

Growth Moderates in 3Q as Pricing Impact Weakens

Strong underlying industrial demand continued throughout the quarter, but a slowdown may be ahead.

Despite whispers of a pending economic slowdown, strong revenue growth in the industrial, construction and building materials distribution sectors continued in 2022’s July-September period, according to the Third Quarter Baird-MDM Industrial Distribution Survey, which polled and collected commentary from over 500 wholesale distribution executives nationwide. See the table below for a breakout of all 20 distribution sectors’ revenue and pricing summaries.

Overall, distributors posted an annualized growth rate of 9.3% during 3Q, down from 2Q’s 10.4% but exceeding Baird’s expectations by 110 basis points. The survey figures illustrated what many publicly traded distributors and suppliers voiced in their 3Q earnings reports, noting another robust growth quarter, while demand "softening" crept in near its end. Recent distributor growth in the Baird-MDM survey peaked in 2Q 2021 at 20.3%,

a figure that benefited from favorable comparisons to the height of the COVID-19 pandemic’s business impacts throughout 2020. The growth rate decline coincided with the Institute for Supply Management’s Purchasing Managers Index falling another 1.9 percentage points from August to September, with September’s reading of 50.9 narrowly in expansion territory and its lowest mark since May 2020 (43.5) during the height of shutdowns.

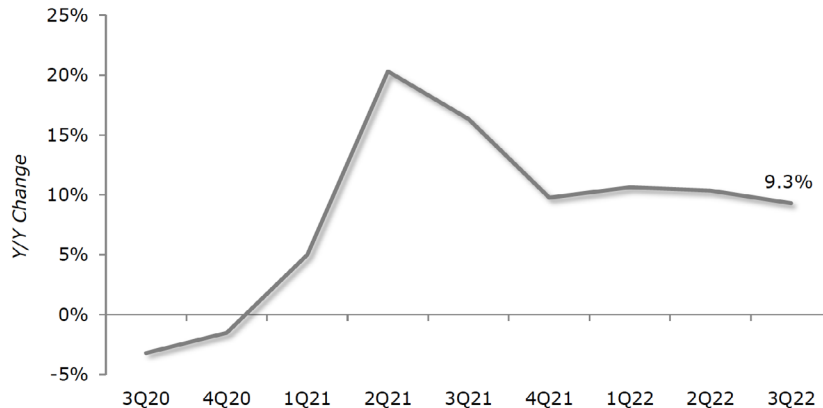
The year’s 4Q figures to be another solid revenue quarter for most distributors, when using 2019 (“the last normal year”) as a benchmark, albeit considerably slower than the past 18 months. The distribution sector has been riding high for two years on benefits from pricing, but given the amount of economic red flags out there, it makes forecasting anything beyond 1Q 2023 a tough estimate.

– Deeper sector breakouts on following pages

Third-quarter revenue growth across 20 industrial, construction and building materials distribution sectors in the U.S. was 9.3% compared to the third quarter of 2021, based on the latest Baird-MDM Industrial Distribution Survey.

	3Q22 Revenue Growth	3Q22 Pricing	4Q22 Forecast	2023 Forecast
Overall	9.3%	6.3%	6.4%	5.6%
Datacomm	14.6%	12.3%	11.8%	5.6%
Electrical	12.6%	9.0%	8.9%	6.8%
Mechanical/Power Transmission	11.9%	6.9%	7.6%	7.4%
Facilities Maintenance/Jan-San (MRO)	11.1%	8.1%	11.8%	11.3%
Roofing	11.1%	6.2%	7.2%	3.6%
Hoses & Accessories	10.5%	3.3%	9.2%	6.7%
OEM Fasteners	10.4%	11.0%	9.2%	10.5%
Pool & Spa	10.2%	6.2%	7.2%	6.5%
HVAC	9.3%	7.5%	7.6%	5.6%
Waterworks Products	9.0%	8.8%	5.8%	5.0%
Industrial/Energy PVF	8.9%	8.1%	6.7%	5.1%
Gases & Cylinder Rental	8.9%	7.3%	4.9%	7.2%
Wallboard/Gypsum	8.5%	7.3%	2.1%	0.6%
Welding Hardgoods	8.4%	6.1%	5.3%	6.6%
General Industrial (MRO)	8.2%	5.9%	5.7%	6.6%
Lumber & Building Materials	7.8%	6.6%	4.2%	2.5%
Plumbing	7.7%	6.6%	3.8%	2.8%
Metalworking/Cutting Tools	7.1%	6.3%	4.0%	4.3%
Safety	2.4%	4.1%	2.1%	3.8%
Landscape Supplies	-0.9%	2.9%	0.1%	2.1%

3Q: Strong, but Slower Growth as Gap Shrinks Between Price & Revenue



Best Performing in 3Q:

Datacomm	+14.6%
Electrical	+12.6%
Mechanical/PT	+11.9%
FM/Jan-San	+11.1%
Roofing	+11.1%
Hoses & Accessories	+10.5%
OEM Fasteners	+10.4%
Pool & Spa	+10.2%
HVAC	+9.3%

Source: Baird/MDM Industrial Distribution Survey, 3Q 2022

Of the 20 distribution sectors our survey tracked, 19 witnessed year-over-year growth in 3Q, with landscape supplies being the only sector that saw a decline (-0.9%) after posting 9.2% revenue growth in 2Q. While just five sectors saw double-digit growth in 2Q, eight sectors achieved the feat in 3Q. As was the case in 2Q, Datacomm and Electrical led the way with 14.6% and 12.6% growth, respectively. Facilities Maintenance/Jan-San (11.1%) and Roofing (11.1%) also maintained their double-digit growth from 2Q.

“We had another bang-up quarter,” one surveyed distributor said. “Our bookings stayed solid and backlog is hanging in there, but I will say the last 10 days or so of September we were a bit slower on the booking side. Every day we’re waiting for

something to turn because we’ve just had unbelievable demand, sales growth and gained new customers, but all in all, we’re still in a pretty good spot.”

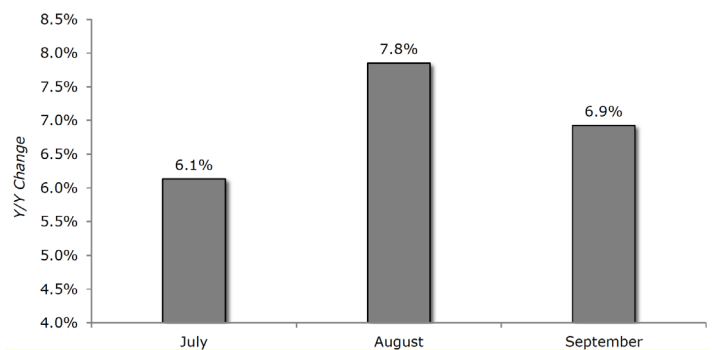
Pricing’s 6.3% overall impact on 3Q revenue growth was considerably less than 2Q’s 8.9%, as the gap between pricing and revenue growth doubled from 1.5% in 2Q to 3.0% in 3Q. 3Q’s pricing impact was more on par with 4Q 2021, when it had a 7.0% impact on revenue growth.

In terms of sector movement in 3Q, earning the biggest sequential jump was Pool & Spa, which surged from No. 20 (last) in 2Q at 2.4% growth to No. 8 in 3Q at 10.2%. Mechanical Power/Transmission also jumped from No. 16 to No. 3, seeing its growth increase from 8.6% in 2Q to 11.9% in 3Q.

3Q: Another Healthy Quarter Despite Slow Start

Survey data found that despite a rough start, 2022’s third quarter ended up seeing solid distribution sector growth. Industry concern over a slow July (6.1%) was eased by stronger growth in August (7.8%) and September (6.9%).

“Our July was very disappointing (almost scary) from a volume standpoint when you factor in the price increases,” commented one distributor. “August and September’s rebound was encouraging - most of our customers report record order volume, but material and employee shortages continue to be a challenge to increasing production.”



Source: Baird/MDM Industrial Distribution Survey, 3Q 2022

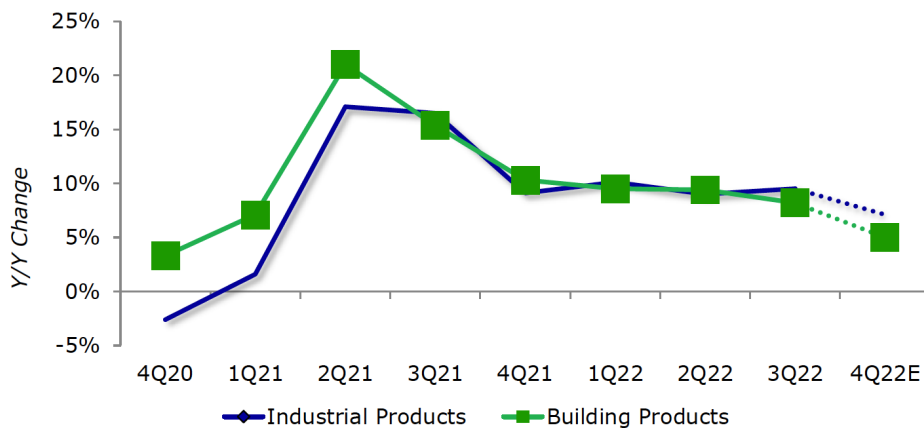
The Baird-MDM quarterly survey is the deepest financial performance benchmarking analysis for industrial wholesale distribution sectors, representing more than \$100 billion in aggregate annual revenue across six distribution categories. Survey participants receive a complete readout of the quarterly results. For questions or to participate, contact info@mdm.com, or Baird Senior Associate Quinn Fredrickson (qfredrickson@rwbaird.com). For this quarterly report, Robert W. Baird & Co. surveyed about 500 distributors and manufacturers of various sizes.

4Q & 2023: Sharp Decline in Outlook

While survey data found that distributors across all tracked sectors are expecting growth in 4Q — including Landscaping Supplies, which is projected to rebound from this past quarter — growth may not be as robust as in 3Q. Overall outlook for distributors went from 9.3% in 3Q to 6.4% projected for 4Q in our latest survey. While eight sectors posted double-digit growth in 3Q, just two sectors, Datacomm and Facilities Maintenance/Jan-San (MRO), are projected for such growth in 4Q.

Further out, overall outlook for distributors in 2023 is even more bleak, coming in at a projected 5.6%. Just two sectors — Facilities Maintenance/Jan-San and OEM Fasteners — are projected for double-digit growth in 2023.

“We think demand will remain fairly strong through 2Q23 based on our customers' backlogs, which we’ve verified, but there is absolutely no indicator for the back half of the year in terms of what our customers are saying,” a distributor explained. “At some point there has to be some ramifications on order flows with the macro factors and the cost of money skyrocketing.”



<u>Strongest 4Q Forecasts</u>	
FM/Jan-San (MRO)	+12%
Datacomm	+12%
OEM Fasteners	+9%
Hoses & Accessories	+9%
Electrical	+9%
<u>“Weakest” 4Q Forecasts</u>	
Landscape Supplies	+0%
Safety	+2%
Wallboard	+2%
Plumbing	+4%
Metalworking	+4%

Source: Baird/MDM Industrial Distribution Survey, 3Q 2022

Distribution Sector Survey Highlights

Here are key takeaways for some of the 20 industrial, electrical, construction and building materials sectors pulled in the 22Q3 quarterly survey.

INDUSTRIAL

The industrial category includes general industrial MRO, safety, cutting tools, fasteners, mechanical & power transmission, hoses & accessories and facilities MRO & Jan-San. Key themes in the third quarter for this sector were:

- Some easing in supply chain, freight and container cost headwinds
- Facilities maintenance and general MRO see continued solid demand, buoyed by return to office/travel and overall industrial momentum
- Safety growth constrained by prior year COVID growth comparisons
- OEM/production-tied products see nice sequential uptick in growth/demand
- Current margin feedback positive but some concerns ahead

Key Fact: Revenue growth for Mechanical Power/Transmission increased sequentially by 3.3% to 11.9%, vaulting from the No. 16 ranking among all tracked sectors in 2Q to No. 3 in 3Q.

ELECTRICAL

The electrical category includes electrical and datacomm.

Key themes for this sector:

- Strong industrial, utility and data center trends continue.
- Non-residential construction market feedback also positive
- Residential market softening with starts/permits
- Softening commodity pricing leading to some margin pressure

– Sector highlights continue on next page

Key Fact: Electrical and Datacomm occupied the No. 1 and 2 rankings among the 20 tracked distribution sectors for the second consecutive quarter.

HVAC/PLUMBING

Key 3Q themes in HVAC and plumbing were:

- HVAC unit volumes up again only very modestly
- HVAC pricing continues to power solid dollar growth and margins, however
- Slowing noted in plumbing demand
- Uptick in competitive pressures among plumbing respondents

Key Fact: 3Q revenue growth for HVAC — one of five sectors to experience double-digit growth in 2Q — decreased sequentially by a percentage point to 9.3%.

BUILDING PRODUCTS

The building products sector includes roofing, lumber & building materials, pool & spa, landscaping supplies and wallboard/gypsum. As a diverse sector, the areas had different key themes in 3Q:

- Roofing: Current quarter demand/pricing healthy but signs of competitiveness increasing
- Lumber & Building Materials: Demand falling with rising rates though backlog partially offsets
- Pool & Spa/Landscape Supplies: New construction demand down; can pricing hold?
- Wallboard/Gypsum: Still strong commercial, residential softening

Key Fact: 3Q revenue growth for Pool & Spa saw the greatest sequential increase — 2.4% to 10.2%, an increase of 7.8 percentage points — of all tracked sectors, while Landscaping Supplies experienced the greatest sequential decrease — 9.2% to -0.9%, a 10.1-point decrease — of all tracked sectors.

PIPES, VALVES & FITTINGS

This sector includes industrial/energy PVF and waterworks products. Key 3Q themes were:

- Industrial/Energy PVF sees modest volume growth as availability improves
- PVF prices continue to march higher
- Waterworks seeing continued strong price realization

Key Fact: PVF's 3Q revenue growth was exactly the same as in 2Q — 8.9%.

GASES & WELDING

The gases and welding sector includes gases & cylinder rental and welding hardgoods. Key 3Q themes were:

- Demand remains healthy
- Product shortages and allocation continue to drive pricing higher

Key Fact: 3Q revenue for Welding Hardgoods decreased sequentially by 1.2%, dropping from No. 6 to No. 14 among tracked sectors in the process.

Industry Voices

Deeper commentary by survey respondents across the 20 product category verticals. Survey responses were collected during the first two weeks of October 2022:

INDUSTRIAL

- “International freight (ocean) is declining, domestic freight is declining some but not nearly as much.”
- “Logistics problems are slowly improving and we can see this in our sea freight costs and transit times.”
- “We don't have quite as many back orders ... still some challenges but for the most part that has improved since the summer has moved on.”
- “Supply Chain continues to improve but still not perfect. Container rates dropped sequentially.”
- “Our business is buoyed with a greater return to the office work environment, hospitality and travel and larger national accounts.”
- “Industrial segment remains strong (incoming orders), backorders still too high; some pessimism about 2nd Half of 2023 but most believe post-pandemic momentum won't dissipate.”
- “Revenues being negatively impacted by comparing to 2021 with higher COVID sales.”
- “While there is demand, pricing has been adjusted (upward for non-COVID-related products) vs. reduced for covid related products.”
- “We're hitting on all cylinders. Machine shops are busy. We had a couple of nice big projects come in.”
- “Most of our customers continue to be busy. We're hearing record backlogs but you can't get people and you can't get material.”
- “With some of the stuff we sell that has particularly long lead times with a year of inventory there's a real risk there where your prices adjust before your cost does... you have

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to wade through the inventory you have on hand. Inflation helps you on the way up, hurts you on the way down.”

ELECTRICAL

- “Industrial saw accelerating trends with OEM business outperforming MRO business. Datacomm project activity strong with most activity around data center, energy and intelligent building opportunities.”
- “Price increases in the utility supply market have slowed. Demand in utility supply is still very strong. Single phase and three phase transformers remain the biggest utility supply chain issue in the marketplace.”
- “Data center market continues to drive our performance.”
- “Overall industrial and certain commercial markets are so robust that their growth is able to overcome softness in other sectors if you have the products and solutions to provide.”
- “Commercial construction seems pretty solid so that we're encouraged by.”
- “Industrial and commercial construction is definitely outpacing growth everywhere else.”
- “Resi slowing, retail mixed, light industrial strong.”
- “Resi is softer for sure.”
- “Industry cannot afford rapid price declines. We need a slow multi-year correction.”
- “Margin seems to be flattening out, slowing business may cause some to make bad decisions.”
- “Customers like to selectively forget how much pricing and lead times have increased. Maintaining margin has been more difficult than in previous periods.”
- “GM% has dipped over the same time as last year. Seeing smaller competitors being more competitive (sometimes desperate) in the market. Backlog is way up over last year, primarily as a result of power distribution equipment being delayed.”
- “Copper seems to be flattening, which will put less pressure on ALL products.”

HVAC/PLUMBING

HVAC:

- “Majority of revenue increase is due to inflation, though we are still growing in unit volumes. We are seeing some negative mix shift due to high inflationary increase in last 18 months.”
- “Prices and margin continue to increase, but volume is flat to down.”
- “Most of our sales revenue growth continues to stem from higher prices. These price increases from our vendors are passed through to our customers.”
- “Flat to slightly up in unit sales but with strong inflation.”
- “We're seeing plenty of revenue growth based on pricing. We'll be right around 1-2% volume growth.”

- “Unit volumes are down but price-driven cost increases are keeping dollar growth strong.”
- “Margins have held strong due to increased prices to customers. Everyone knows what's happening inflation-wise, so price increases have been easy to pass on.”

PLUMBING:

- “Plumbing slowing.”
- “Significant slowdown in remodeling and new build.”
- “September was an inflection point for us with regard to margin strength. Gross margin percentage rolled over in September and it is our belief that we have entered a period of slow steady margin compression from all-time highs to normalization as significant COVID-related price increases roll off.”
- “Seeing most area distributors cutting pricing in order to promote sales and reduce inventory ahead of soft prices.”
- “In the market is back and distributors are fighting for market share via price cuts. We see increased sales but a decrease in margin. Also, Home Depot and Lowes are also aggressive in our market.”

BUILDING PRODUCTS

ROOFING:

- “Demand is still high and supply is still low.”
- “The market is still strong but showing signs of softening.”
- “Pricing is starting to slide back.”
- “Pricing discipline of last 2 years is going out the window. Sell price is falling quicker than costs from manufacturers. Demand has also dropped quicker with the new construction market being affected by rising interest rates. Demand is there but consumers can't afford new rates.”

LUMBER & BUILDING MATERIALS:

- “Customers with stock in a high-level + housing demand reducing due to elevated mortgage rates.”
- “Margins staying strong although starting to see more dealers and lumberyards dropping prices and tightening inventories. R&R customers reducing backlogs, and NC still strong due to long build cycles.”
- “Building has slowed dramatically with the increase of mortgage rates and the high prices associated with construction.”

POOL & SPA/LANDSCAPE SUPPLIES:

- “House construction slowing way down, some products are still hard to get, nobody knows how price & availability will be affected.”
- “We expect sale growth to slow but remain positive, pricing to stabilize, and margins to decline slightly as a result of nationwide overstock issues.”
- “Hoping prices hold.”

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WALLBOARD/GYPSUM:

- “Commercial backlogs are strong and architects are still busy (ABI still above 50) so ‘23 looks fine. Residential are starting to really see lower demand. Residential expected to be down 33% in 2023.”
- “Demand is very high and looks strong for this quarter. We are seeing a slowdown in residential but not commercial.”

PIPE, VALVES & FITTINGS**INDUSTRIAL/ENERGY PVF:**

- “Even though pricing has gone up, we are starting to see some stock come back and thus customers are able to purchase.”
- “Supply chain improvements and price increases are not affecting demand.”
- “Supplier price increases have finally slowed but revenue was still positively impacted by price increases throughout 2022. Margins continue to be diluted from inflated freight costs.”
- “Product availability has really made pricing a ‘non-issue’ this entire year.”

WATERWORKS:

- “We’re not conceding pricing in this market. Demand is still strong and we can sell what we have in inventory. We’re finding that we’re gaining market share because many of our competitors are having delivery and inventory issues.”
- “3Q22 continued at a fast pace with high volume. We have been able to continually pass through price increases and maintain high margins.”
- “Market demand has been a huge driver of our revenue increase. We have also had issues with product availability which has also raised prices.”

GASES & WELDING

- “If you have the inventory, you are in the driver’s seat.”
- “The products that are readily available have seen strong sales and margin growth. Still wrestling with supply chain issues.”
- “The lack of supply for rare gases that come from parts of the world like Ukraine have driven prices to levels never seen before. We have been able to pre-buy some of these and have sold for very large gross margins improving our specialty gas sales and profits. Helium supply remains tight which has increased pricing substantially.”
- “Volatile commodity pricing for gases and hardgoods, coupled with unpredictable lead times makes for challenging revenue/pricing trends. It seems clear to me that pricing trends will continue to climb in the near future.”
- “The supply crunch has caused revenues to increase as prices increase, but costs associated with selling the product have increased proportionately, so margins remain compressed.”
- “Price increases keep coming and there's no end in sight. Energy costs will only get worse this winter. Vendors are using it to cover costs but also to get their pricing in line and margins up.”



MDM MarketPulse is a quarterly summary report of the Baird Industrial Distribution Survey in partnership with Modern Distribution Management. It includes analysis of survey responses by more than 500 distribution executives representing more than \$100 billion in aggregate annual revenue across industrial, electrical and construction/building materials sectors, and is published quarterly by Modern Distribution Management, a brand of Gale Media, Inc., 6309 Monarch Park Place, Suite 201, Niwot, CO 80503.

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