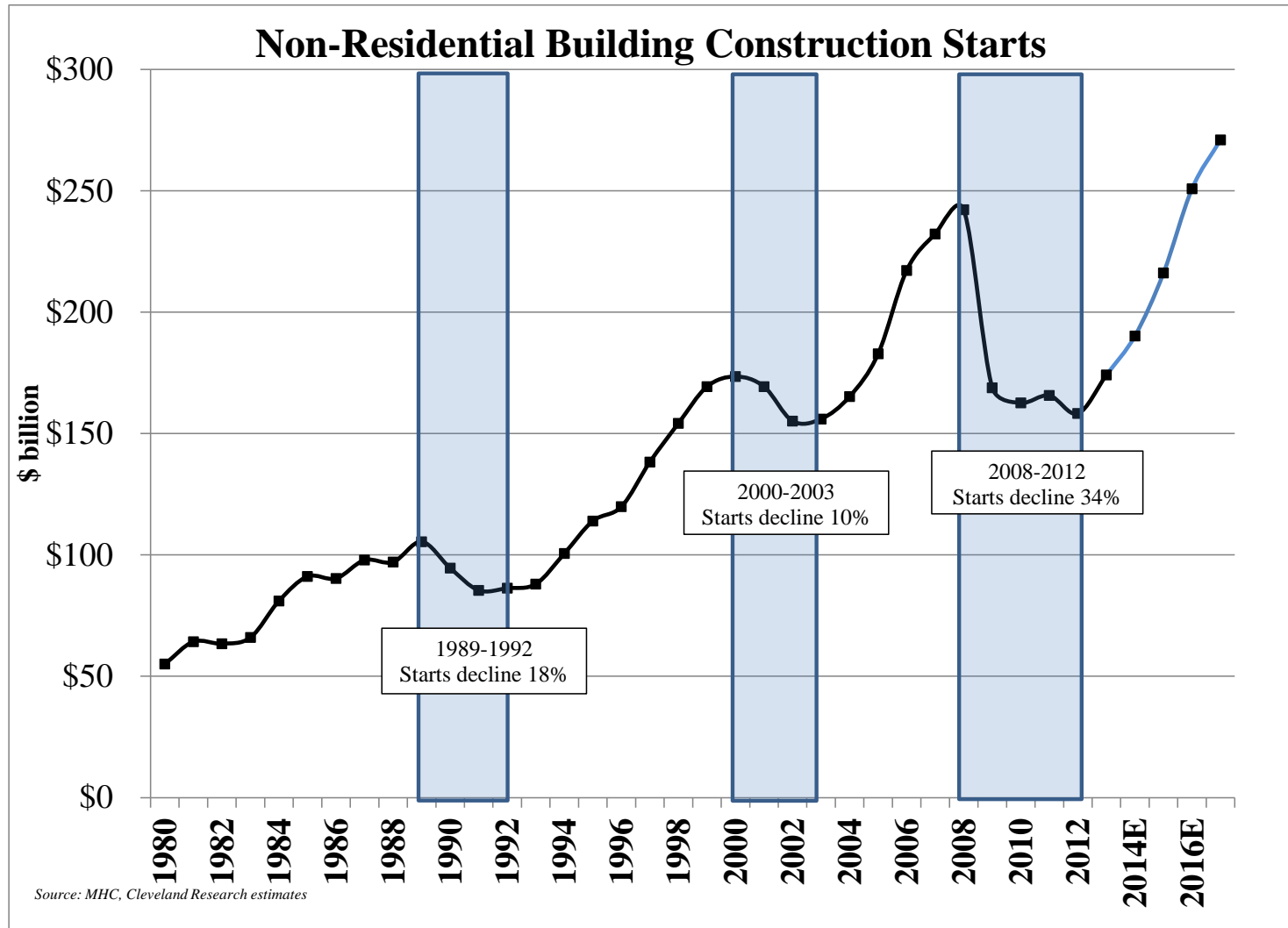
Construction Equipment Up 8-10% YTD; 2014 up ~10%,



CE – 2015 Forecast Up ~10%



2015 - Steady Improvement Forecast Across Non-Res, Residential and Non-building Construction



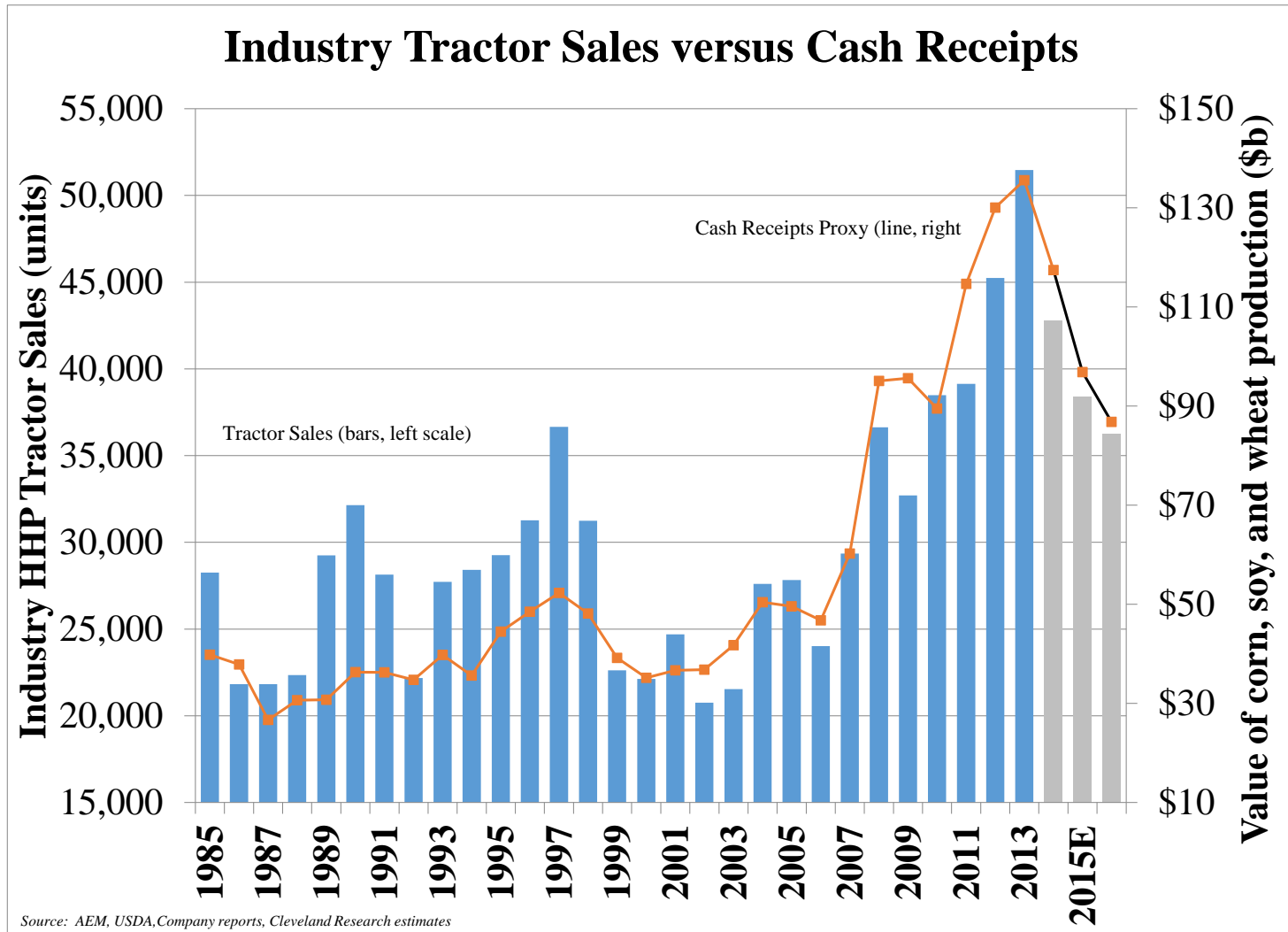
2015 - Steady Improvement Forecast Across Non-Res, Residential and Non-building Construction

McGraw-Hill Construction Starts History and Forecast										
U.S. Starts Forecast (Value \$mm)	2008	2009	2010	2011	2012	2013	2014E	2015E	2016E	2017E
Amusement, Social and Recreational Bldgs	0%	-14%	-4%	-12%	-17%	32%	11%	13%	16%	8%
Dormitories	16%	-5%	1%	-15%	7%	-13%	6%	6%	13%	12%
Government Service Buildings	7%	15%	-32%	-14%	-8%	-25%	11%	6%	12%	13%
Hospitals and Other Health Treatment	23%	-33%	16%	-7%	-3%	-2%	3%	8%	15%	12%
Hotels and Motels	-9%	-64%	-28%	58%	26%	33%	22%	16%	8%	0%
Manufacturing Plants, Warehouses, Labs	44%	10%	-5%	74%	-25%	42%	34%	-7%	5%	1%
Miscellaneous Nonresidential Buildings	19%	16%	29%	-29%	-9%	2%	-12%	11%	16%	12%
Office and Bank Buildings	-15%	-28%	-18%	-3%	1%	20%	22%	18%	15%	10%
Parking Garages and Automotive Services	-21%	-47%	9%	26%	23%	28%	9%	10%	9%	1%
Religious Buildings	-5%	-7%	-29%	-10%	-9%	-7%	-9%	4%	13%	16%
Schools, Libraries, and Labs (nonmfg)	9%	-17%	-3%	-11%	-12%	1%	5%	11%	20%	19%
Stores and Restaurants	-27%	-40%	-5%	3%	15%	6%	7%	16%	22%	11%
Warehouses (excl. manufacturer owned)	-22%	-58%	-16%	23%	29%	40%	11%	12%	11%	5%
Nonresidential Building Starts (\$mm)	242,186	168,877	162,640	165,654	159,158	176,020	196,063	215,497	247,299	272,311
% change y/y	1%	-30%	-4%	2%	-4%	11%	11%	10%	15%	10%
Nonresidential Building Starts (sqr ft)	1,377	773	678	703	779	865	935	1,047	1,185	1,268
% change y/y	-18%	-44%	-12%	4%	11%	11%	8%	12%	13%	7%
Single Family Housing Starts	1,203	951	978	905	1,146	1,425	1,566	1,883	2,420	2,546
% change y/y	-42%	-21%	3%	-7%	27%	24%	10%	20%	29%	5%
Nonbuilding Starts (bridges, highways, etc, \$mm)	152,486	144,769	148,329	150,515	163,780	147,222	129,500	135,800	149,100	163,300
% change y/y	9%	-5%	2%	1%	9%	-10%	-12%	5%	10%	10%

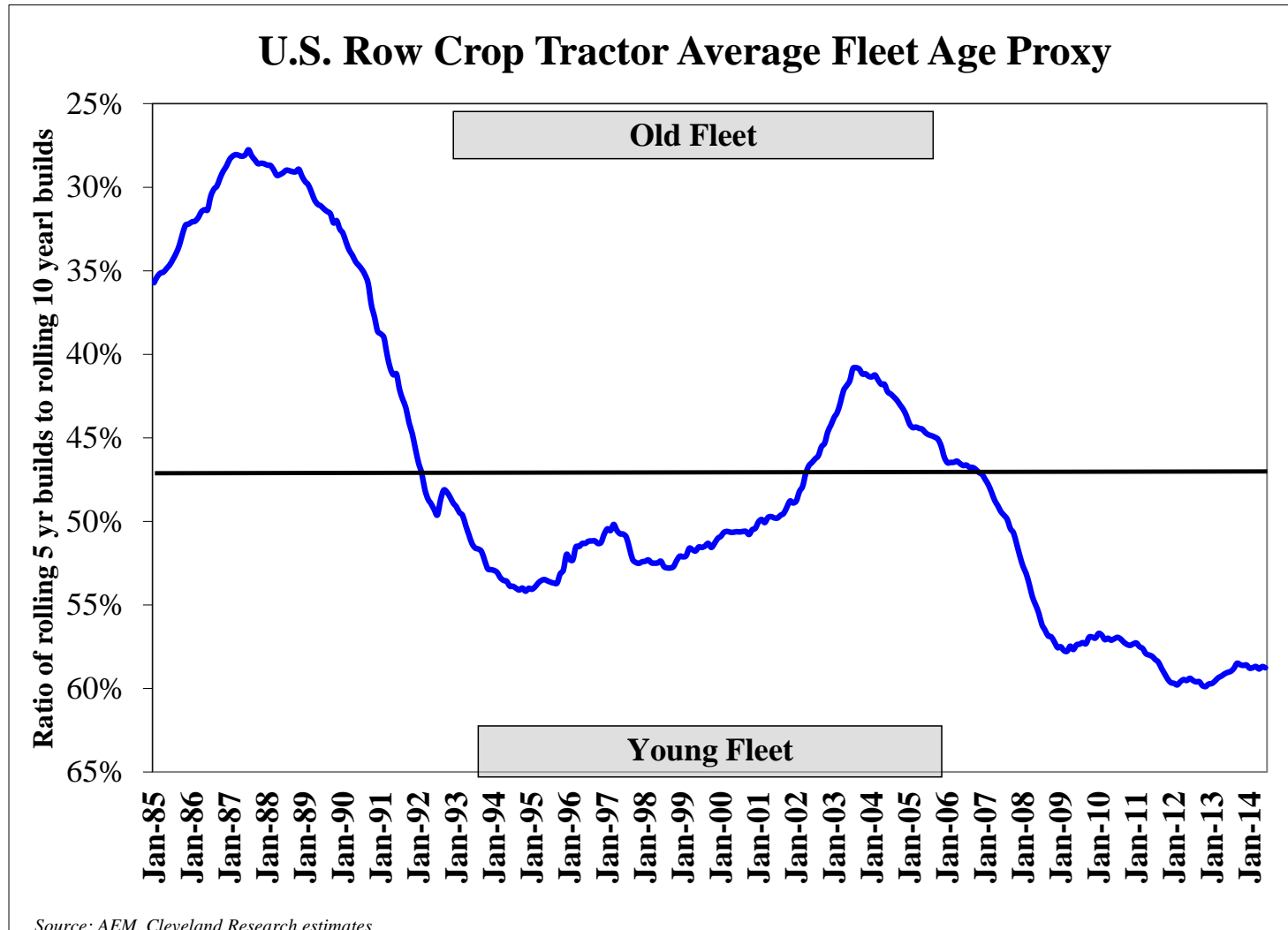
Source: MHC (3Q14 fcast)



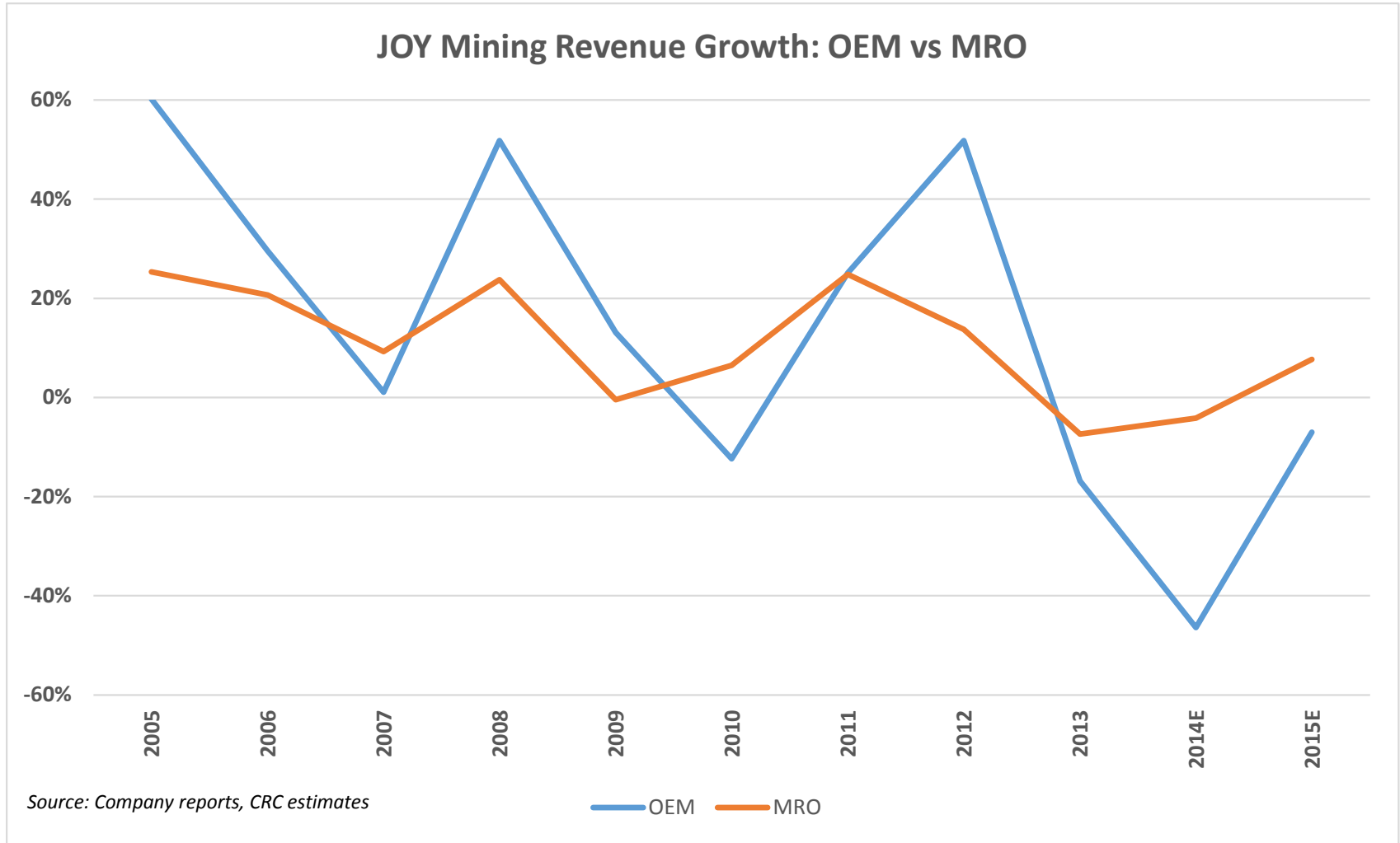
Ag Equipment – 2014 Down ~10%



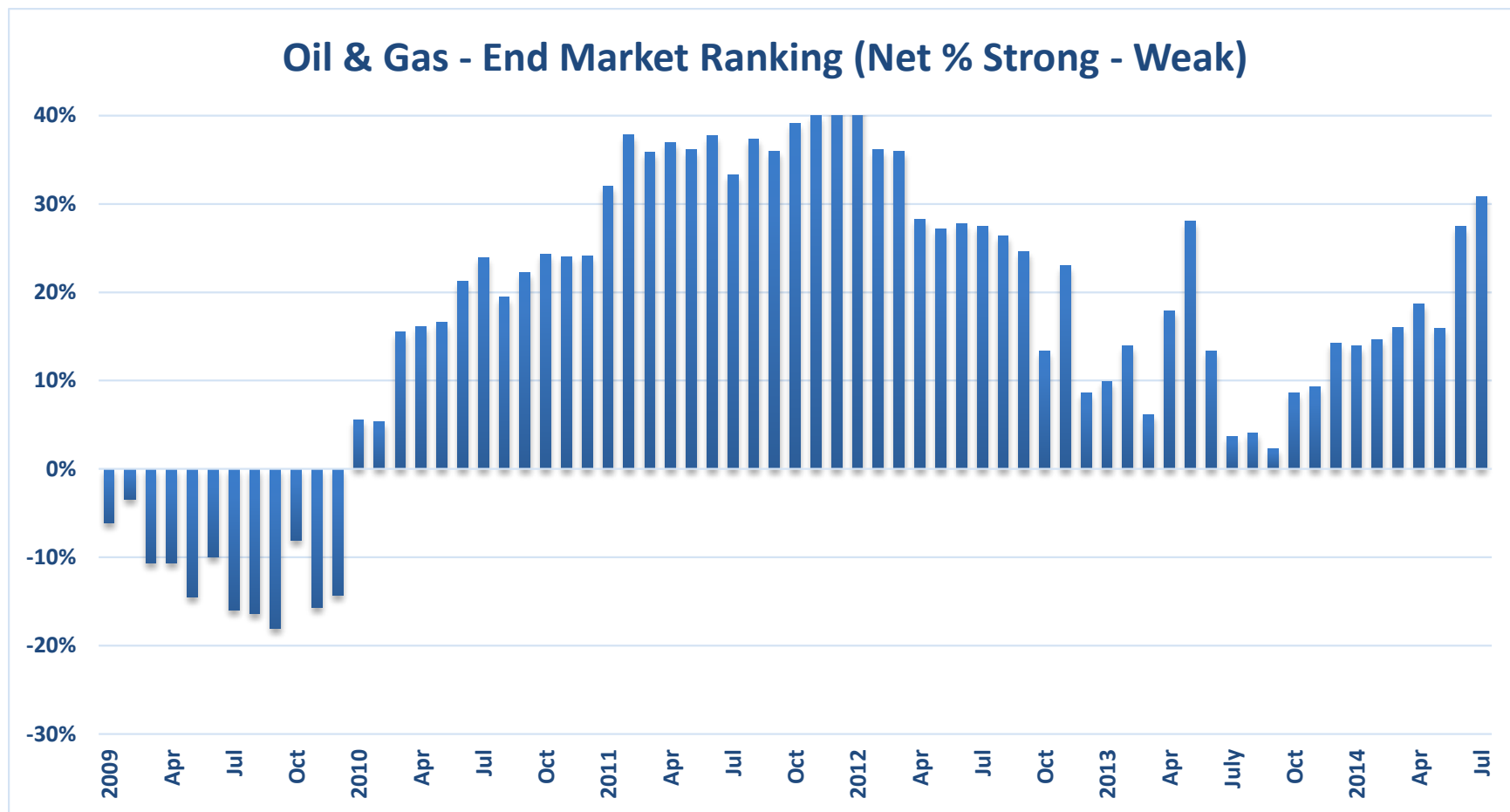
Ag Equipment – 2015 Down ~15%



Mining Revenue Trends – OEM vs MRO



Oil & Gas – Demand Accelerates



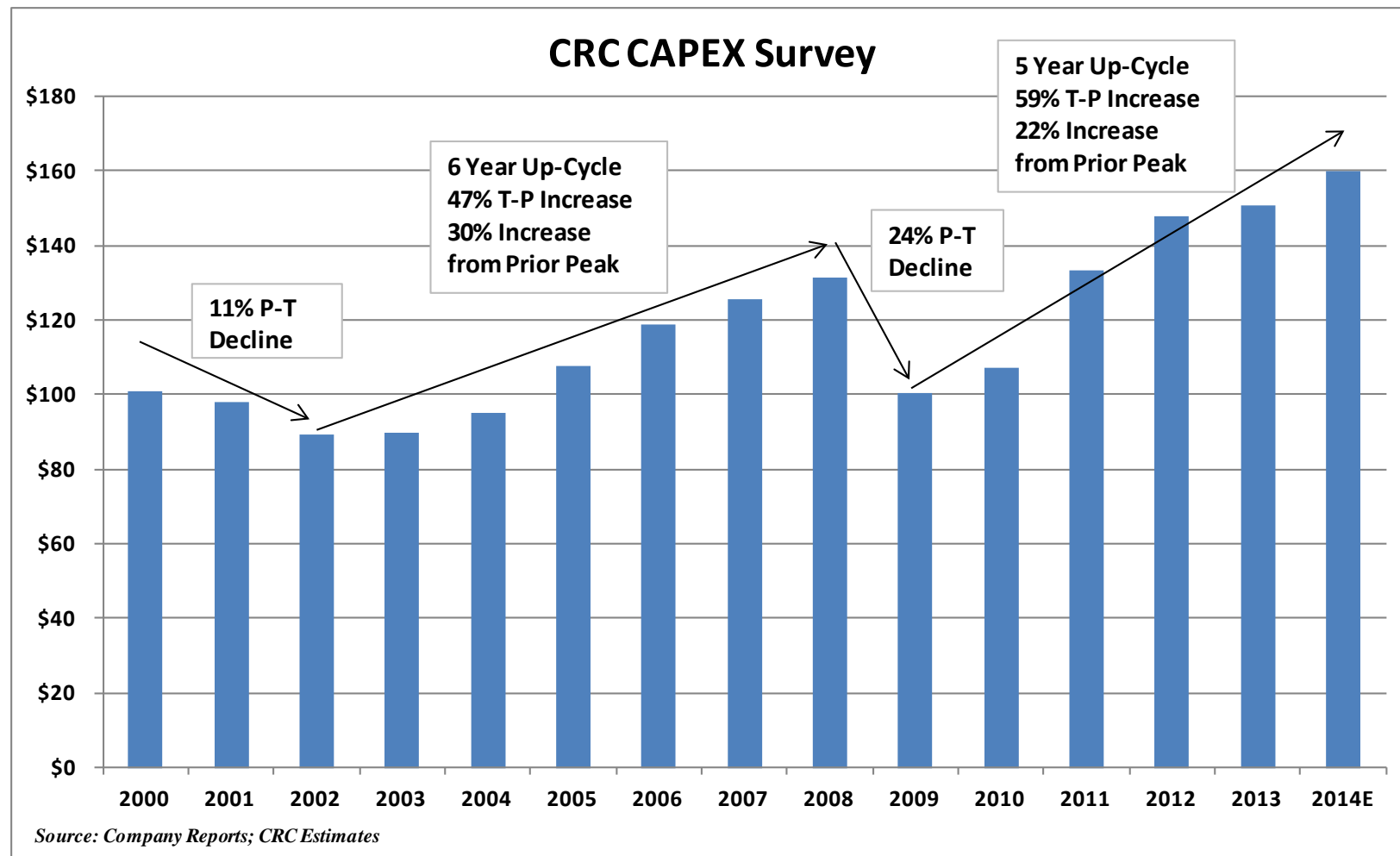
Source: Cleveland Research

Capital Spending Survey Snap Shot

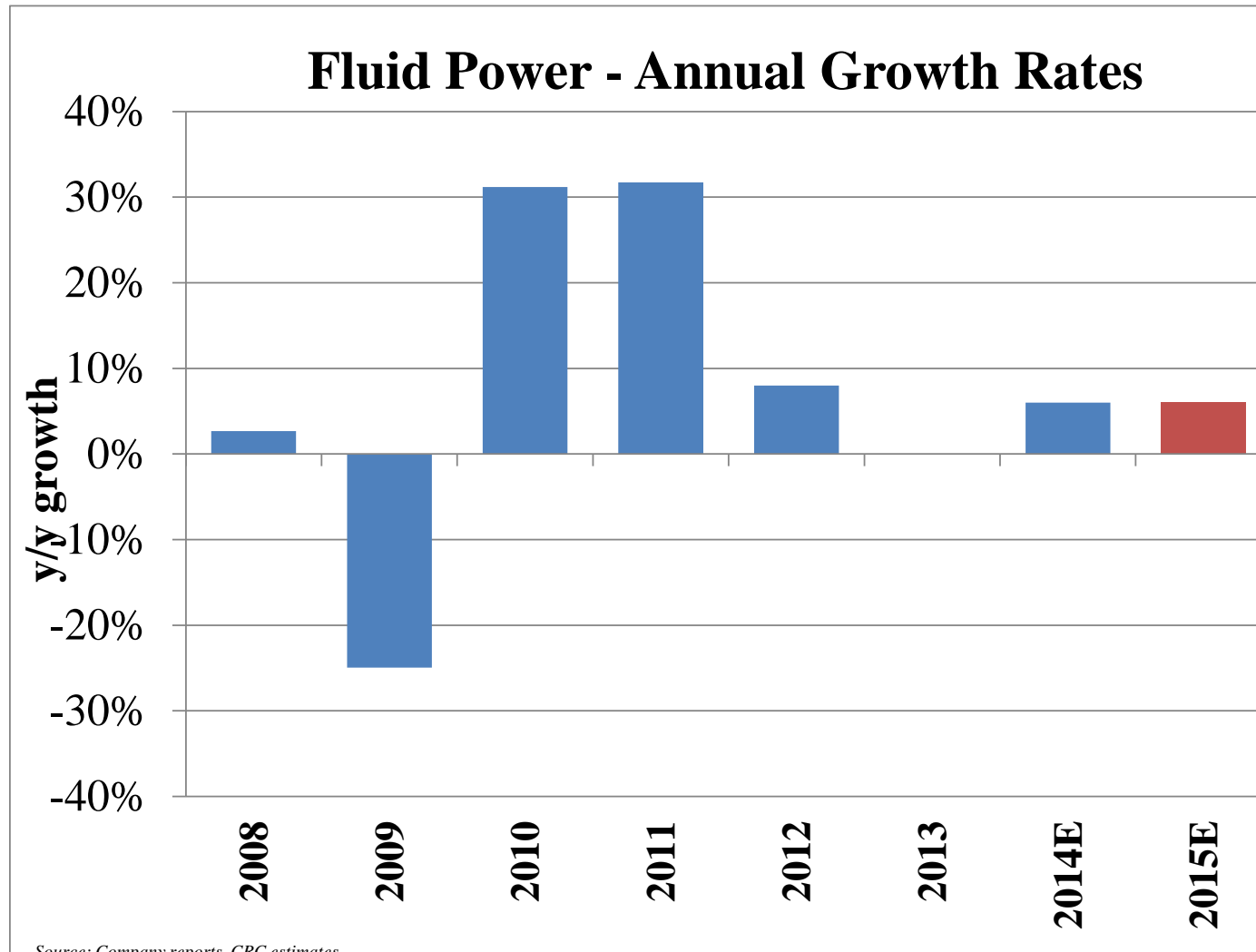
Cleveland Research Company Capital Spending Survey - Trends by Industry Sector											
Capex % change by sector, \$bil	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014E	% of Survey*
Aerospace & Defense	28%	5%	3%	1%	-17%	0%	17%	-5%	-5%	27%	3%
Home & Building Products	-1%	21%	-8%	-13%	-15%	10%	6%	-2%	1%	19%	1%
Transport/Logistics	12%	24%	-17%	-3%	-31%	14%	38%	14%	-14%	16%	7%
Containers & Packaging	8%	-7%	8%	1%	-19%	47%	7%	-16%	11%	16%	1%
Healthcare Equipment	5%	7%	20%	9%	-1%	-2%	2%	6%	10%	15%	2%
Printing/Publishing	28%	5%	13%	-40%	-50%	17%	9%	-12%	7%	14%	0%
Office/Commercial Equip & Services	2%	6%	-5%	-6%	-30%	56%	-11%	20%	-4%	14%	1%
Food & Beverage	15%	17%	10%	2%	-5%	13%	8%	-7%	-3%	13%	8%
Forest/paper products	6%	-1%	5%	-32%	-46%	52%	37%	12%	-10%	10%	2%
Multi-industry/Electrical Equip.	16%	17%	7%	-9%	-27%	5%	22%	16%	21%	7%	8%
Big Three Automotive	6%	-5%	-18%	3%	-31%	-2%	24%	23%	22%	6%	16%
Chemicals	25%	14%	13%	19%	-12%	7%	4%	24%	-2%	6%	8%
Pharmaceuticals	-9%	-5%	8%	-3%	-18%	2%	16%	7%	-9%	6%	6%
Mining	49%	39%	79%	-10%	-16%	-7%	69%	19%	11%	6%	6%
Machinery - Industrial & Mobile	21%	17%	18%	22%	-35%	15%	69%	0%	4%	4%	7%
Railroads	19%	13%	12%	10%	-15%	9%	28%	9%	1%	3%	8%
Specialty Vehicle	8%	-6%	7%	-21%	-52%	45%	28%	12%	50%	2%	0%
Consumer non-durables	22%	16%	8%	6%	-2%	2%	8%	0%	10%	2%	4%
Construction Materials	69%	5%	18%	100%	-69%	-12%	-12%	28%	4%	-3%	0%
Oil & Gas - Equipment & services	33%	64%	39%	27%	-26%	8%	47%	23%	-17%	-6%	7%
Automotive Tier Suppliers	7%	-4%	-1%	11%	-28%	59%	25%	11%	-10%	-9%	2%
Metals	59%	29%	21%	9%	-49%	-21%	25%	14%	5%	-16%	2%

Source: Cleveland Research Company. Ranked by 2014E. *% of survey in dollars.

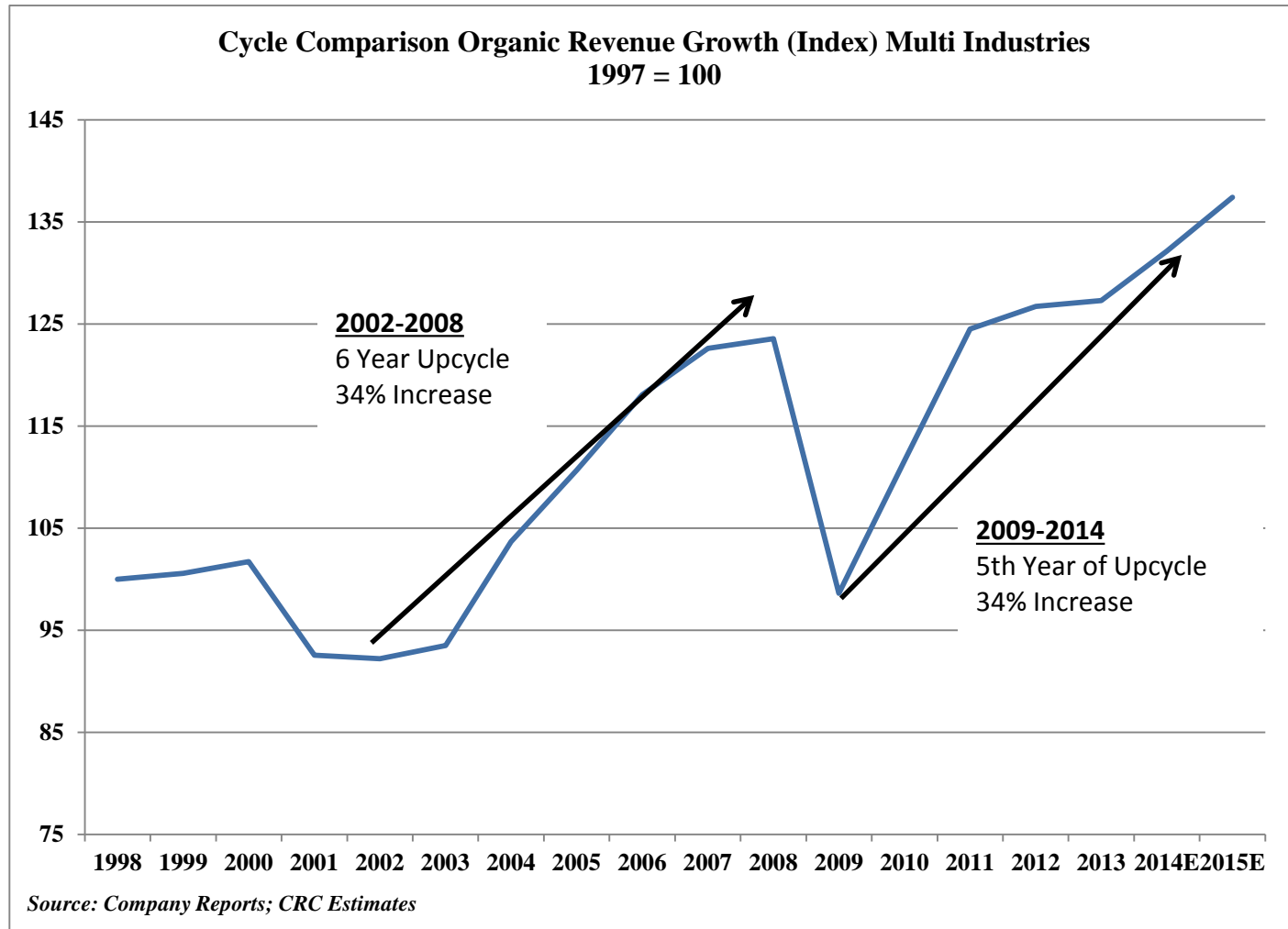
Capital Spending – Snapback in 2014



Initial 2015 Outlook ~6% Growth



Industrial Cycle - Later Innings?



Summary Thoughts

- ▶ 2014 Industrial Demand Trends:
 - ▶ Return of oil & gas strength following 2013 lull
 - ▶ Mixed mobile OEM markets
 - ▶ Snapback in capital spending
- ▶ 2015 – Forecasting mid-single digit growth
 - ▶ Expecting strong oil & gas activity
 - ▶ Continued recovery for N. America construction activity
 - ▶ Slower capital spending growth
 - ▶ Ag markets - OE expected to be down double digits
- ▶ Industrial Cycle
 - ▶ Typical cycle is 5-7 years
 - ▶ Currently in year 5 of recovery – suggests we are in later innings of industrial cycle

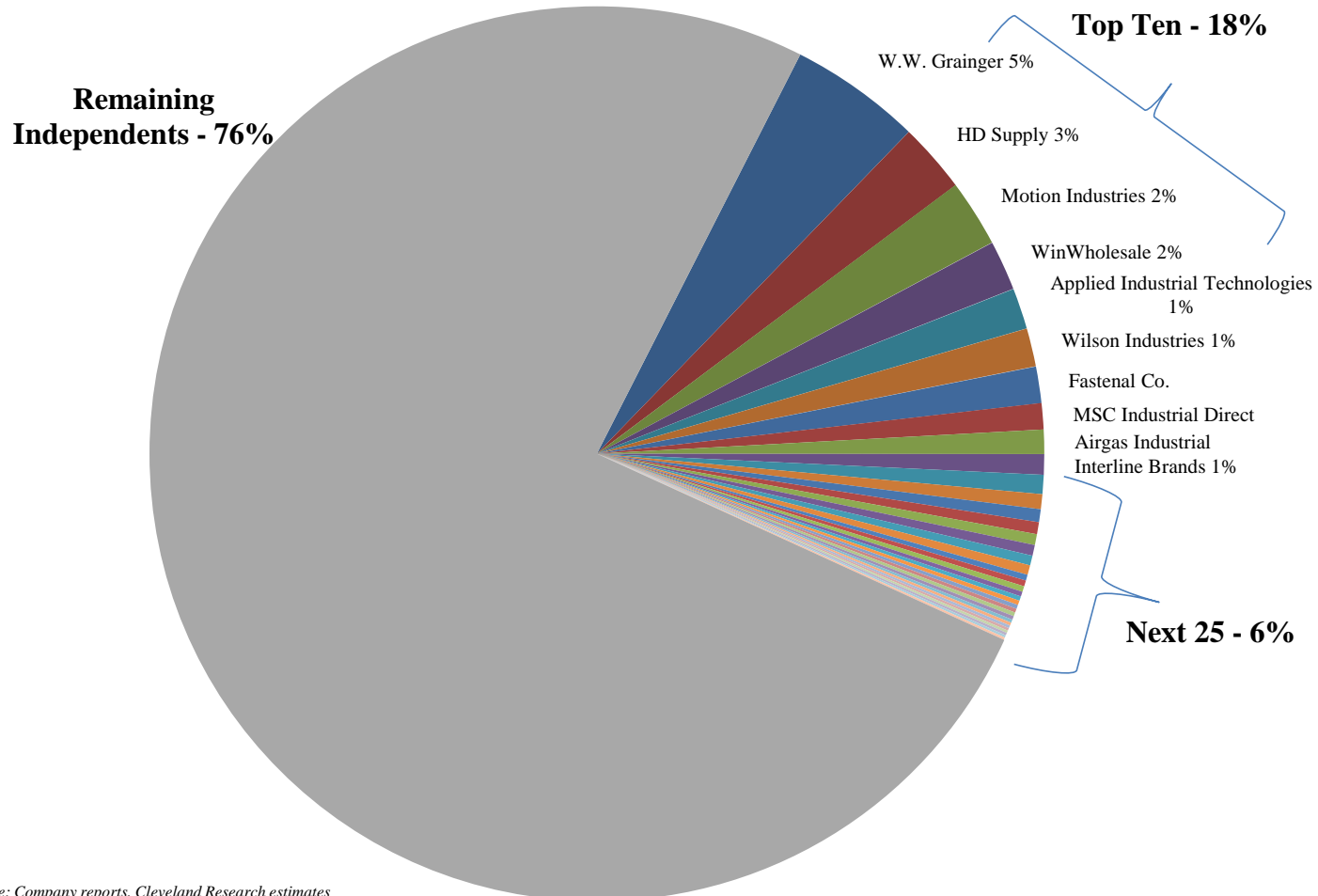


Industrial Distribution Trends

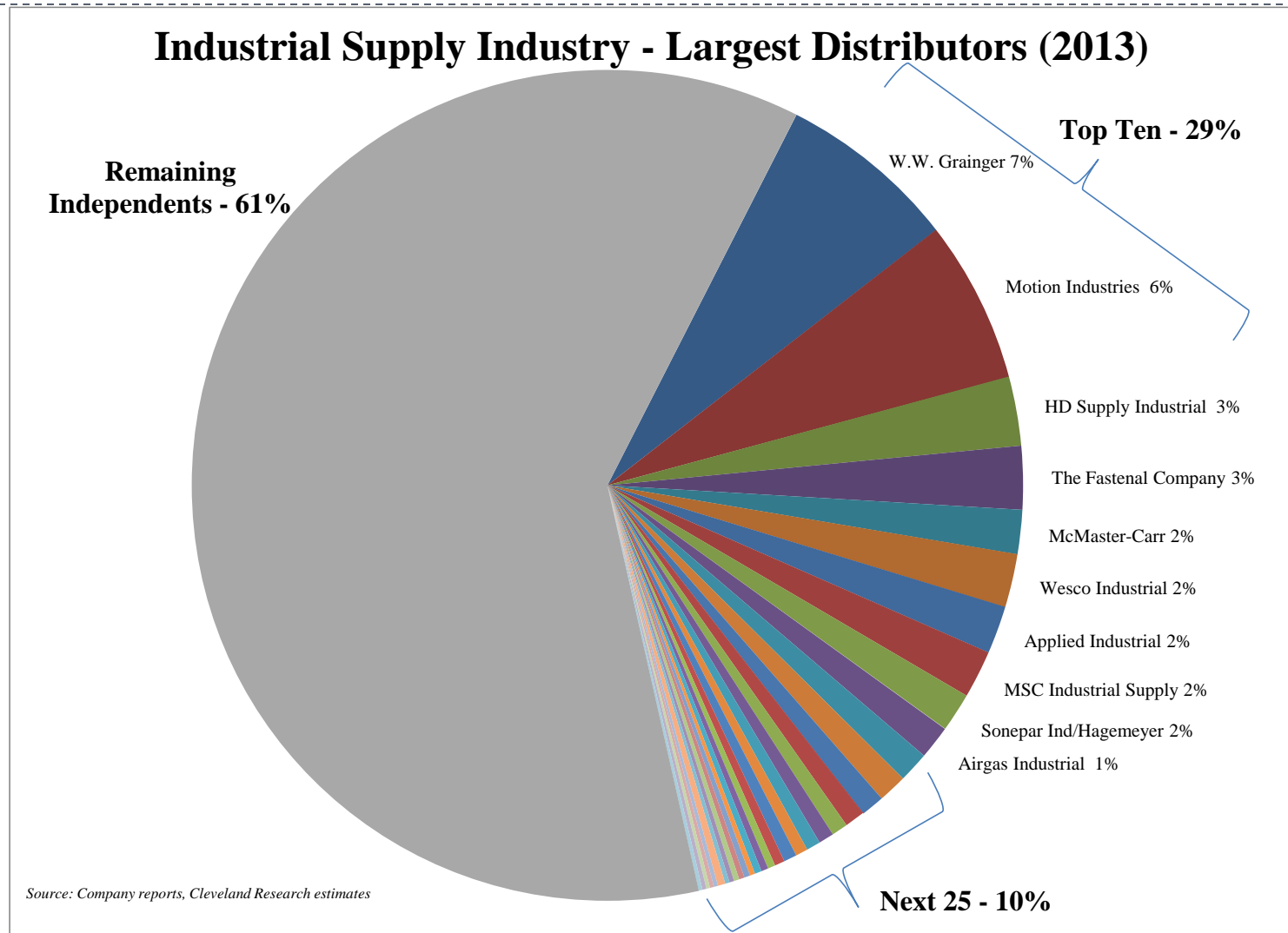


Industry Overview - 2005

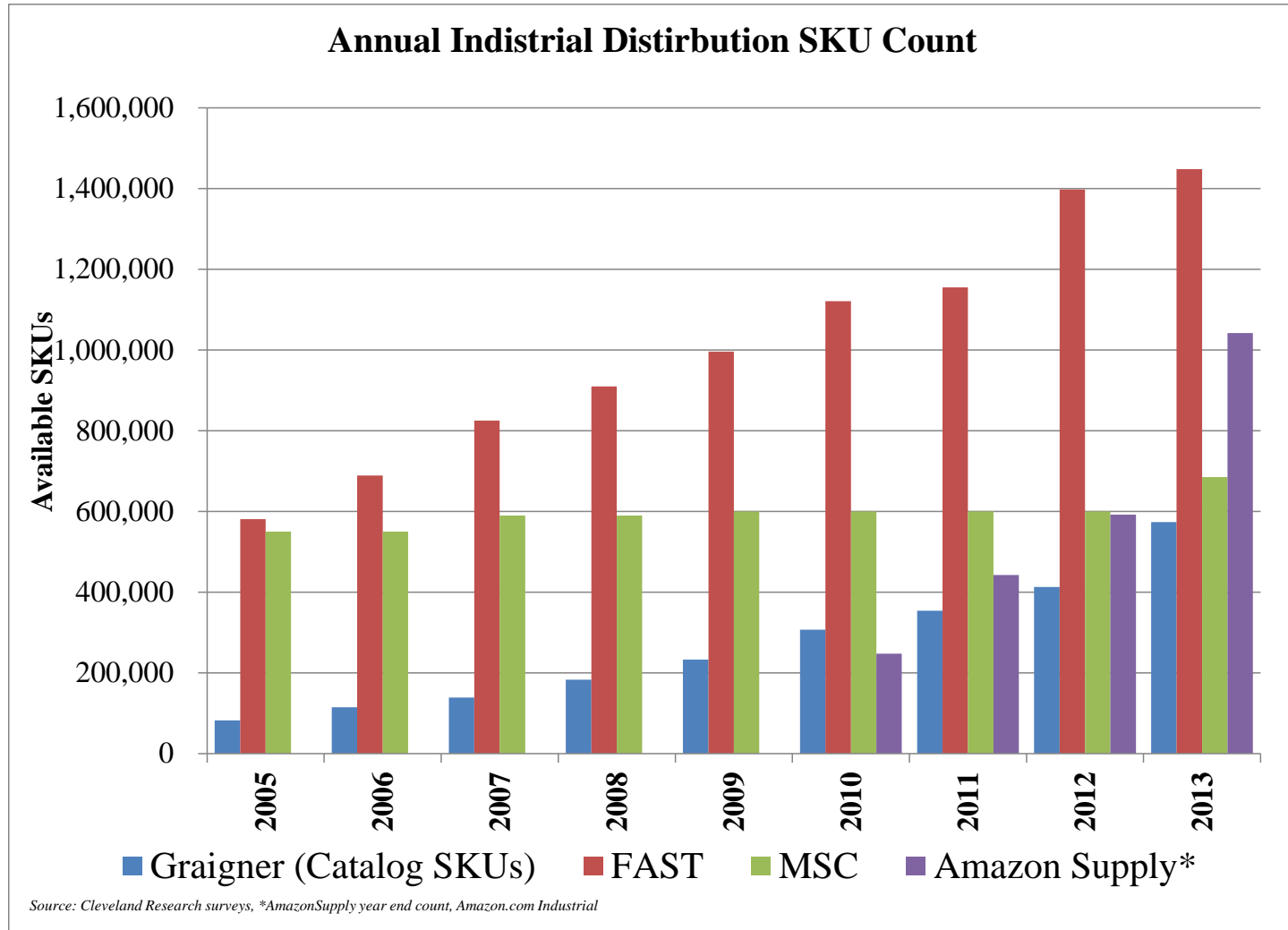
Industrial Supply Industry - Largest Distributors (2005)



Industry Overview - 2013

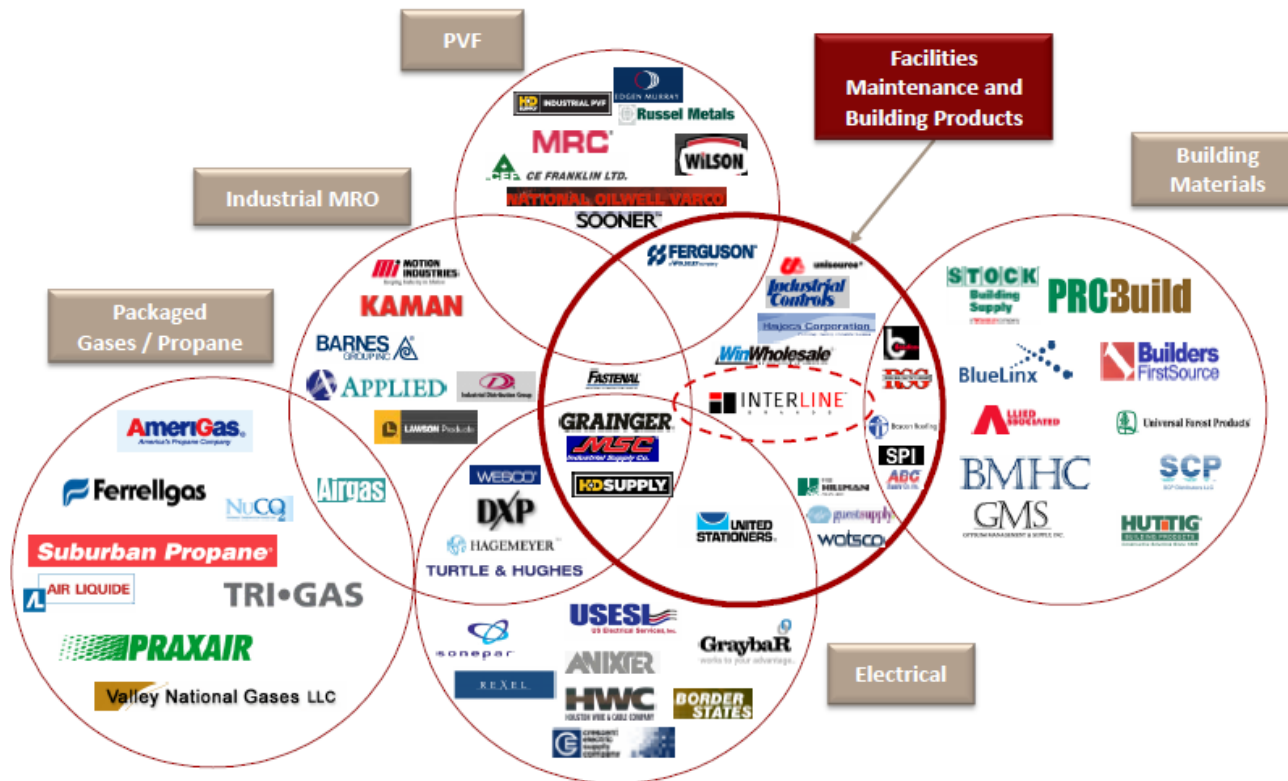


Distributor Comparison



Distributor Comparison

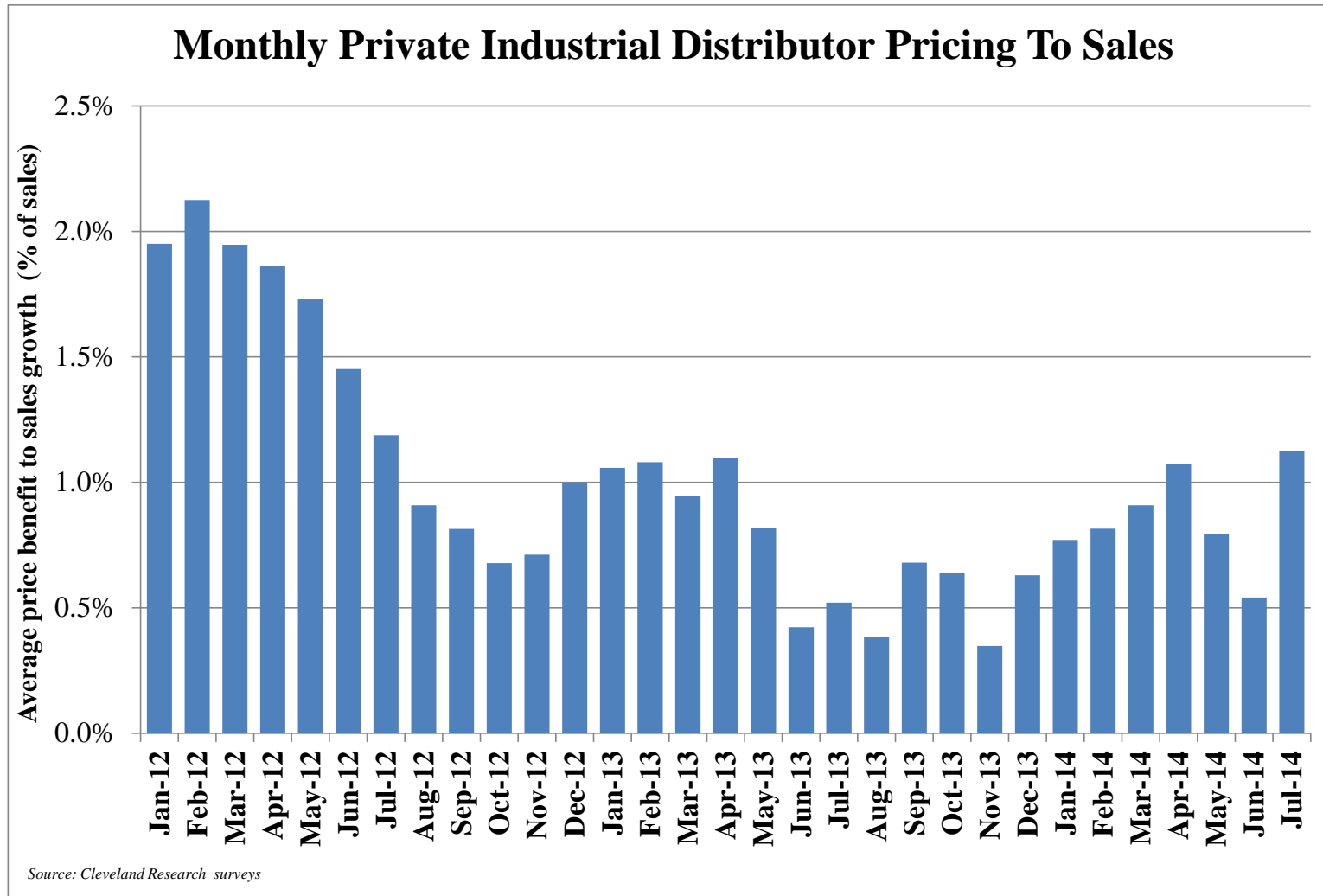
North American Distribution Landscape



Industrial Distribution Pricing Trends

- ▶ Price increases and realization under pressure
 - ▶ Subdued commodity inflation leading to more modest list price increases
 - ▶ OEM - heavy pushback this year
 - ▶ Price transparency - online sales making price comparisons easier
 - ▶ Broadening MRO exposure - harder to differentiate outside of price
- ▶ National Account Pricing – companies increasingly consolidating spend
 - ▶ Gross margin pressure squeezing local branch operations
- ▶ Distributors looking for ways to offset gross margin pressure

Pricing to Sales



Key Initiatives

▶ **Adding Feet on the Street**

- ▶ Targeting small/mid-sized customers with better margin opportunities
- ▶ Grainger - 750 TSRs at end of 2013 (adding 1-2% to sales growth), goal is to add 500 over next 3-5 years; total sellers expected to go from 2,800 in 2013 to 4,000 in 3-5 years

▶ **Adding Technical Specialists**

- ▶ Targeting higher dollar value added and stickier / technical sales
- ▶ Fastenal - Targeting government, metalworking (~30 sales people), safety (~30 sales people), vending
- ▶ MSC – expanding metalworking sales capabilities
- ▶ Grainger – bought ENR metalworking distributor with 40 mw specialists

▶ **Making investments to move away from just transaction based business**

- ▶ OEM kitting/sub assemblies – helping to drive new volume and preserve price
- ▶ System Integration – value add differentiation through system development

Key Initiatives

▶ **eCommerce Investment**

- ▶ SKU expansion, more profitable,
 - e-Commerce channel growing 2x pace of the total business, more profitable
 - Leveraging supplier direct ship to manage new product inventory requirements
 - ZoroTools is online only platform (low sales/service support, no discounting off list), now more than \$80mm in <3 years
 - Launched mobile apps for checking local inventory, etc.

▶ **Private Label / Global Sourcing**

- ▶ Grainger - Private Label/Global Sourcing growing from 13% to 25% of sales over several years
 - Globally sourced product gross margins 25pts above company average
 - Dropping stocked branded skus in favor of private label offering

Key Initiatives

▶ **VMI / Vending Machines**

- Fastenal - Customers with vending growing >20% vs company average in mid teens, contributing ~7% to sales growth.
- Vending distribution center (T-Hub) to house vendible SKUs (4-5k of 60k vended), launched in summer 2014
- Goal (modified): Add one vending machine/store/month but do not sacrifice other sales opportunities to pursue vending and identify/fix underperforming machines (37% of sales are to customers with a machine)
- Gross margin neutral on a like for like customer/item basis vs sold in branch

▶ **Misc**

- SAP / Strategic Pricing – AIT/Airgas
- TSRs lead with Keep Stock (CMI/VMI solutions)
 - Keep stock customers growing 2x faster than other customers, \$400mm in sales in 2013
 - On pace to have 100,000 locations in the next 3-5 years (50,000 at 2013 end)
- Vending distribution center (T-Hub) to house vendible SKUs (4-5k of 60k vended), launched in summer 2014

Questions?

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