

THE FPDA   
MOTION & CONTROL NETWORK



## Review of Industrial Economy & Industrial Distribution Trends

September 22, 2015

Joe Calvello

# Today's Agenda

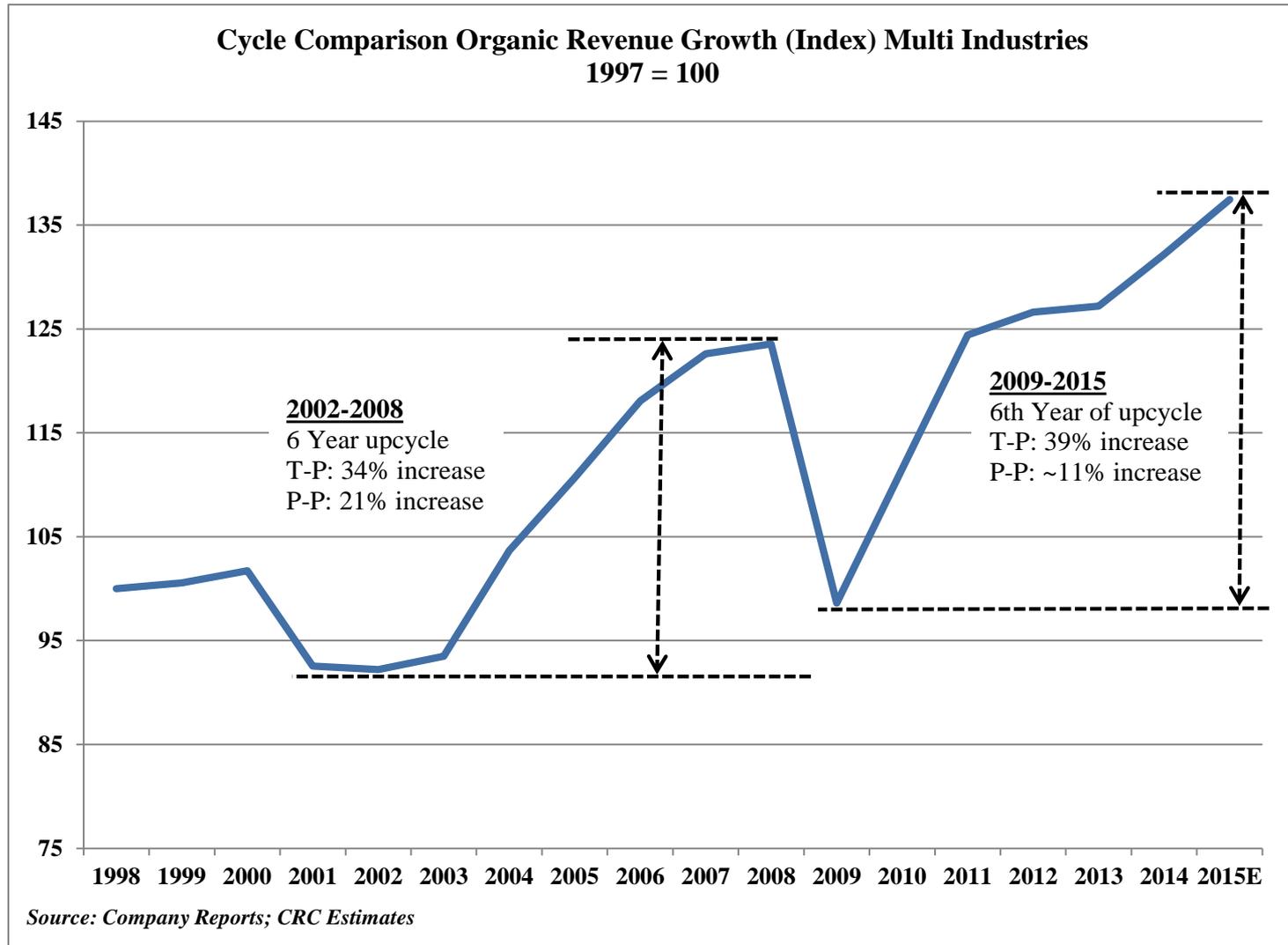
- Macro / Industrial Backdrop
- FPDA / ISD Market Trends
- Initial 2016 Outlook
- Question & Answer
- Appendix: Industrial Distribution Industry Trends



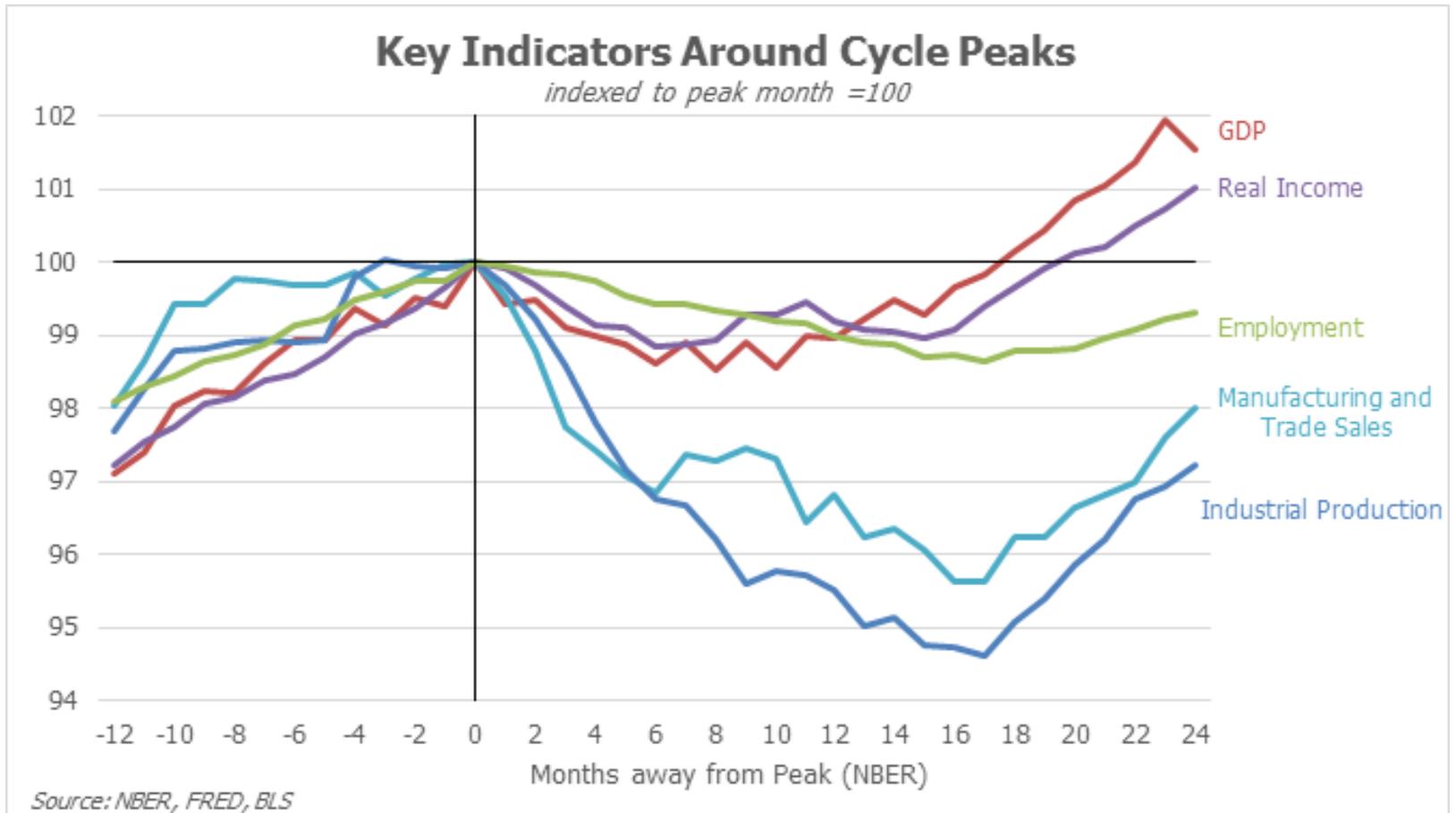
# Industrial Backdrop



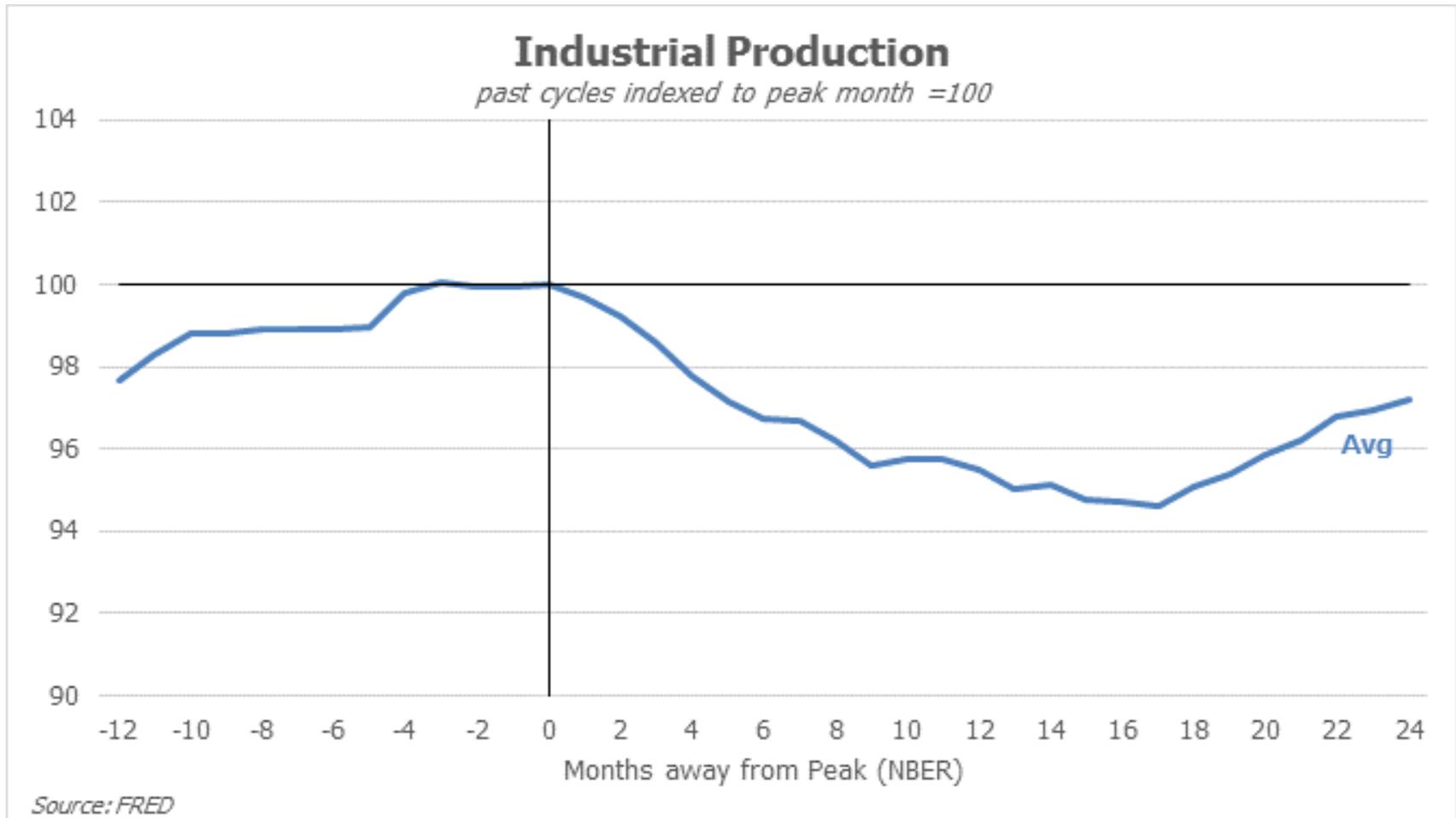
# Where are we in the cycle



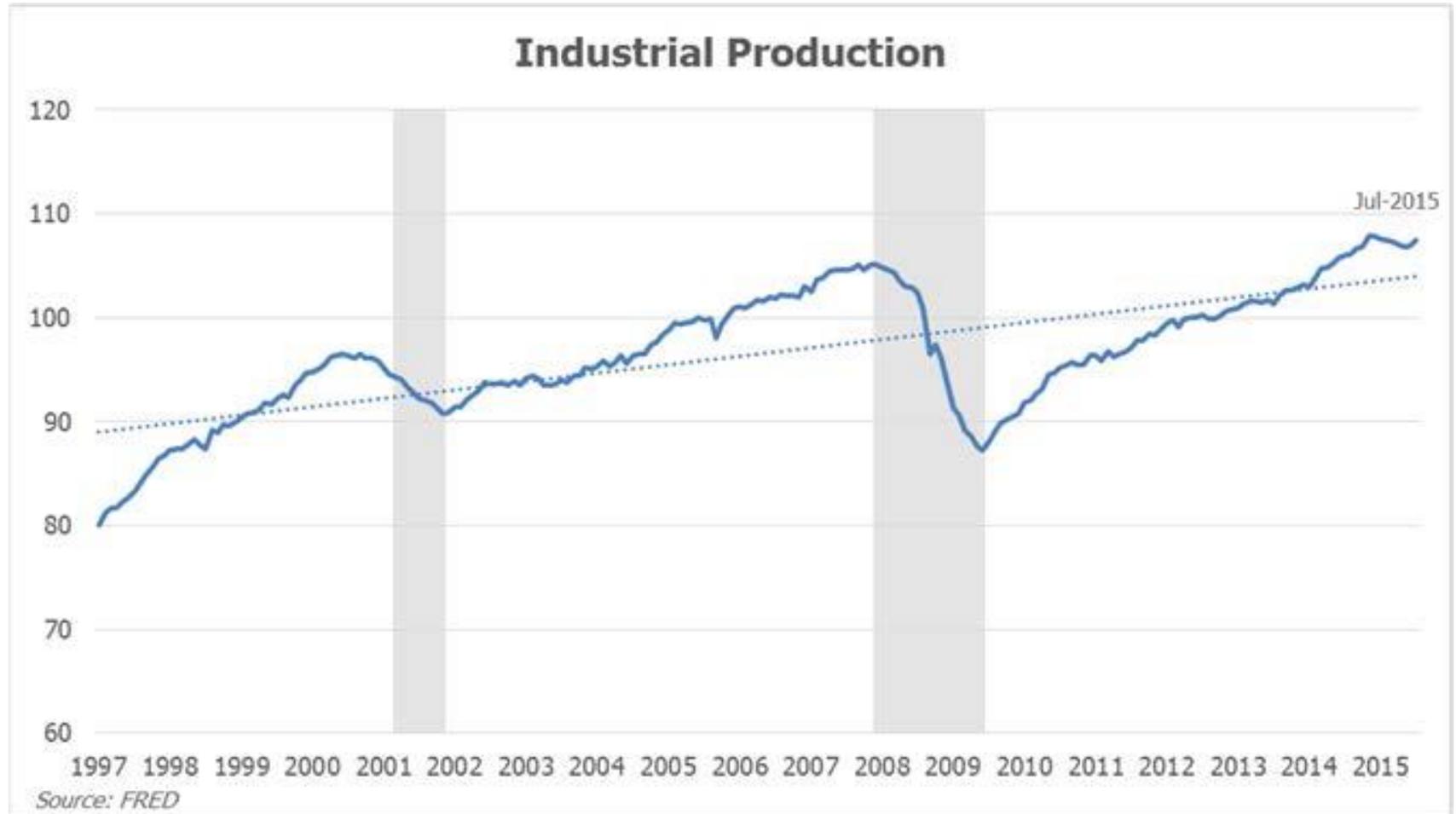
# Where are we in the cycle



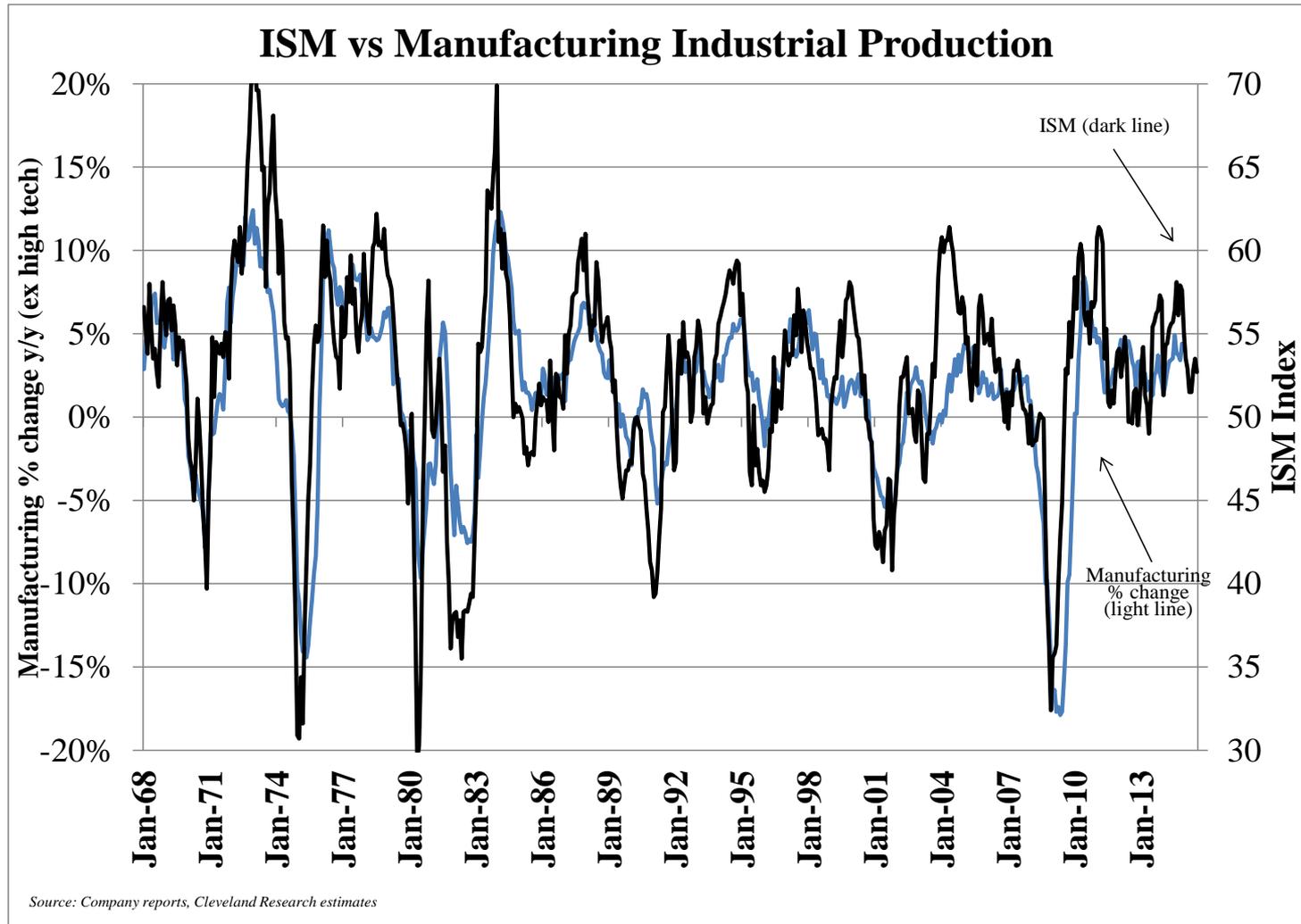
# Where are we in the cycle



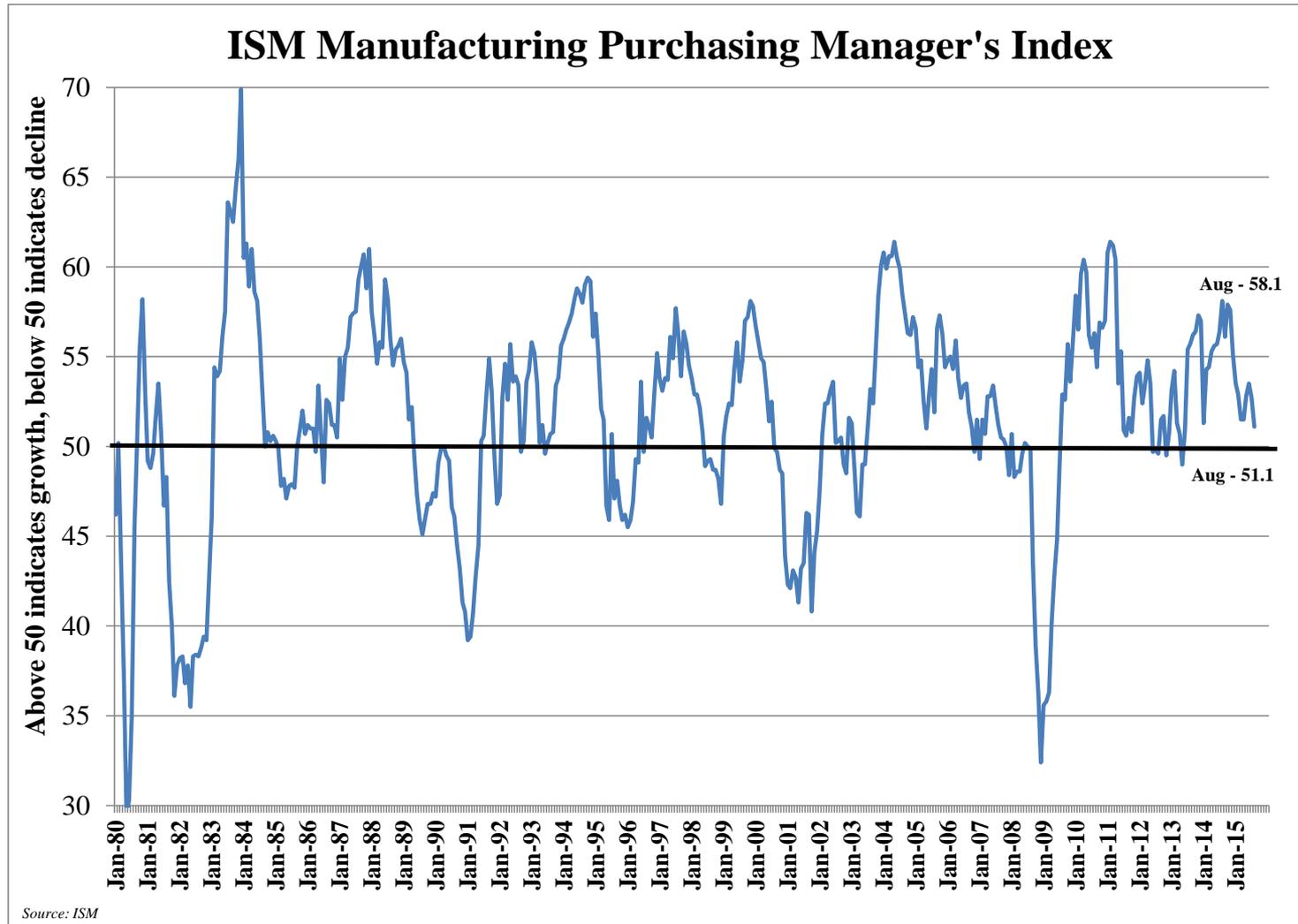
# Where are we in the cycle



# ISM correlates well with IP



# ISM is softening



# Our Industrial Surveys

## HVAC

**Aggregates**  
**Freight Forwarders**  
**Intermodal**  
**Paper & Packaging**

**Ag Equipment**  
**Electrical**  
**Flatbed Trucking**  
**Gas & Welding**  
**Rails**

## Lighting

**Boxboard**  
**Small Parcel Shipping**  
**Waste Services**  
**Wallboard**

**Mining Equipment**  
**Monsanto**  
**Fluid Power**  
**Industrial Distribution**  
**Containerboard**

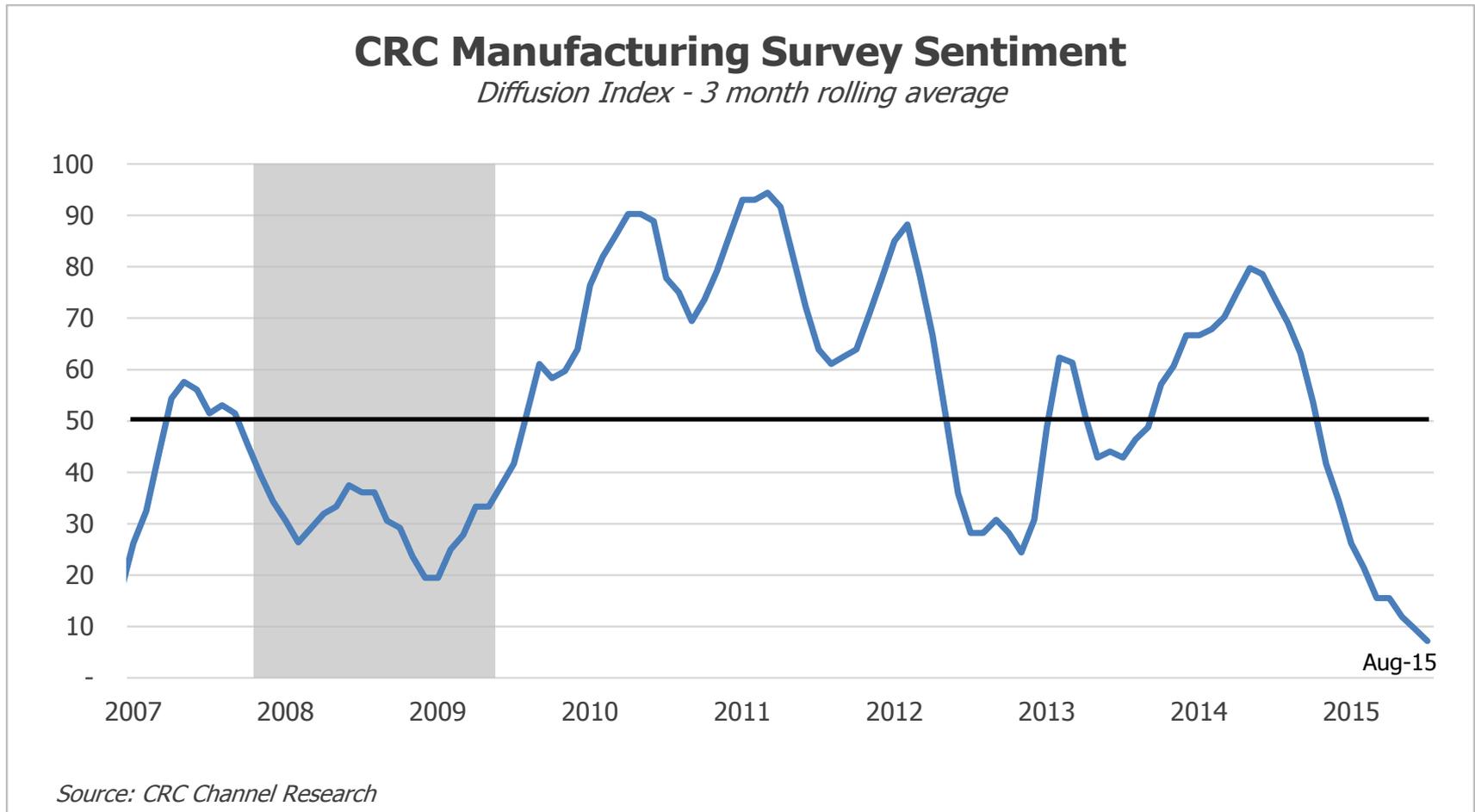
## Truck Brokerage

**Cement**  
**Ethanol & Oilseed**  
**Fertilizer**

**Oilfield Services**  
**Industrial Automation**  
**Frac Sand**  
**LTL Trucking**

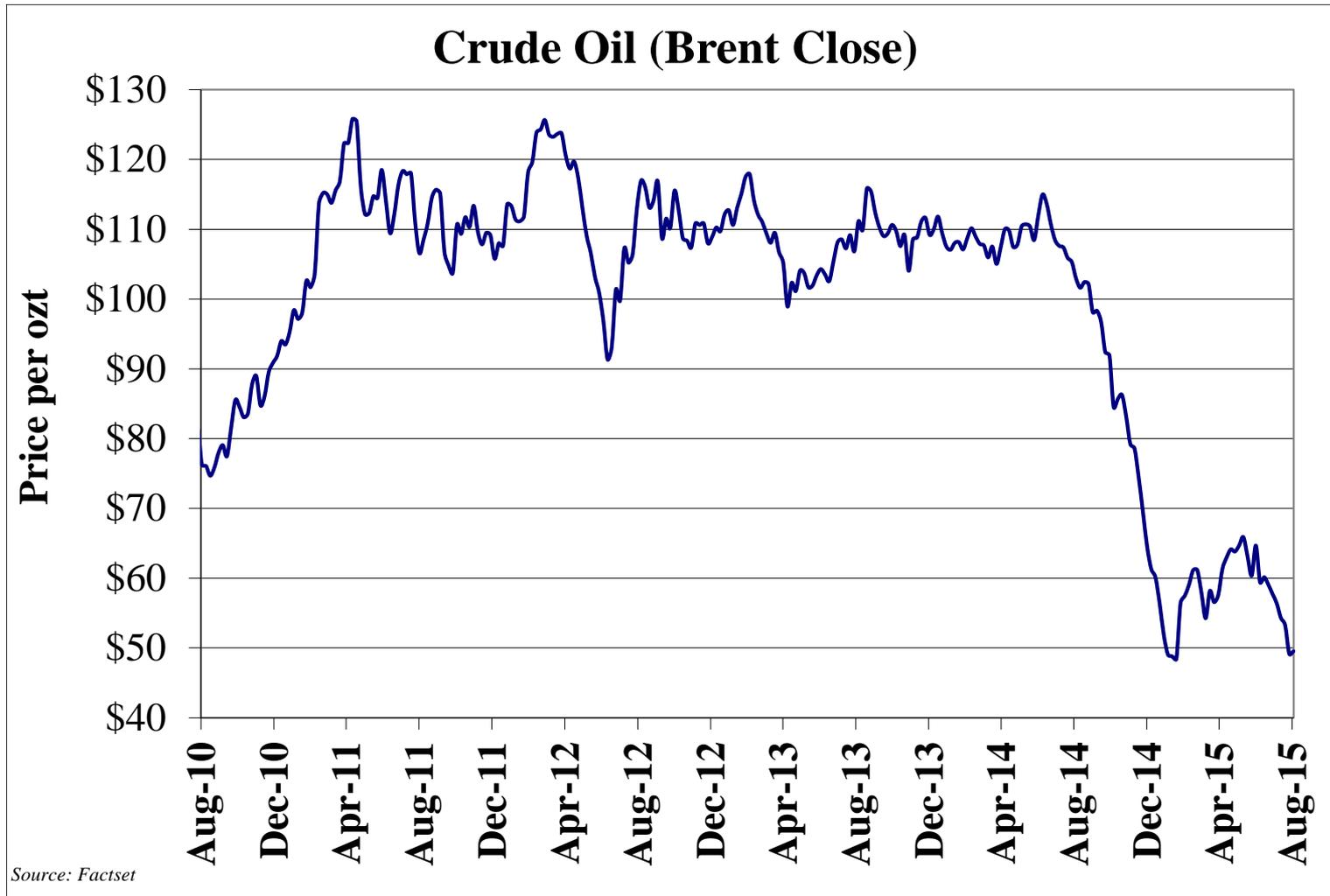


# Manufacturing Sentiment Rolling Over



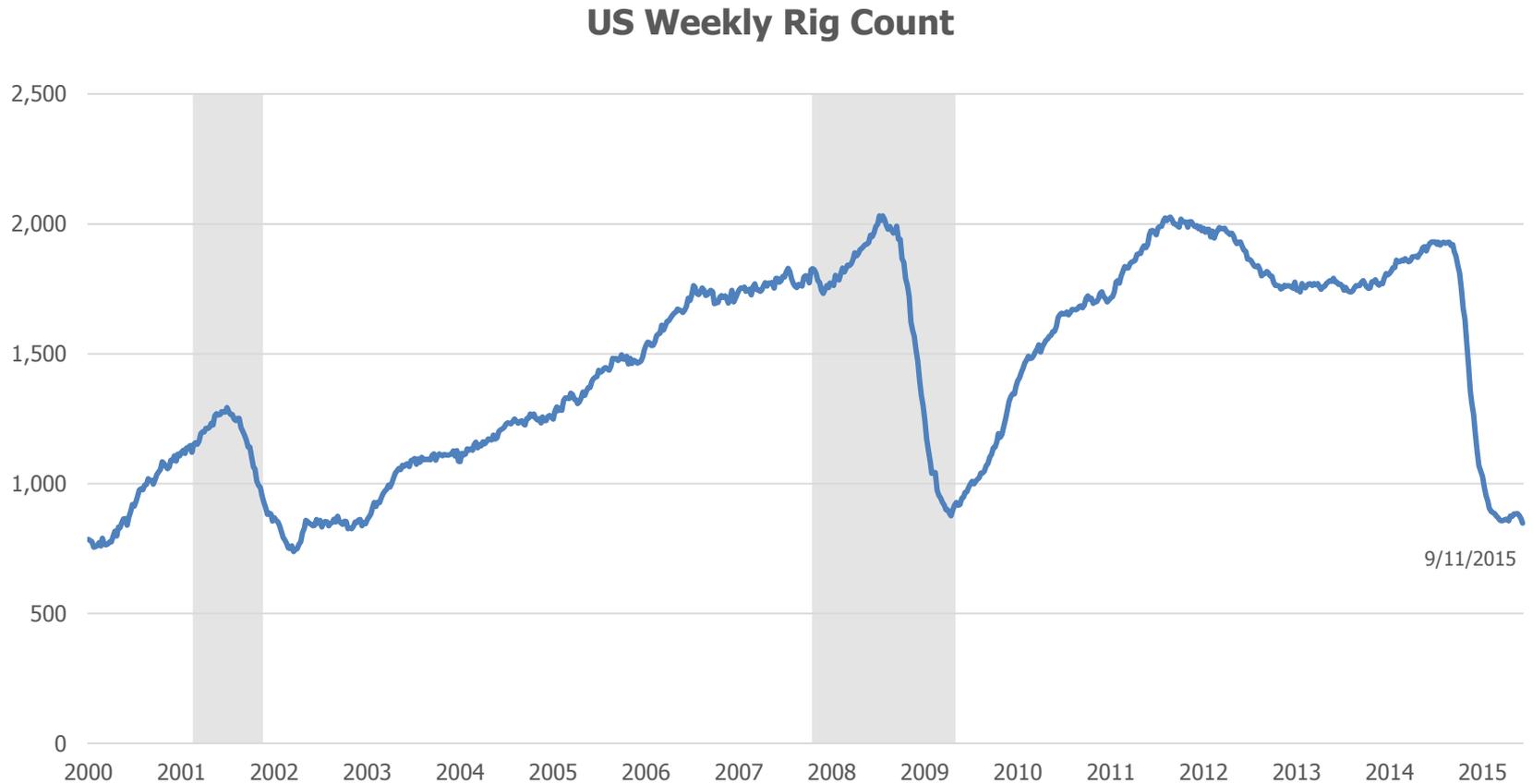
# What Changed?

*Oil prices collapsed*



Source: Factset

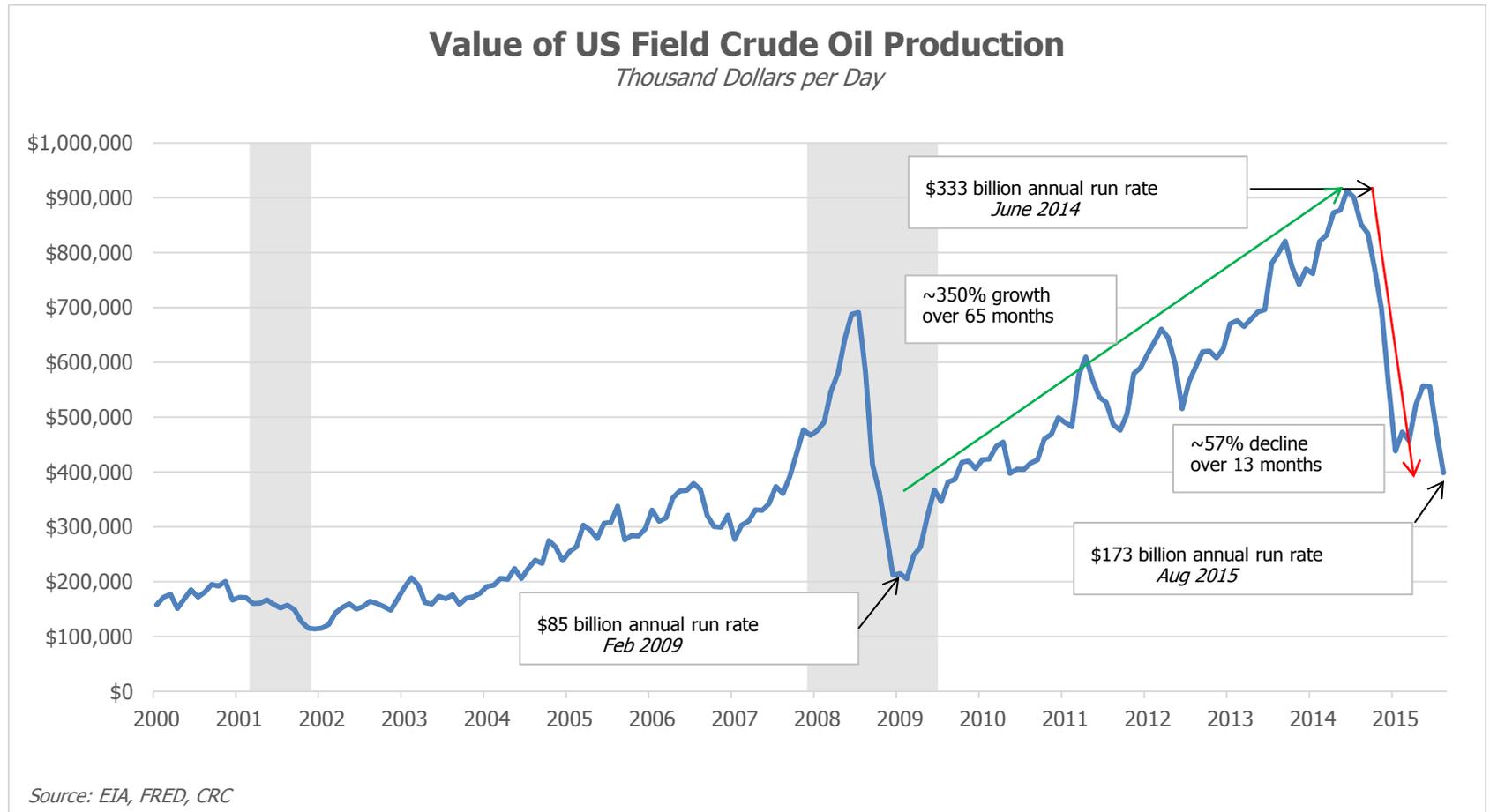
# Collapse in rig count started last October



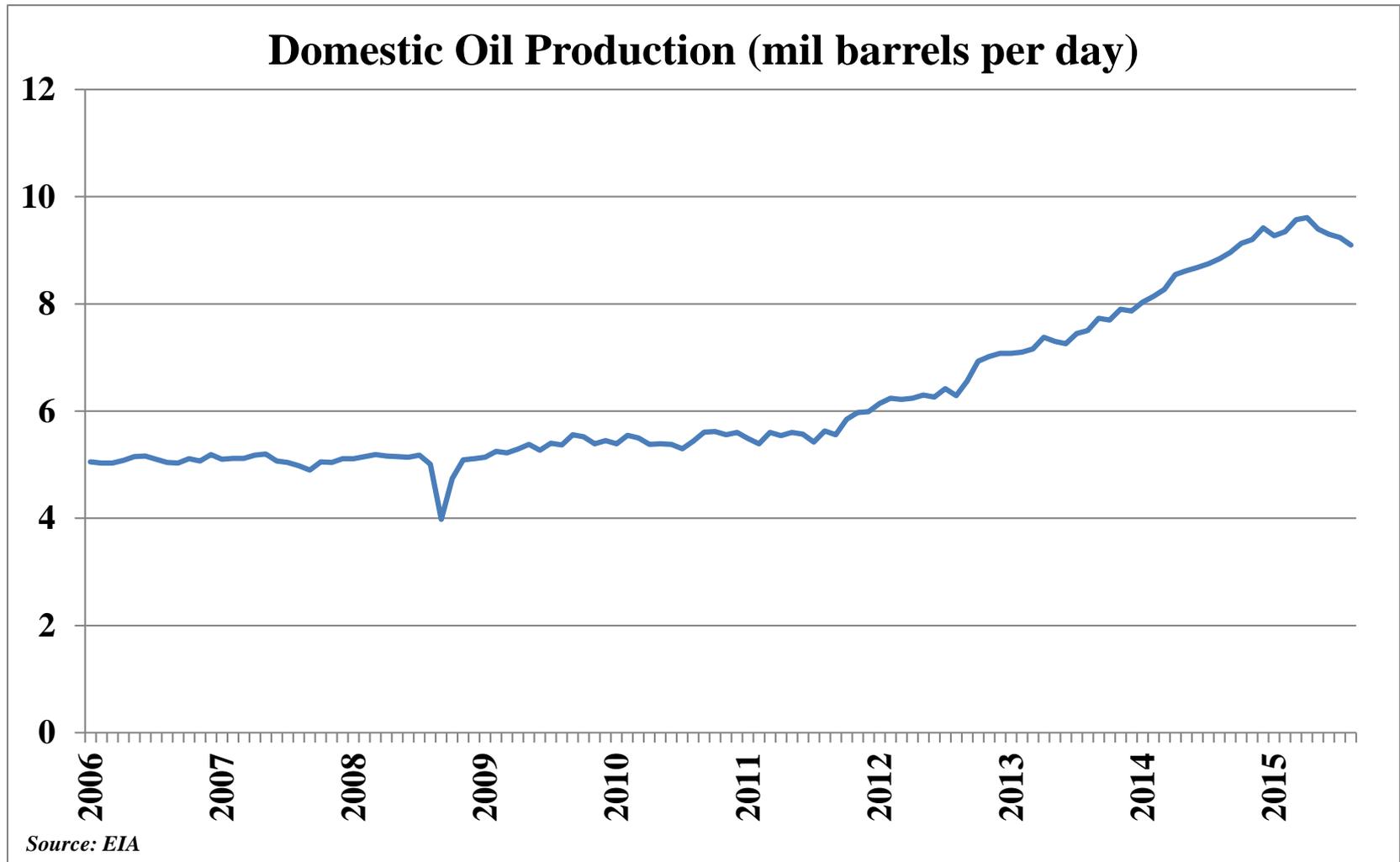
Source: Baker Hughes Rig Count



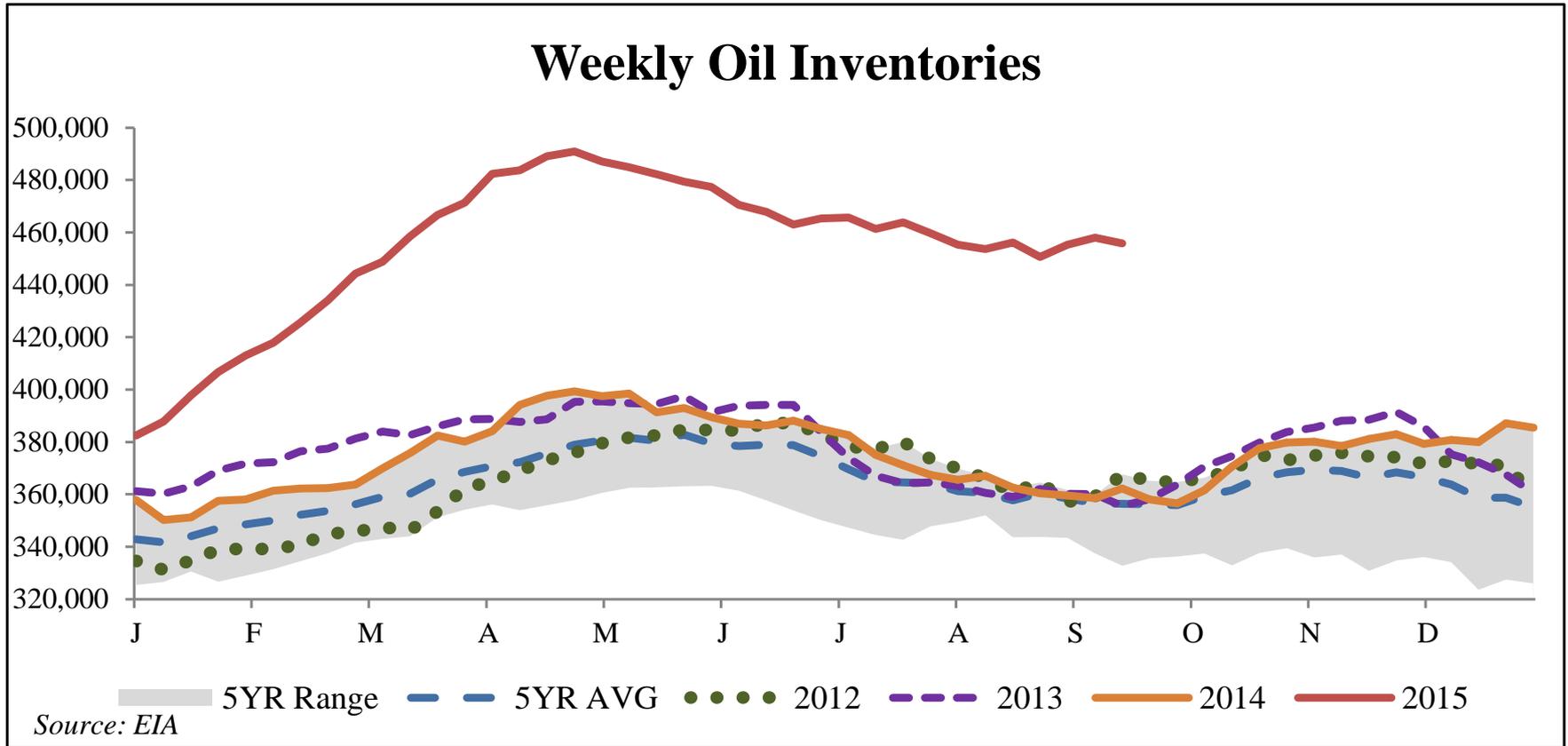
# Production down ~60% over past year



# Excluding price production is still up y/y

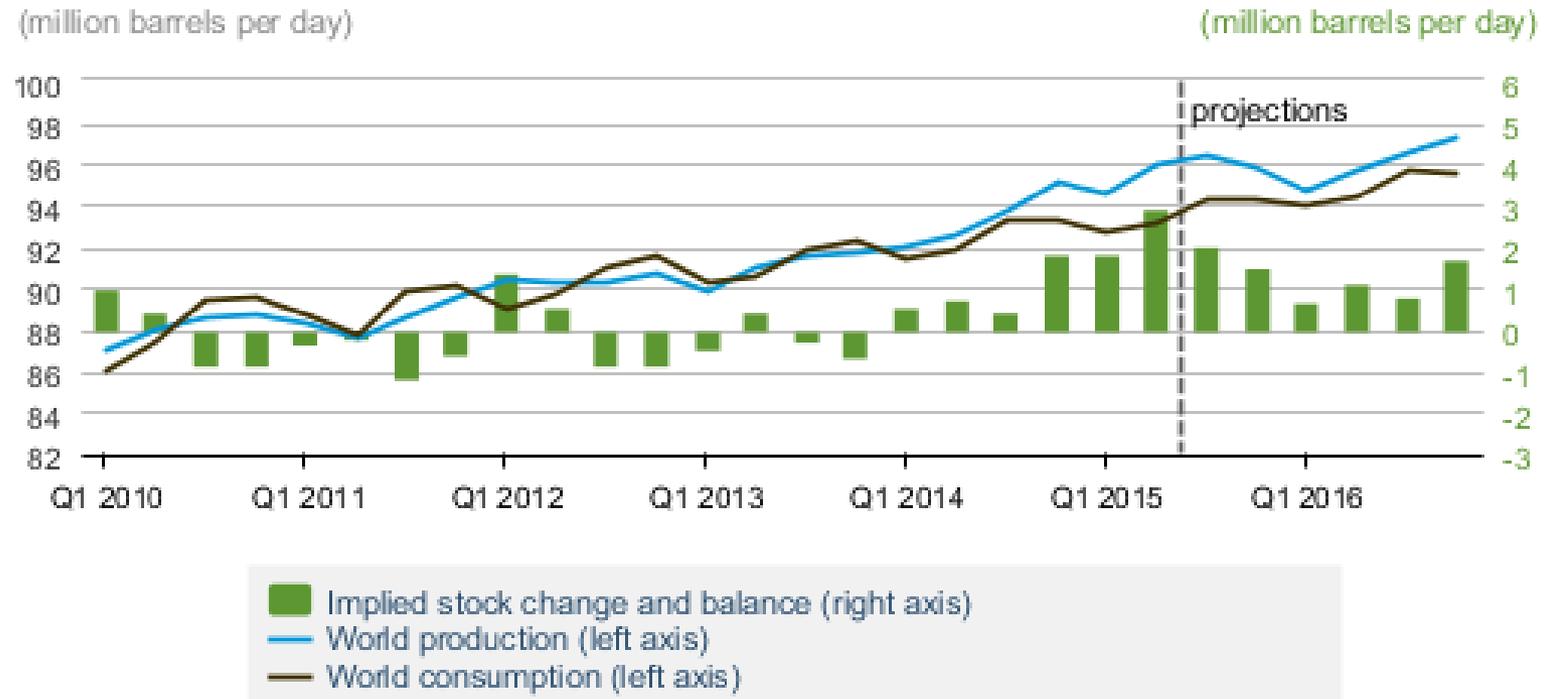


# Inventories are at all-time highs



# Not projected to improve

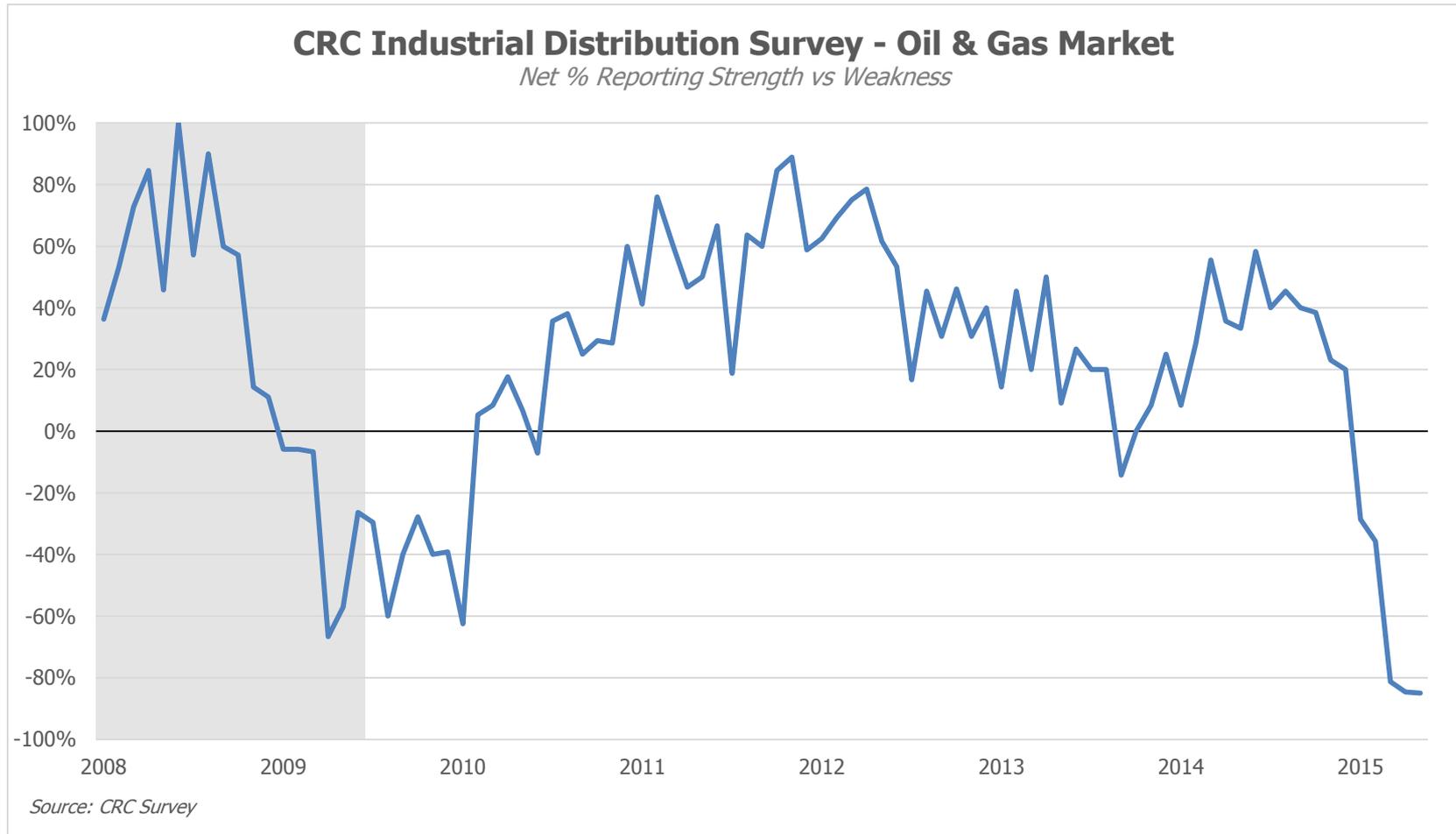
## World Liquid Fuels Production and Consumption Balance



Source: Short-Term Energy Outlook, September 2015

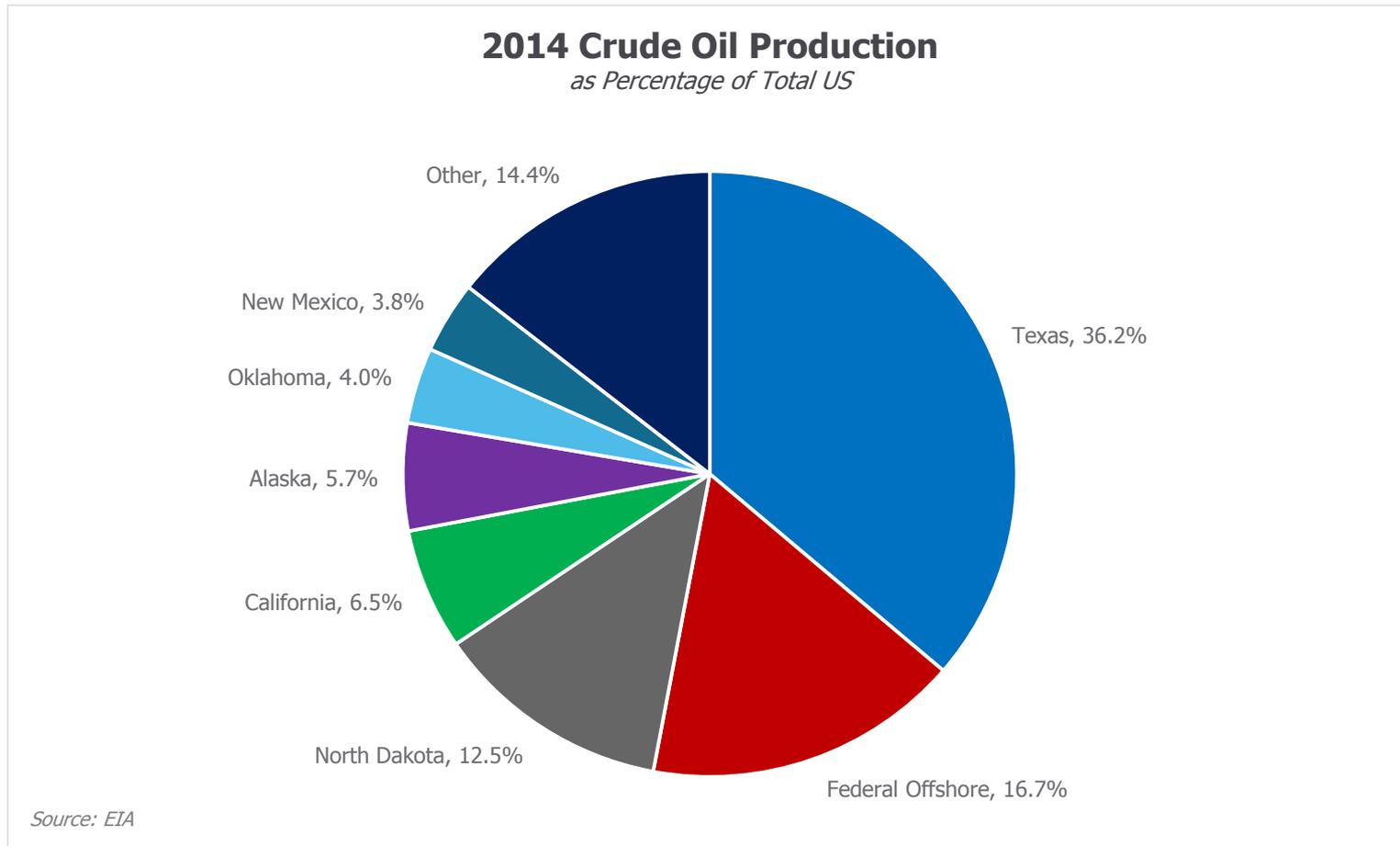


# O/G weakness is spilling over to industrial



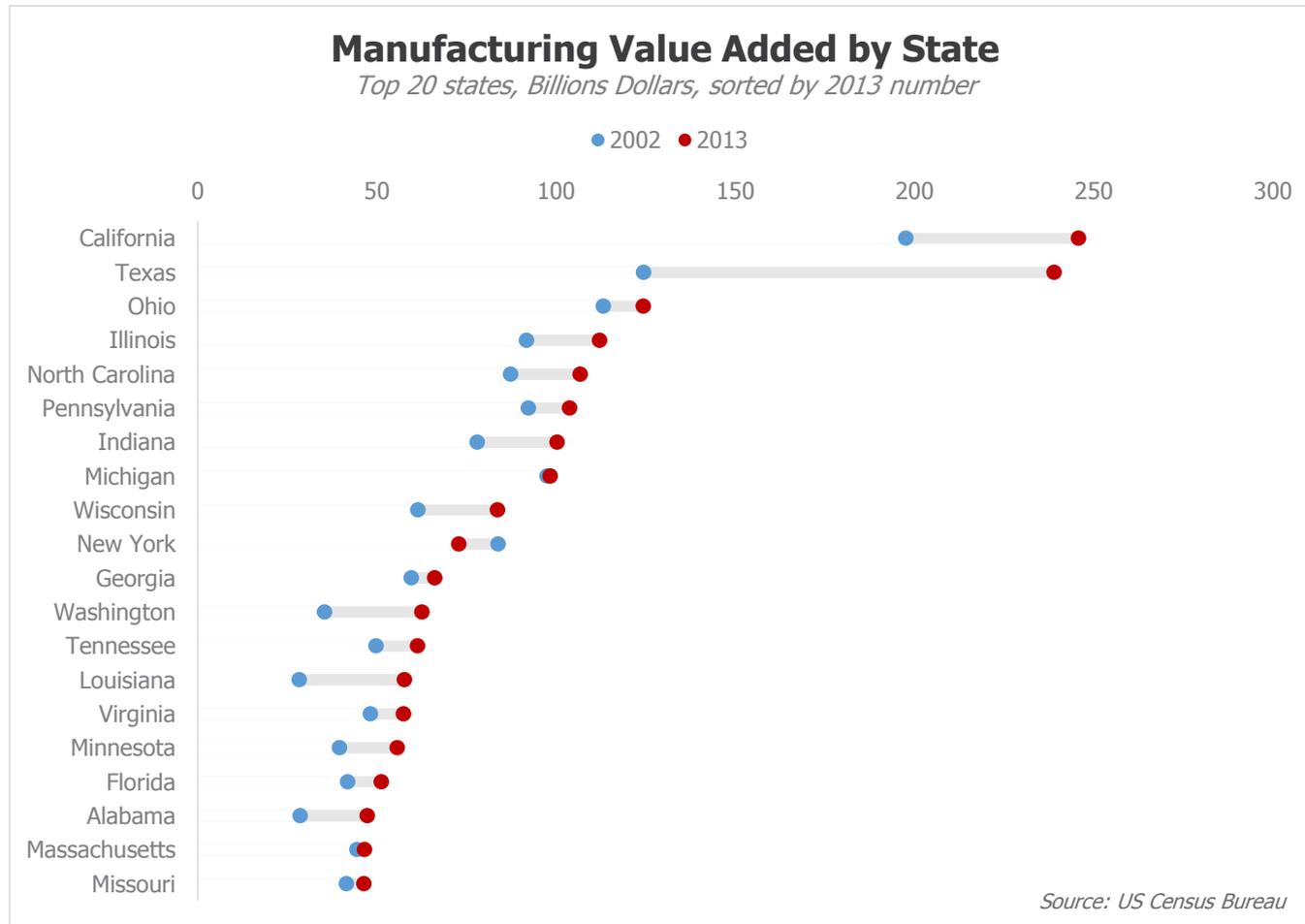
# Manufacturing

*Where the US Oil & Gas boom happened*



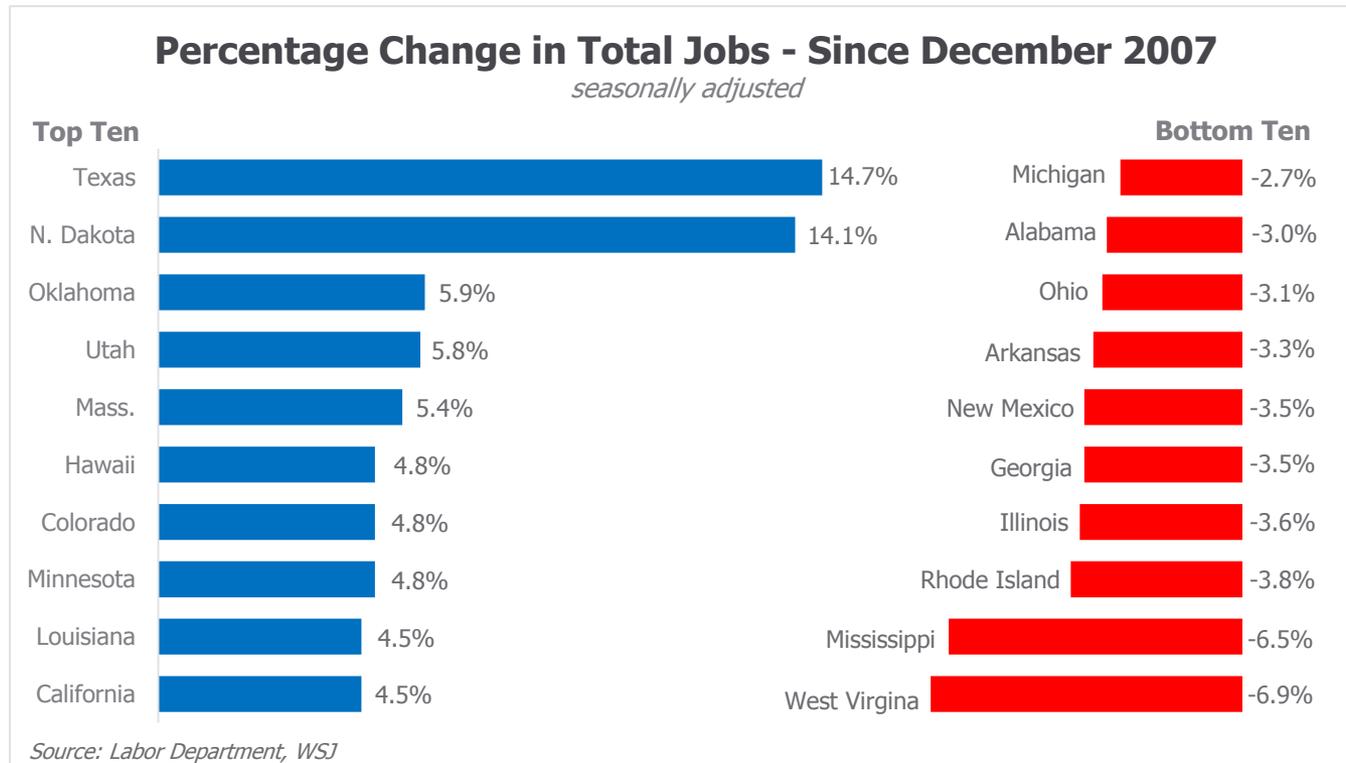
# Manufacturing

Texas!



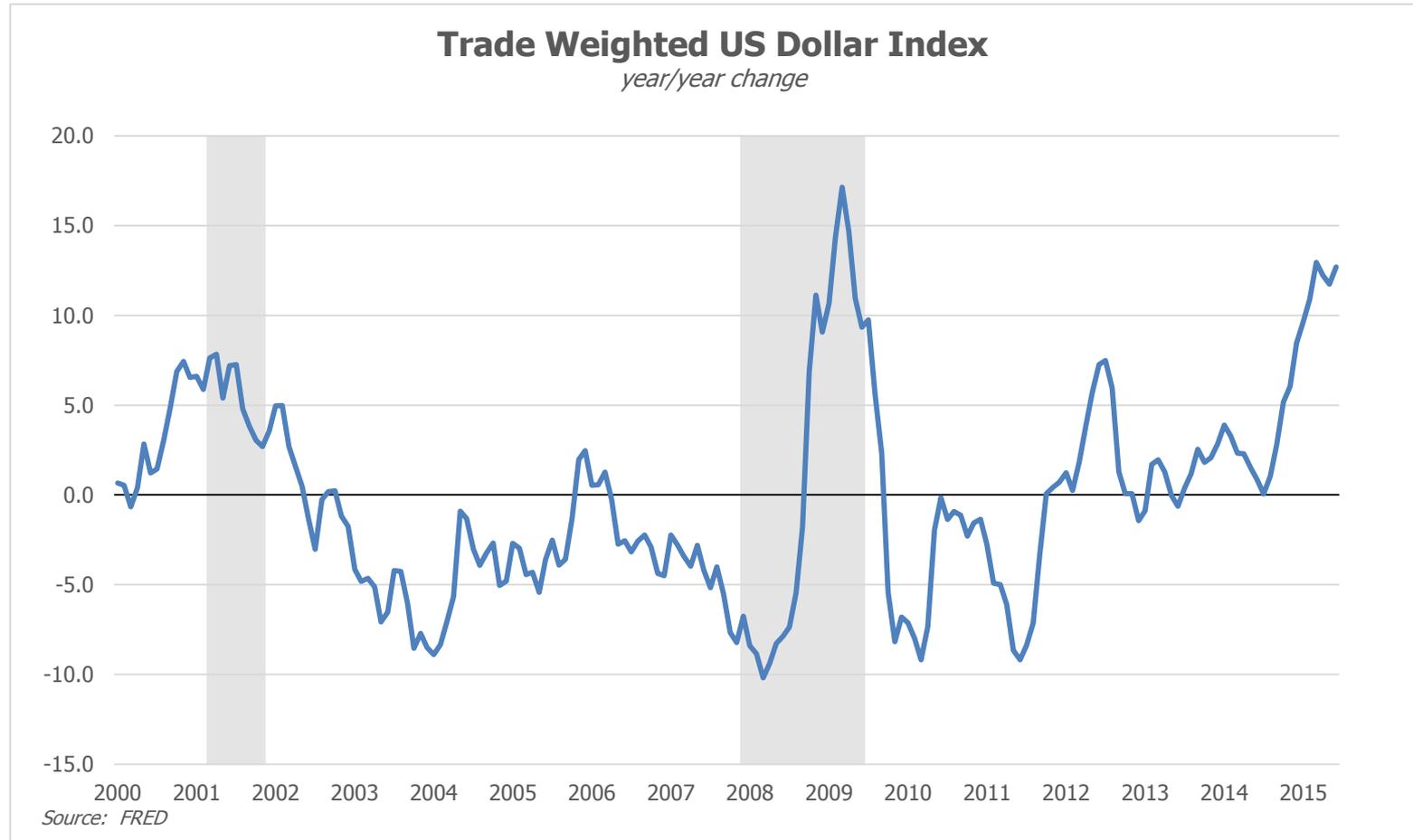
# Employment

## *Job Growth by State, Since Start of Great Recession*

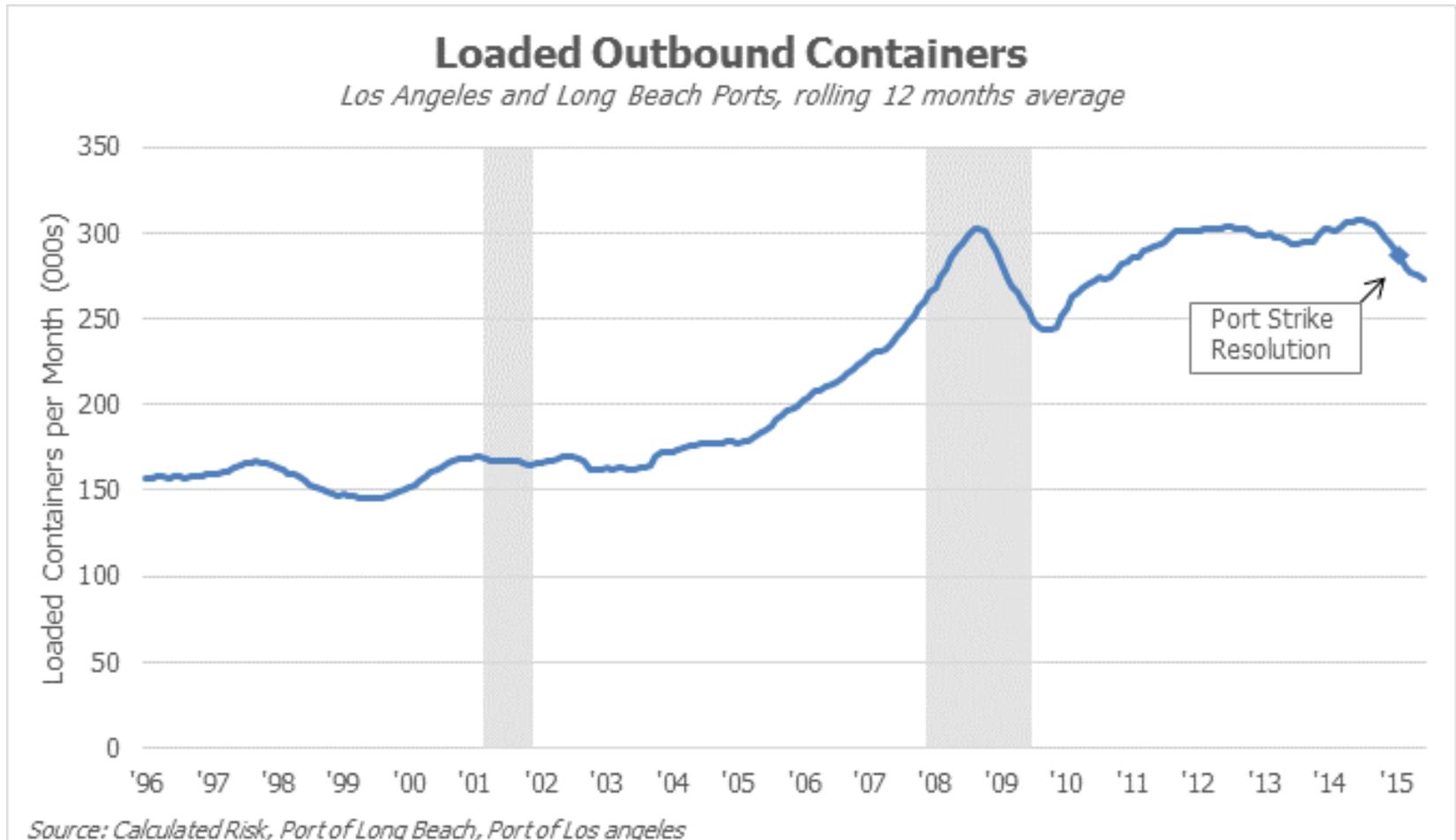


# Currency headwinds

*On top of Oil & Gas weakness...*

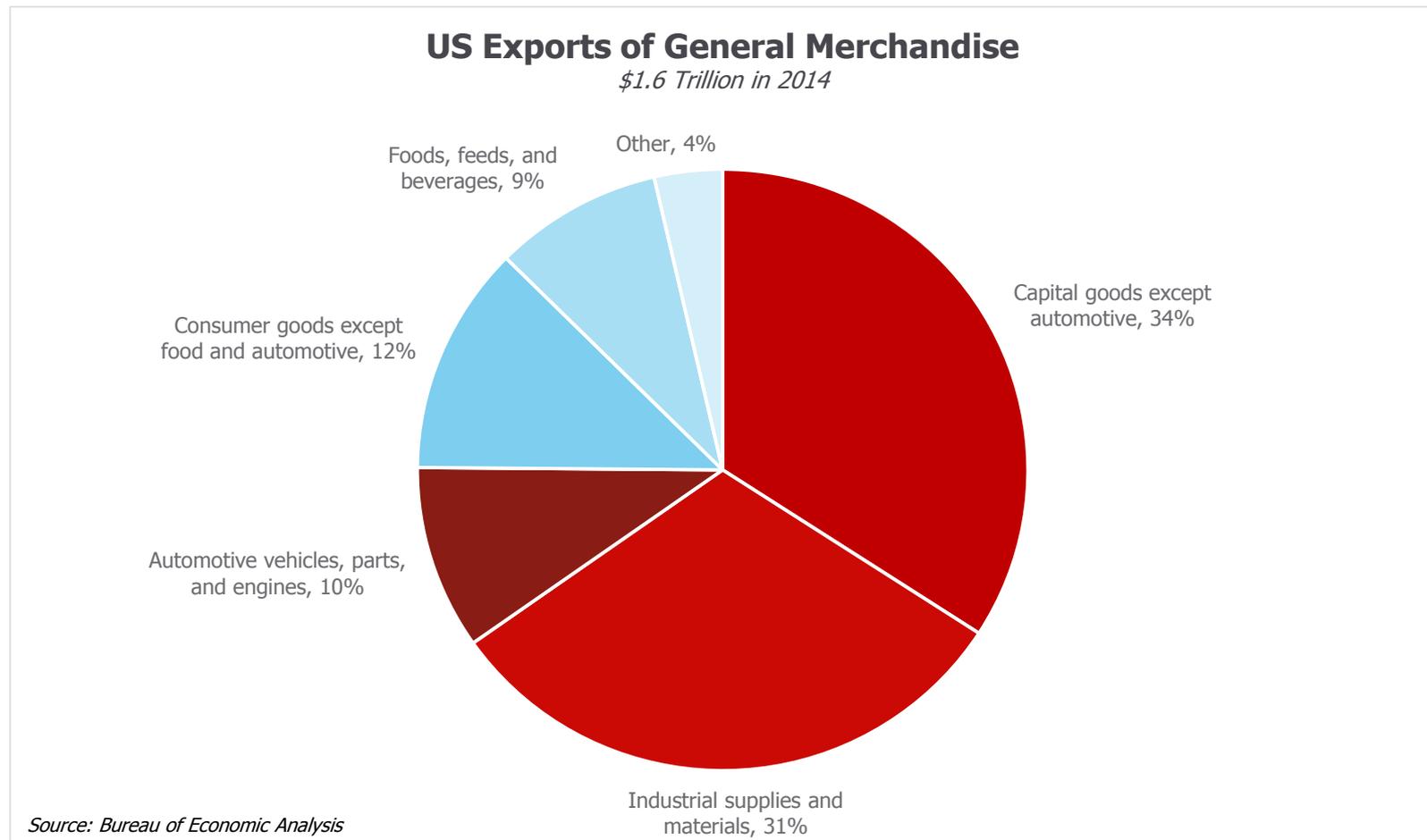


# US Dollar strength pressuring export demand



# Export demand

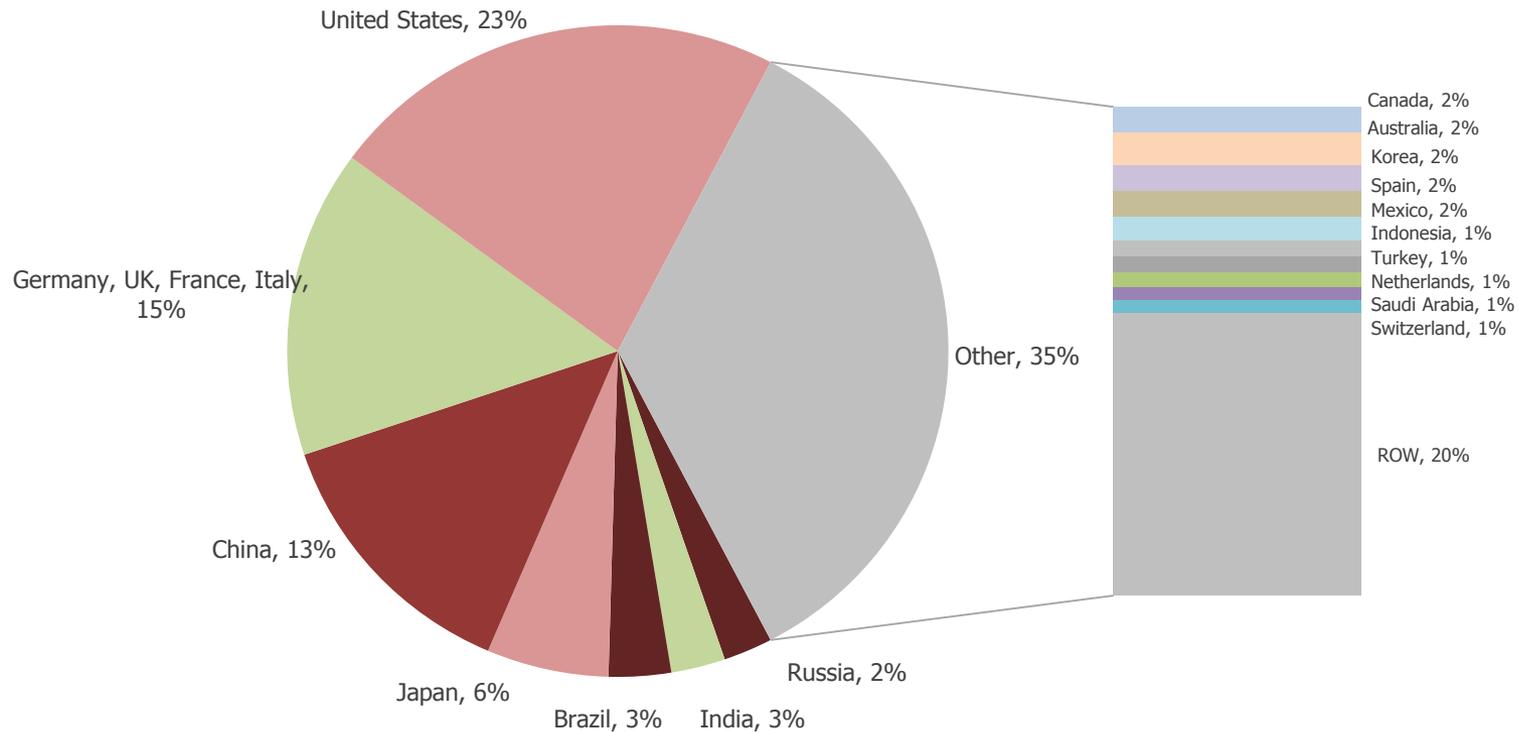
*Outsized impact to industrial & capital goods*



# Global Picture

*Pronounced weakness in China, Russia & Brazil*

**Global GDP**  
2014 Estimates



Source: IMF World Economic Outlook



# What matters most – employment



“Recession is when your neighbor loses his job. Depression is when you lose yours. And recovery is when Jimmy Carter loses his.”

— [Ronald Reagan](#)

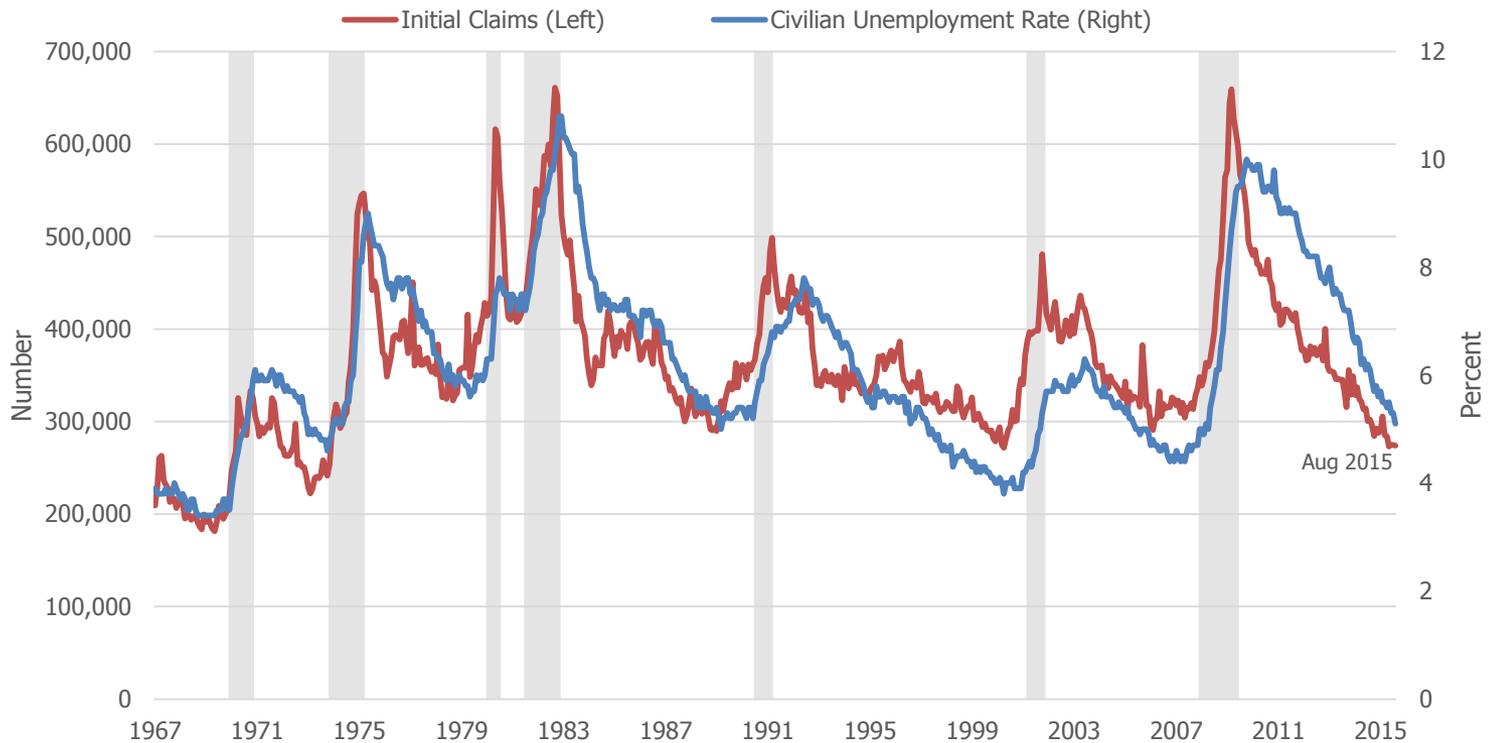


# Employment

*Tough to go much lower for jobless claims and unemployment*

## Unemployment Rate vs. Initial Claims

*seasonally adjusted*



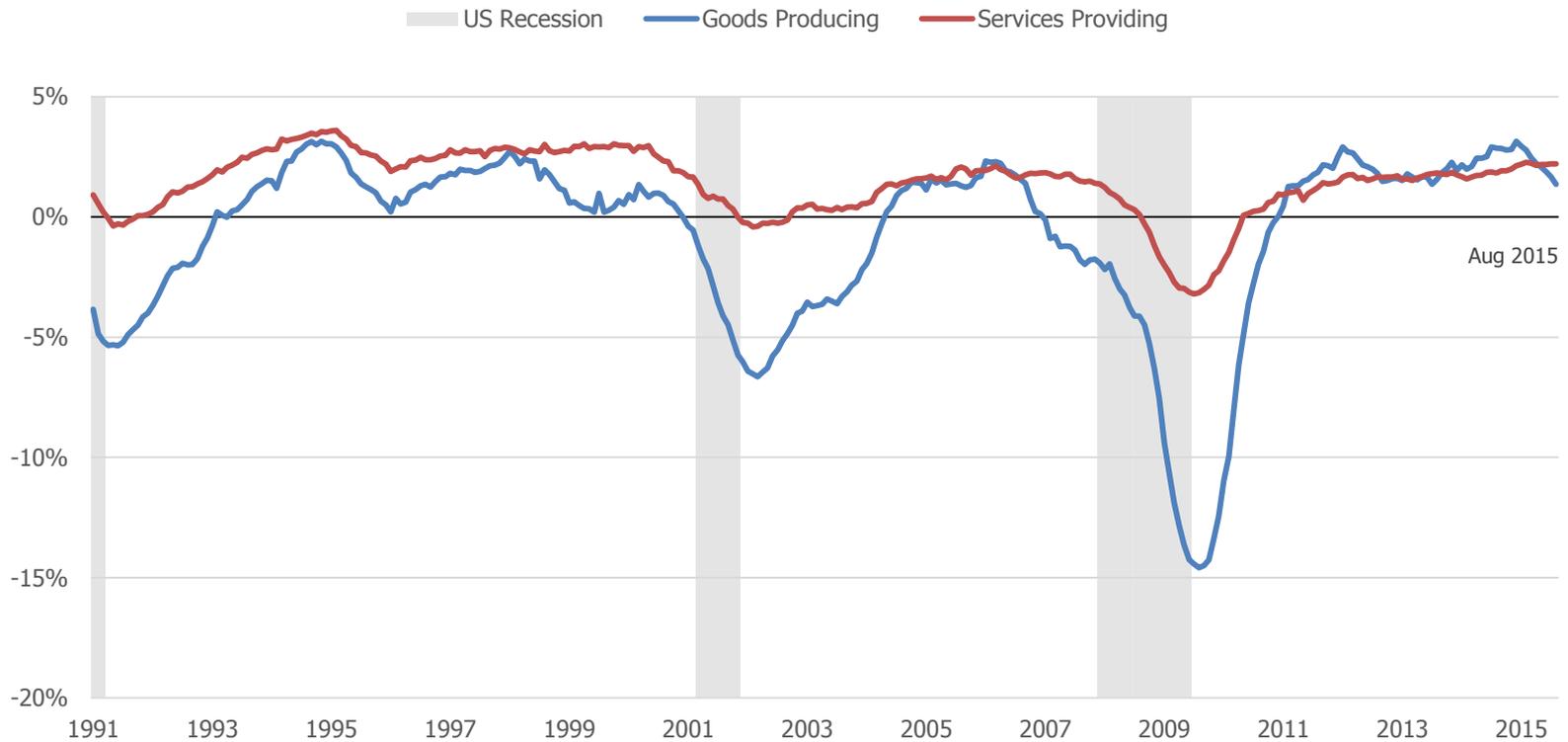
Source: FRED

# Employment

*Goods producing employment leads service employment*

## US Goods and Services Producing Employment

*y/y change, correlation=0.91*



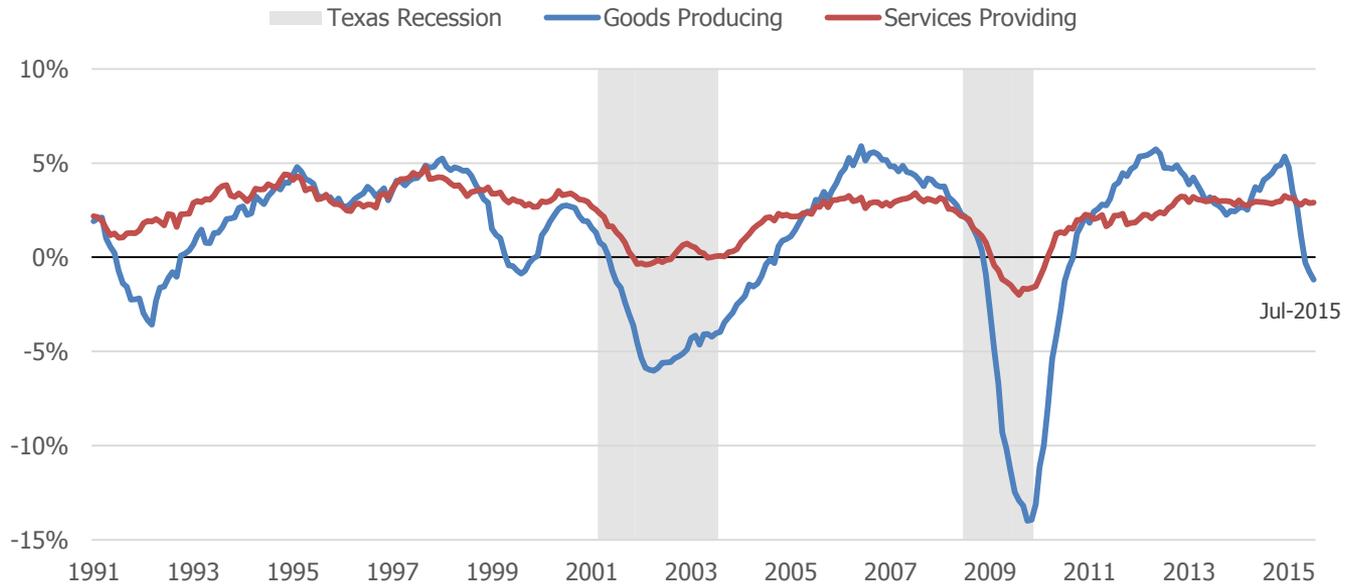
Source: FRED

# Employment

*Keep an eye on Texas...*

## Texas Goods and Services Producing Employment

*y/y change, correlation=0.88*



Source: FRED, Dallas Fed

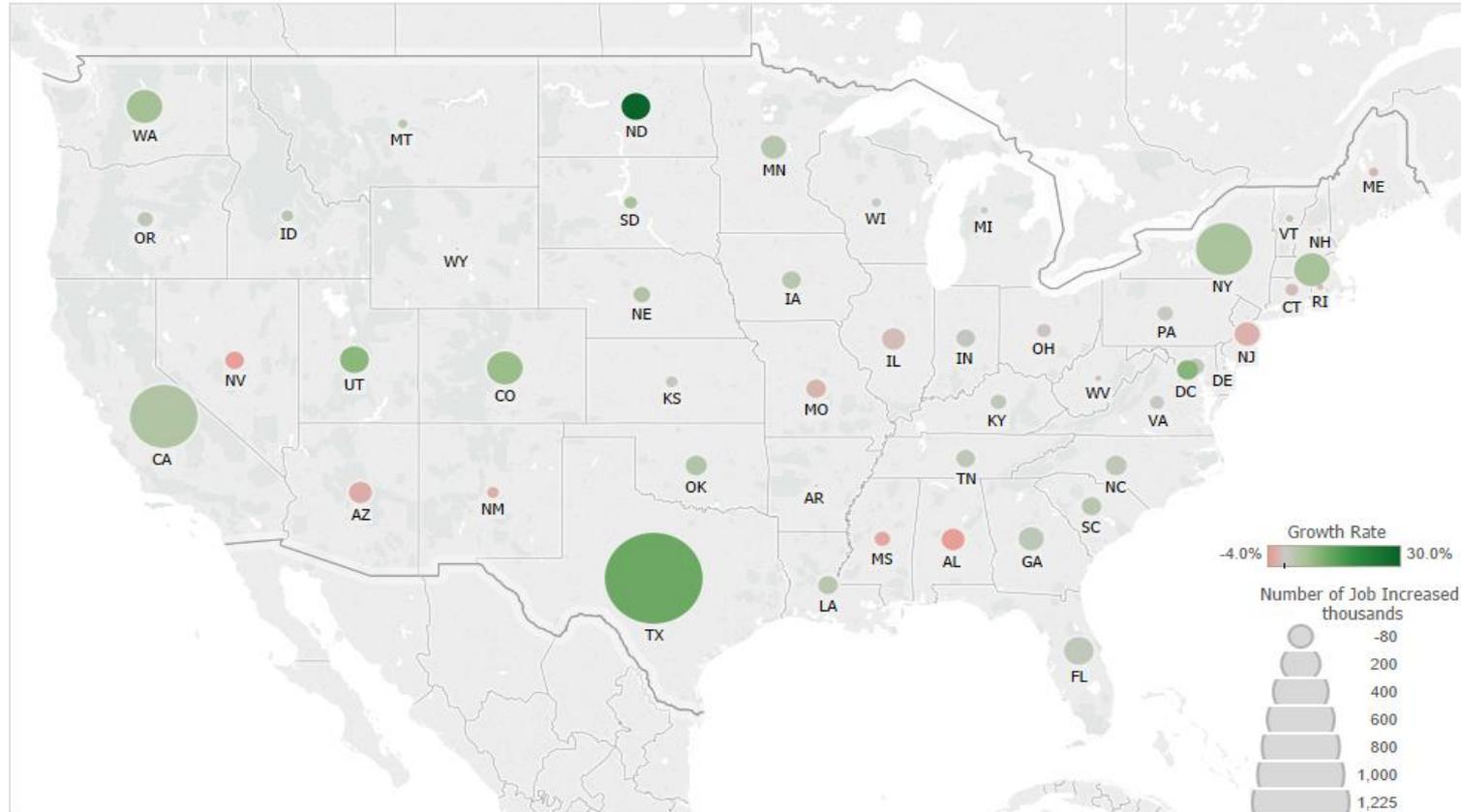


# Employment

*Keep an eye on Texas...*

## Employment Increase by State

*from 2008 to current  
larger the more jobs, darker the higher growth rate*



Data source: BLS



# Summary Thoughts

Risk of an industrial recession is growing by the day

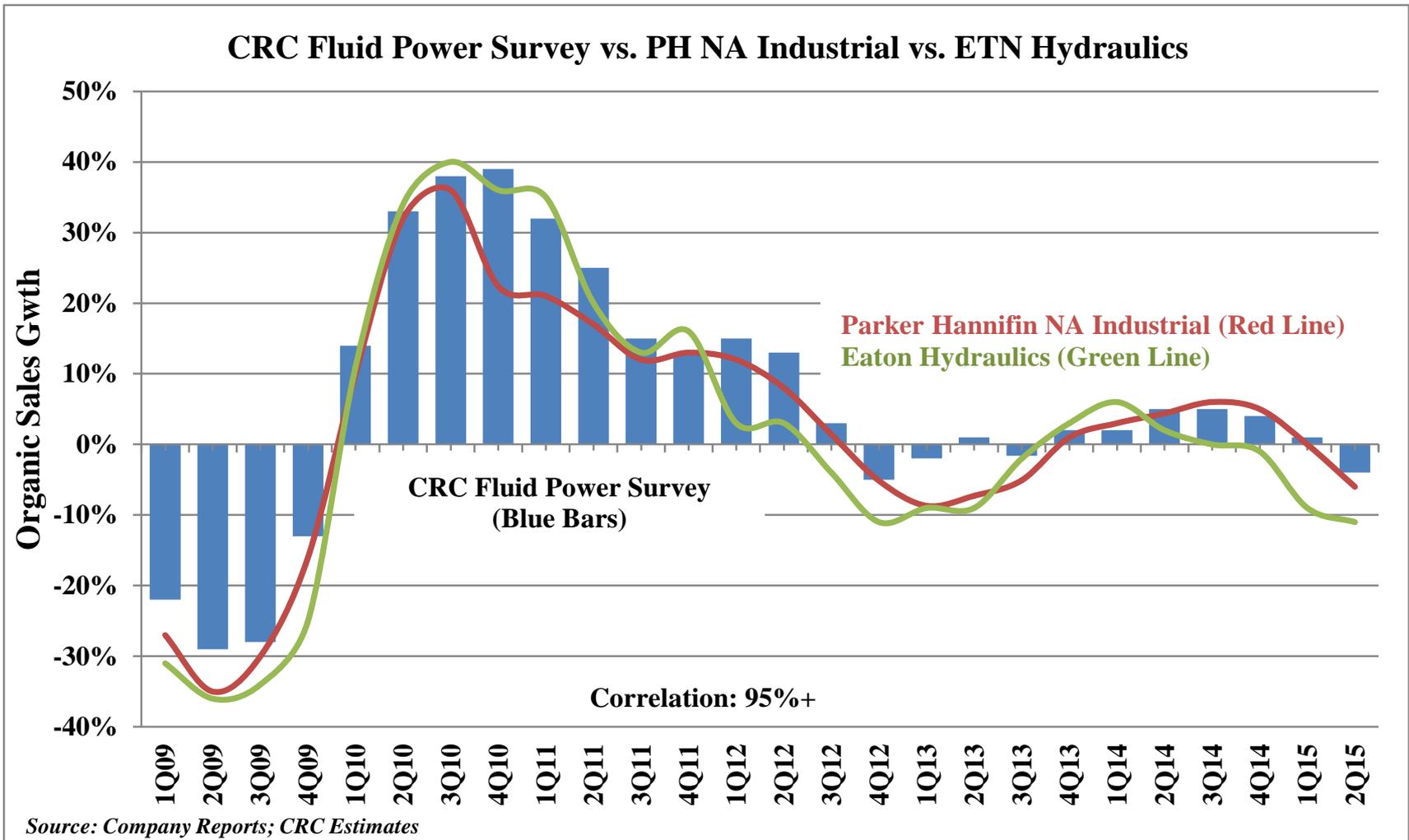
- Tough to overstate the importance of oil & gas to industrial growth over the past 5 years
- Strong dollar and sluggish international markets not helping
- Thankfully the Fed postponed a rate hike last week



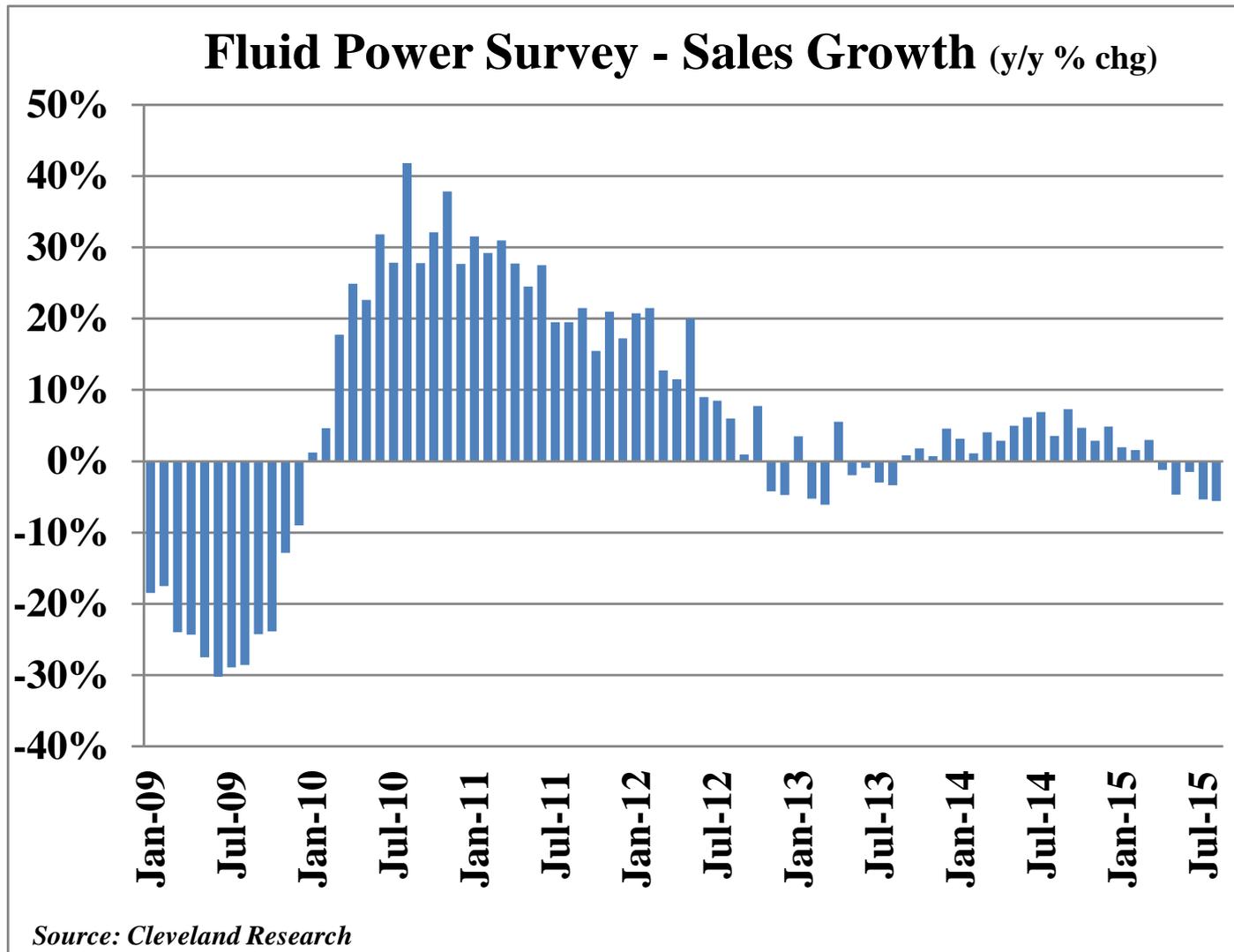
# FPDA / ISD Market Trends



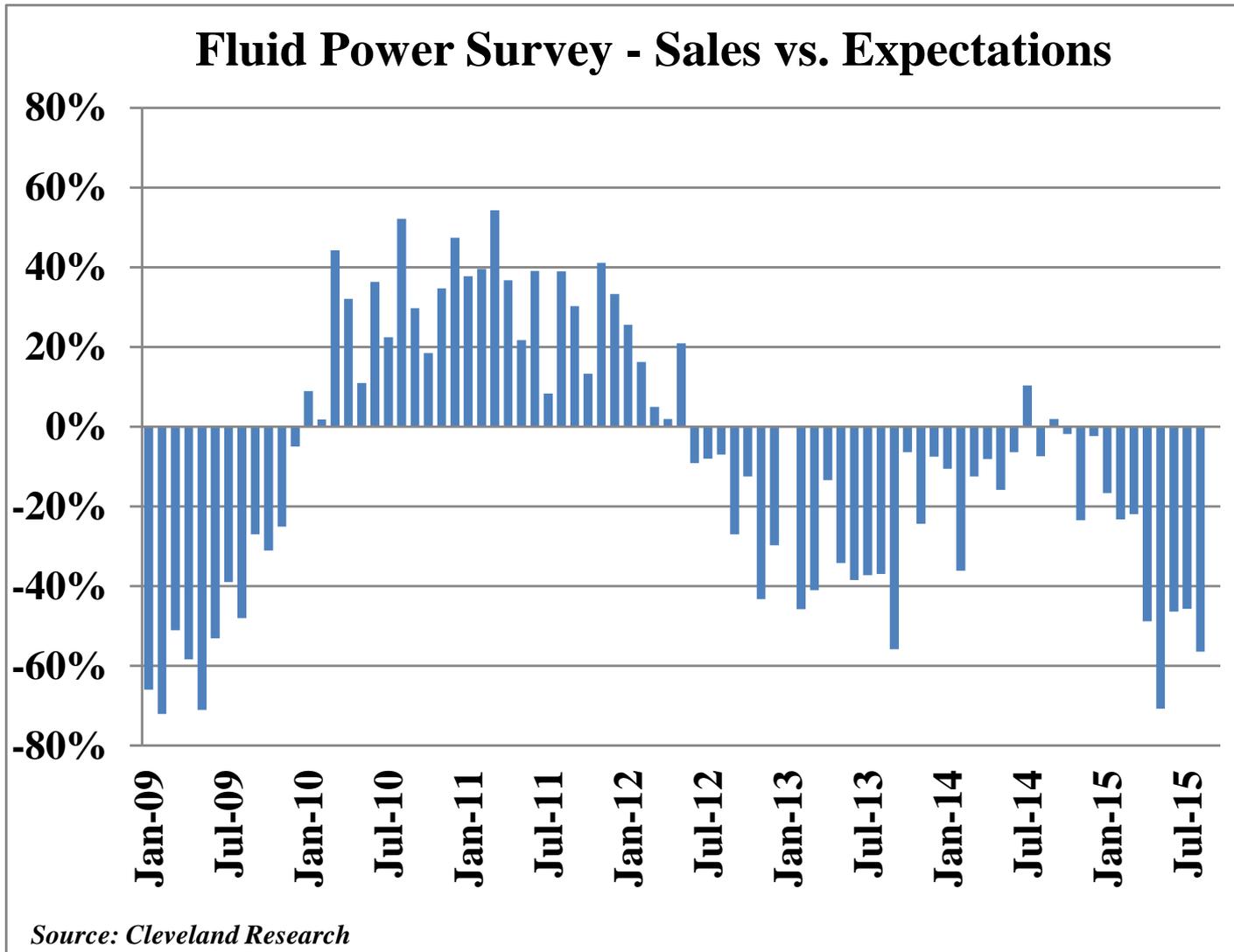
# Fluid Power Industry Survey



# Negative Sales Growth Past Five Months

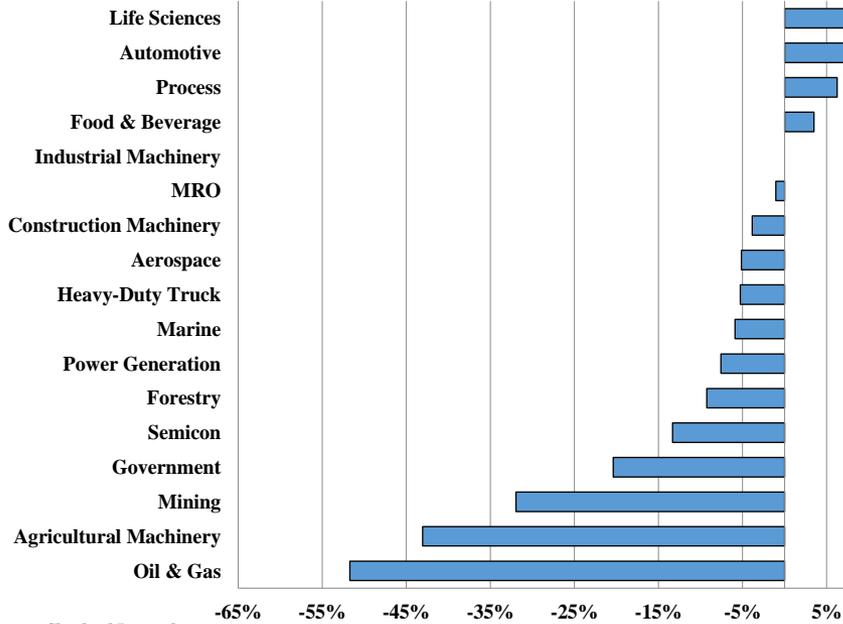


# Results Have Been Disappointing



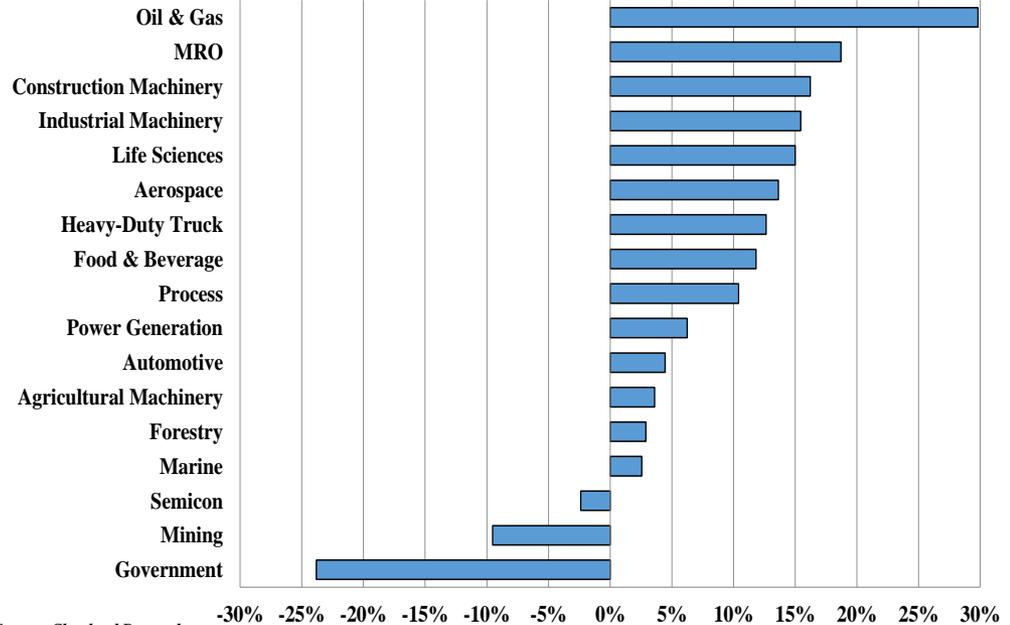
# End Markets: Quite a Contrast

End Market Ranking (Net % Strong - Weak)  
August 2015



Source: Cleveland Research

End Market Ranking (Net % Strong - Weak)  
August 2014

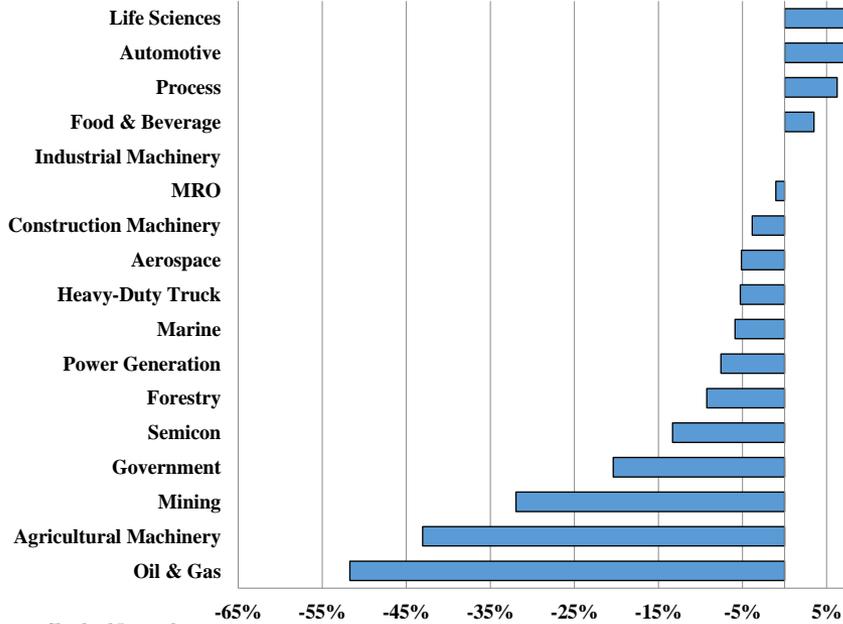


Source: Cleveland Research

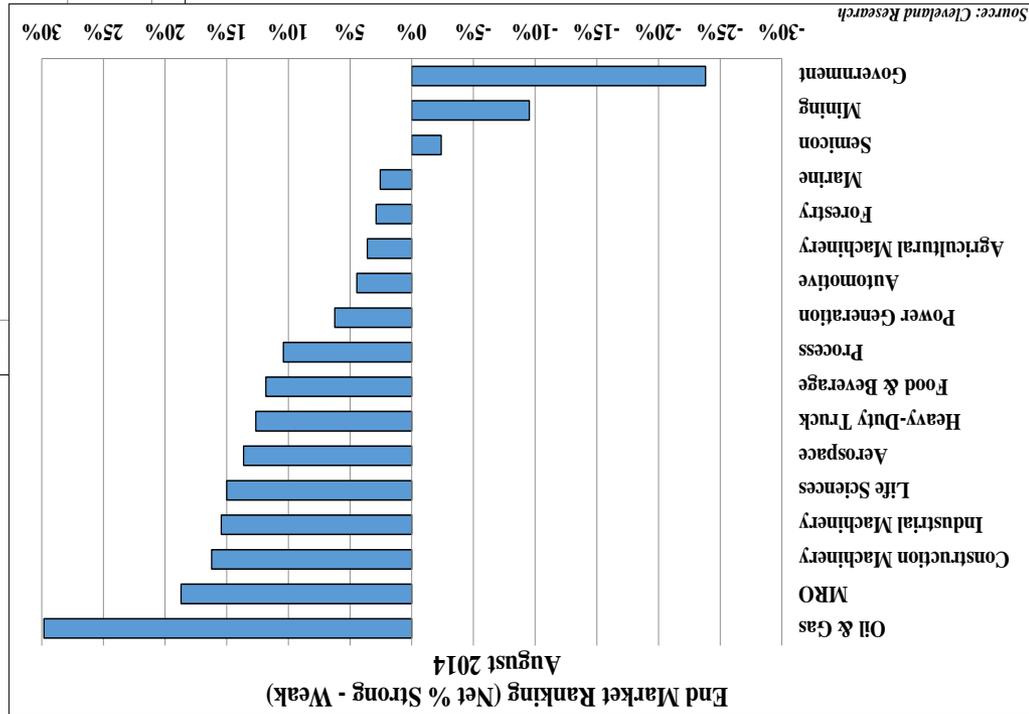


# End Markets: Literally turned on its head

End Market Ranking (Net % Strong - Weak)  
August 2015



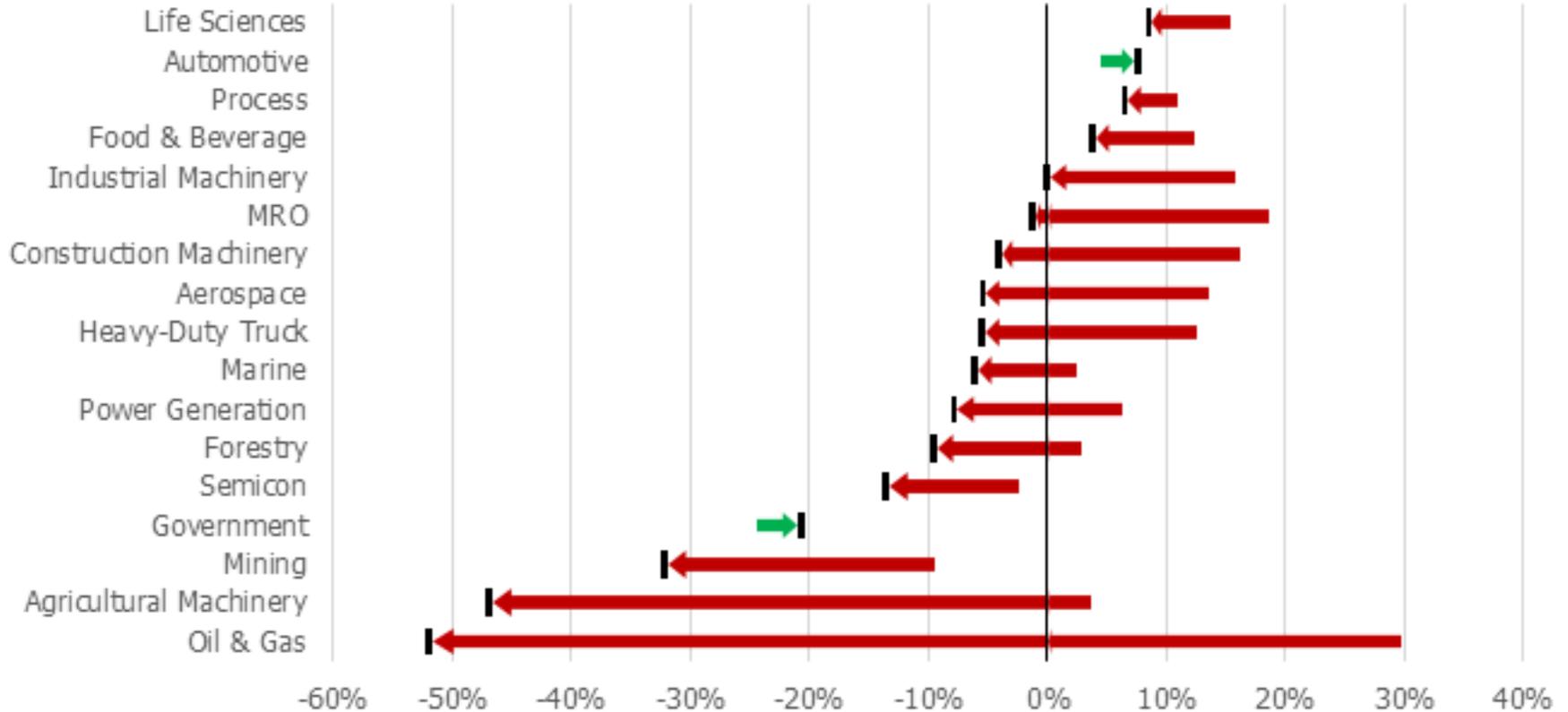
Source: Cleveland Research



# End Markets: A Different View

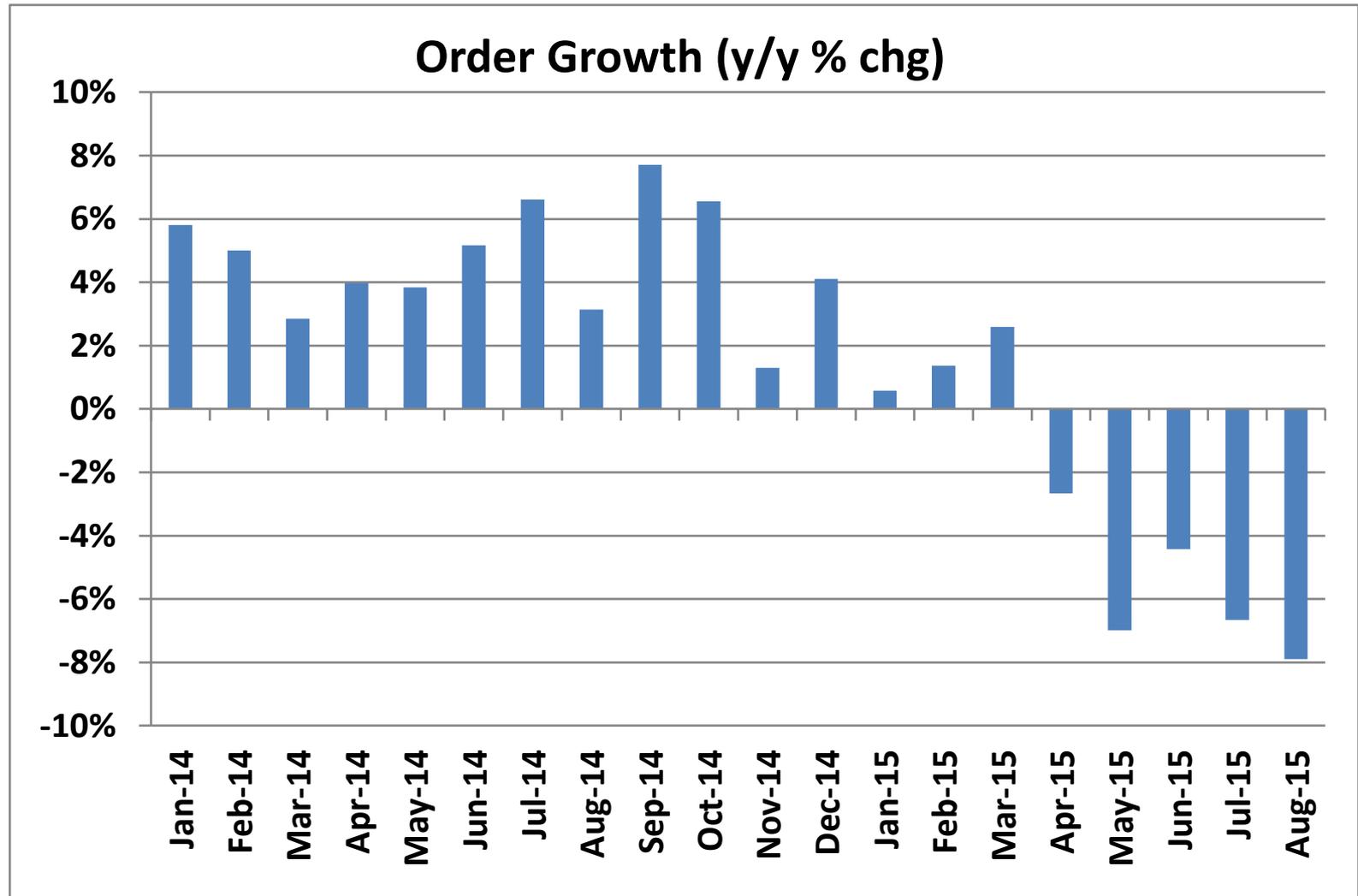
## CRC Fluid Power Survey - End Market Strength

Net % of Reporting Strength/Weakness in Aug 2015; Arrows show change vs Aug 2014

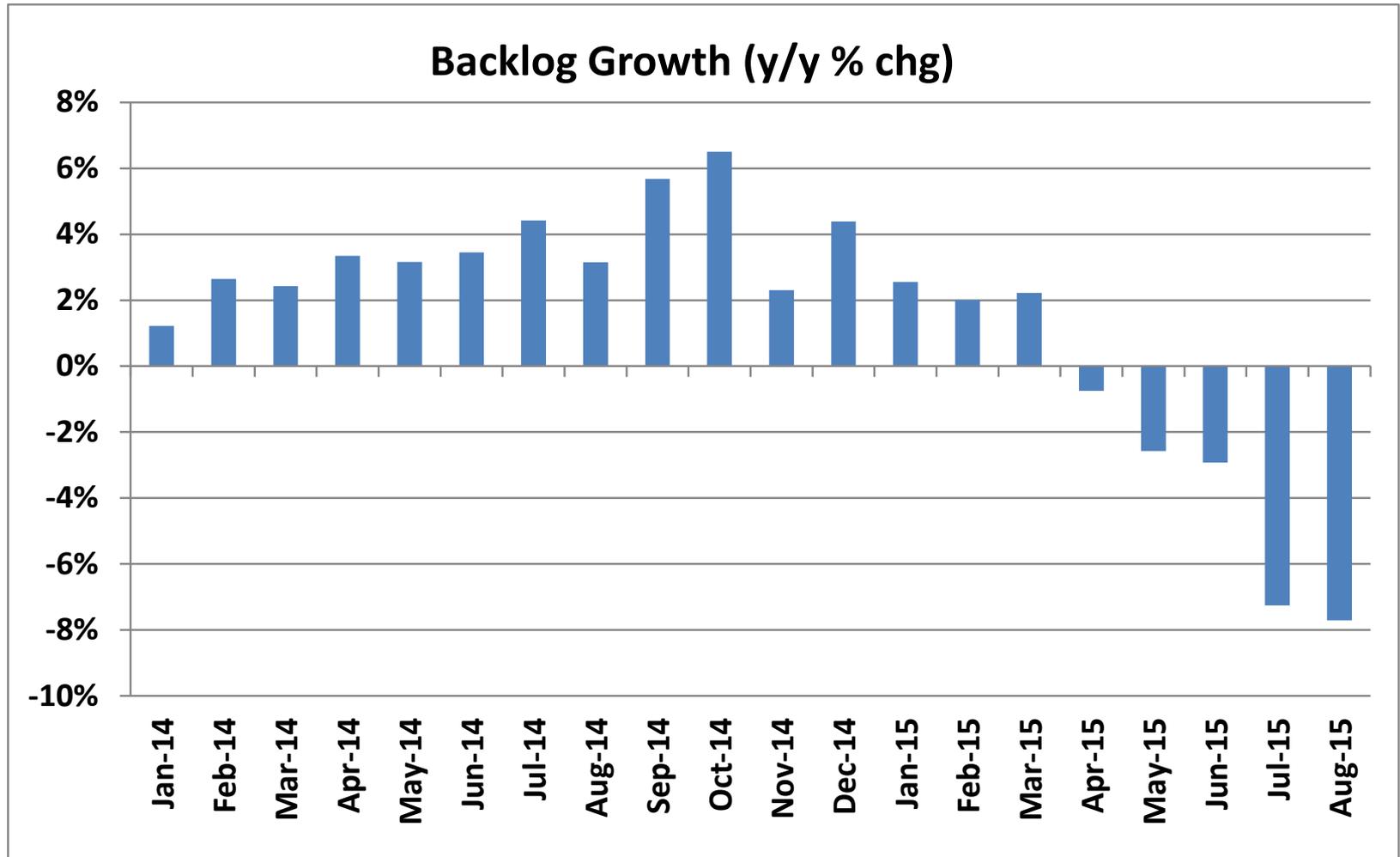


Source: CRC Fluid Power Survey

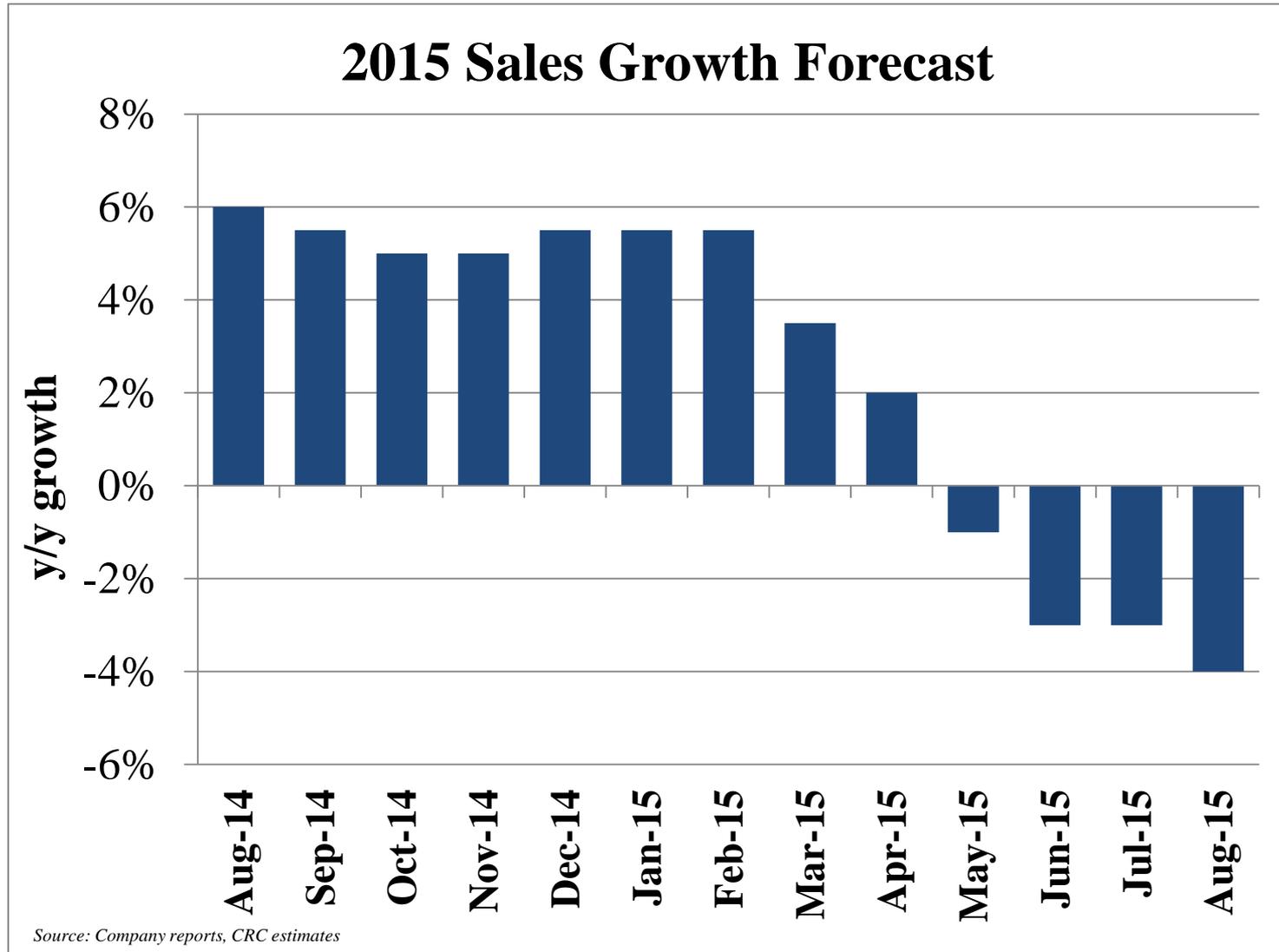
# Weak Orders



# Declining Backlogs



# Outlook Down 1000bps



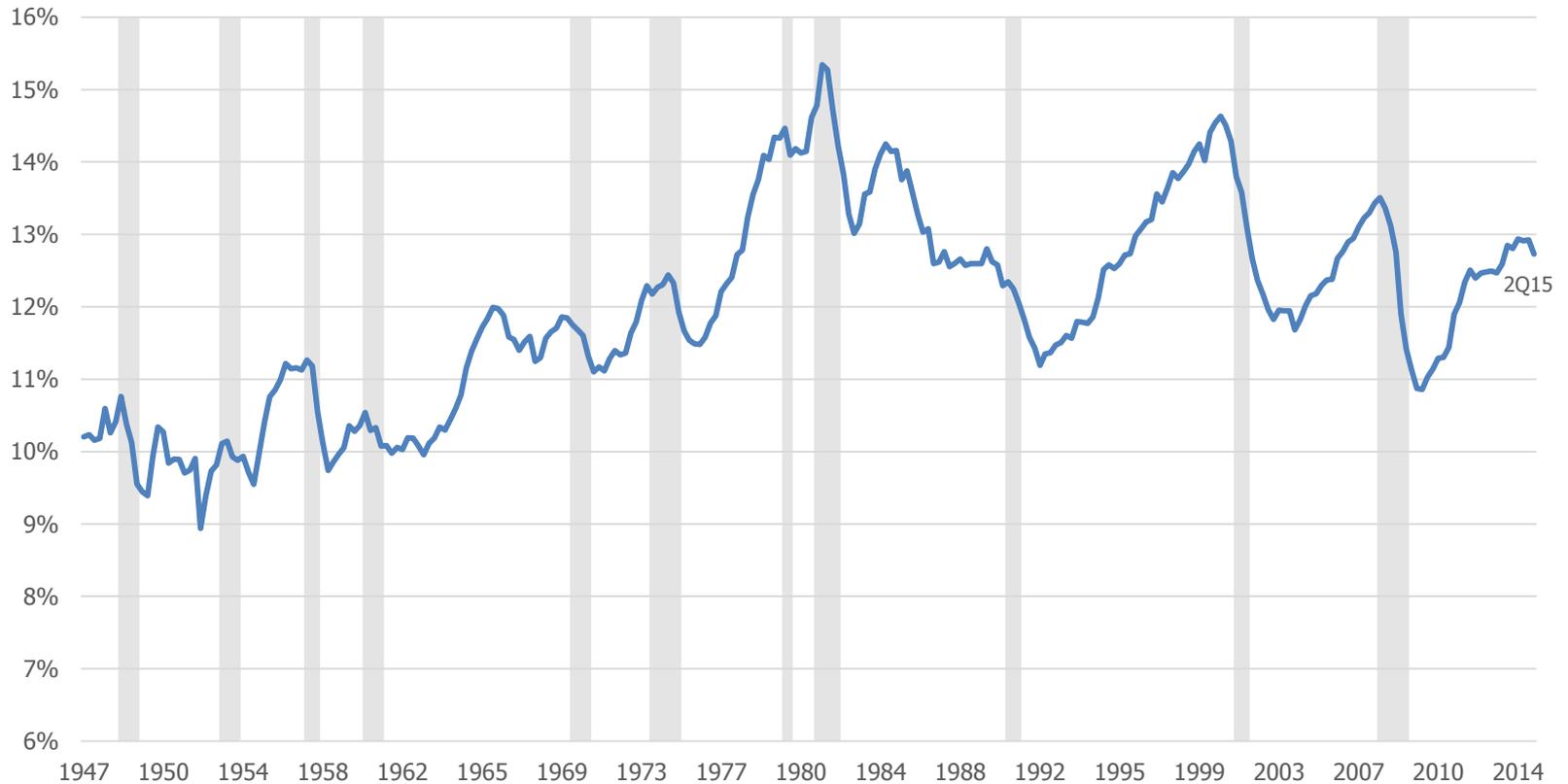
# End Market Review / 2016 Outlook



# Capital spending cycle

*Showing signs of a top*

**Capital Spending As % of US GDP**  
*Nominal*



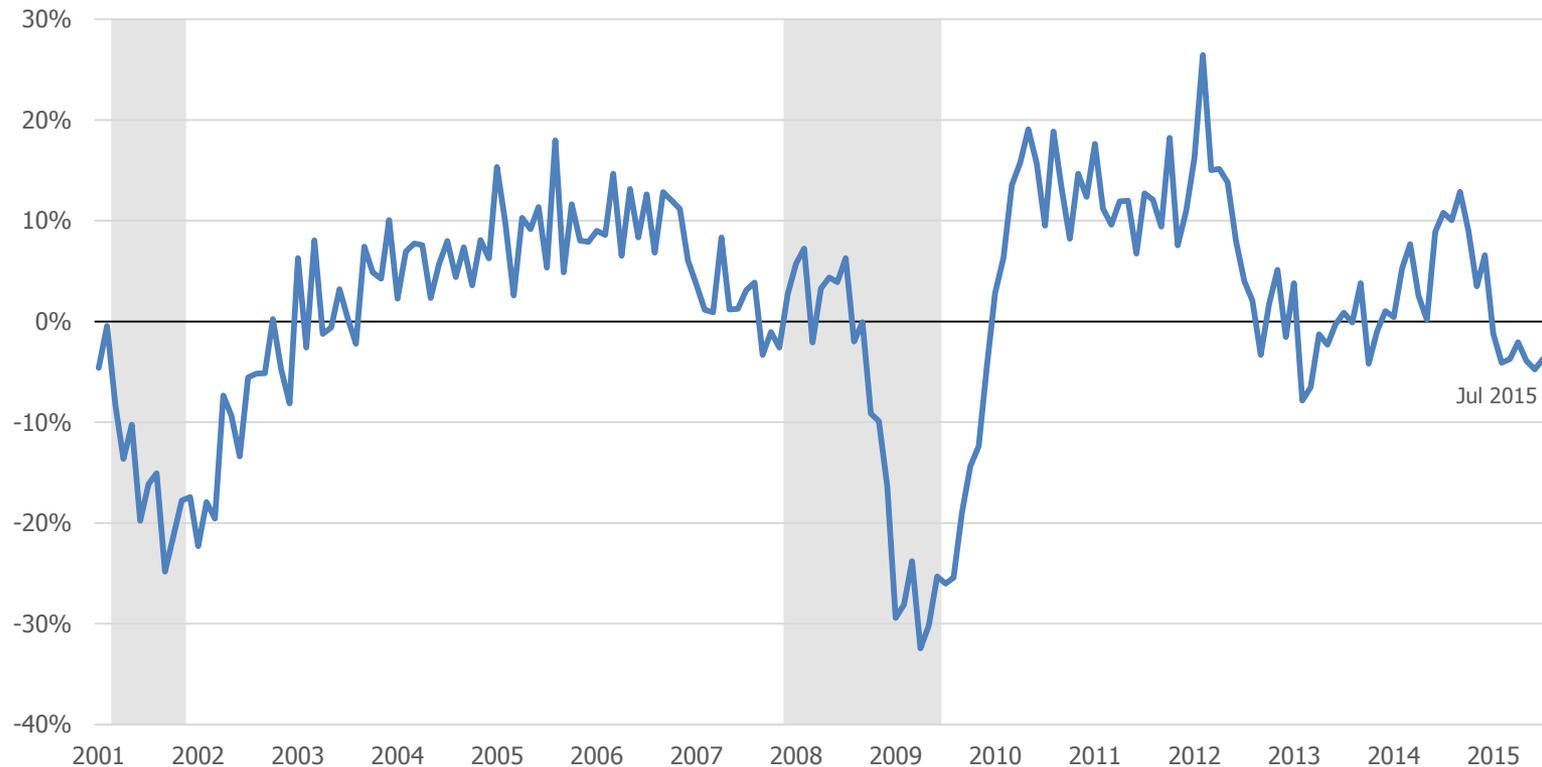
Source: FRED



# Capital spending cycle

*Capital goods orders rolling over*

**Manufacturers' New Orders: Nondefense Capital Goods ex Aircraft**  
*Non seasonally adjusted, y/y change*



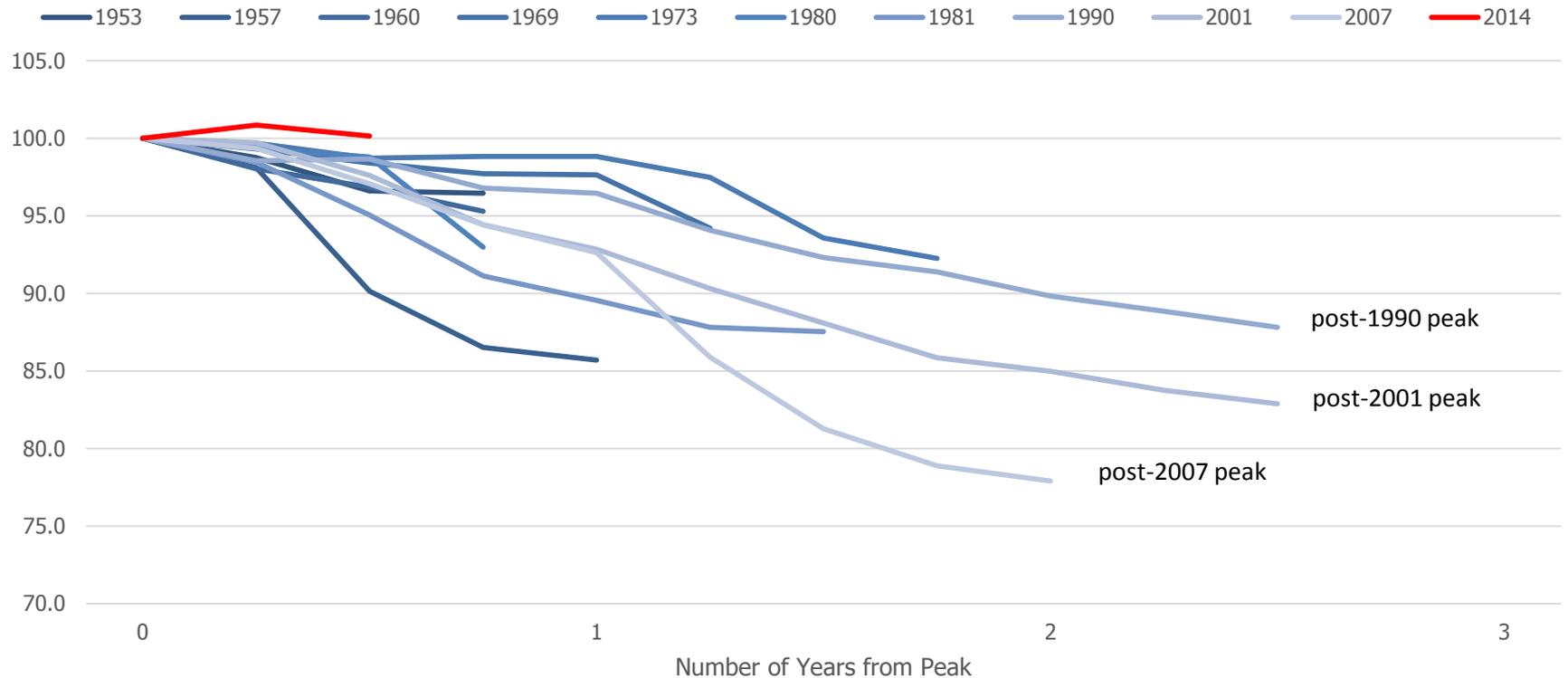
Source: US Census Bureau

# Capital spending cycle

*When it turns it doesn't come back for awhile*

## Capital Spending Cycle - Peak to Trough

*Index Fixed Investment Peak=100, Inflation Adjusted*

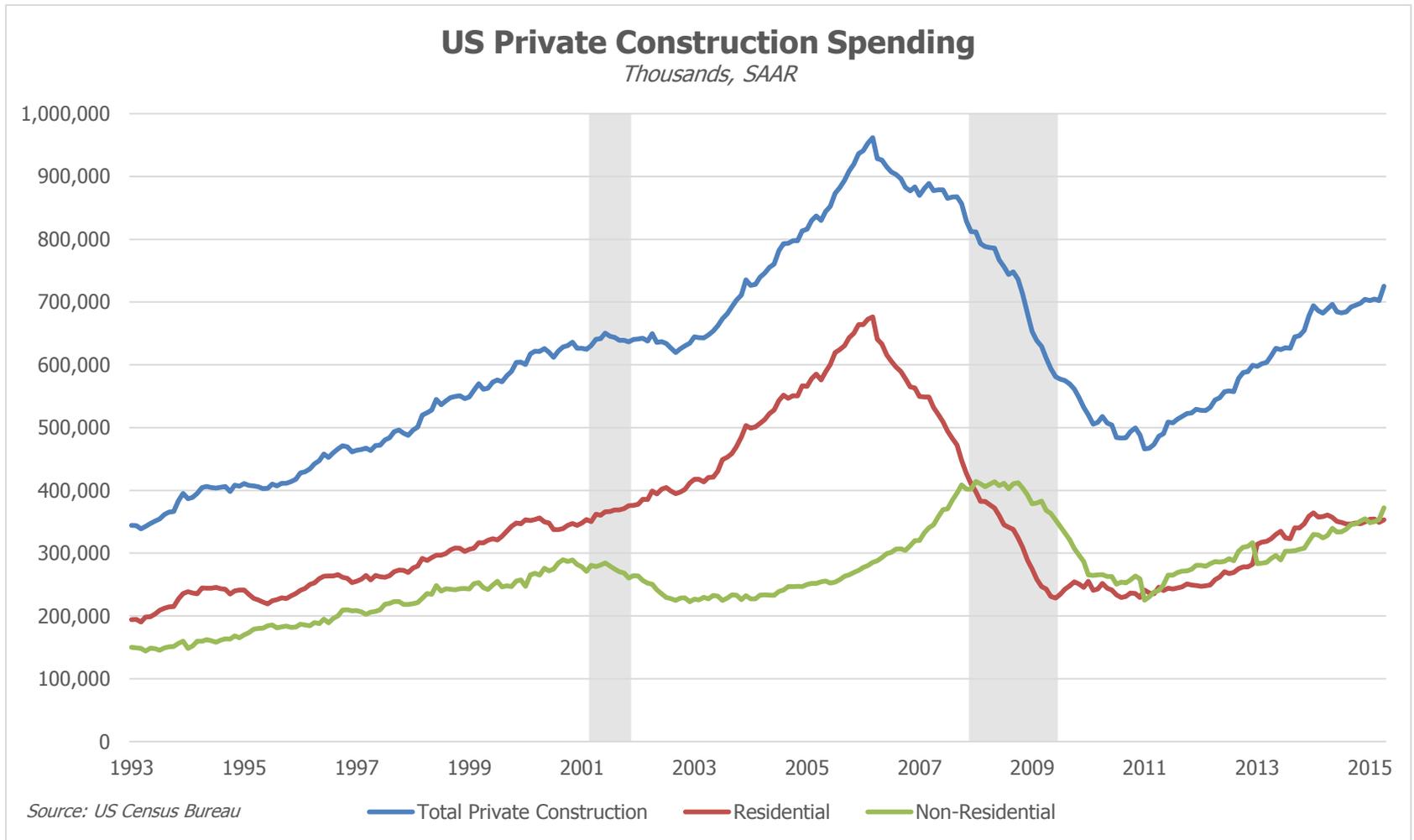


Source: FRED



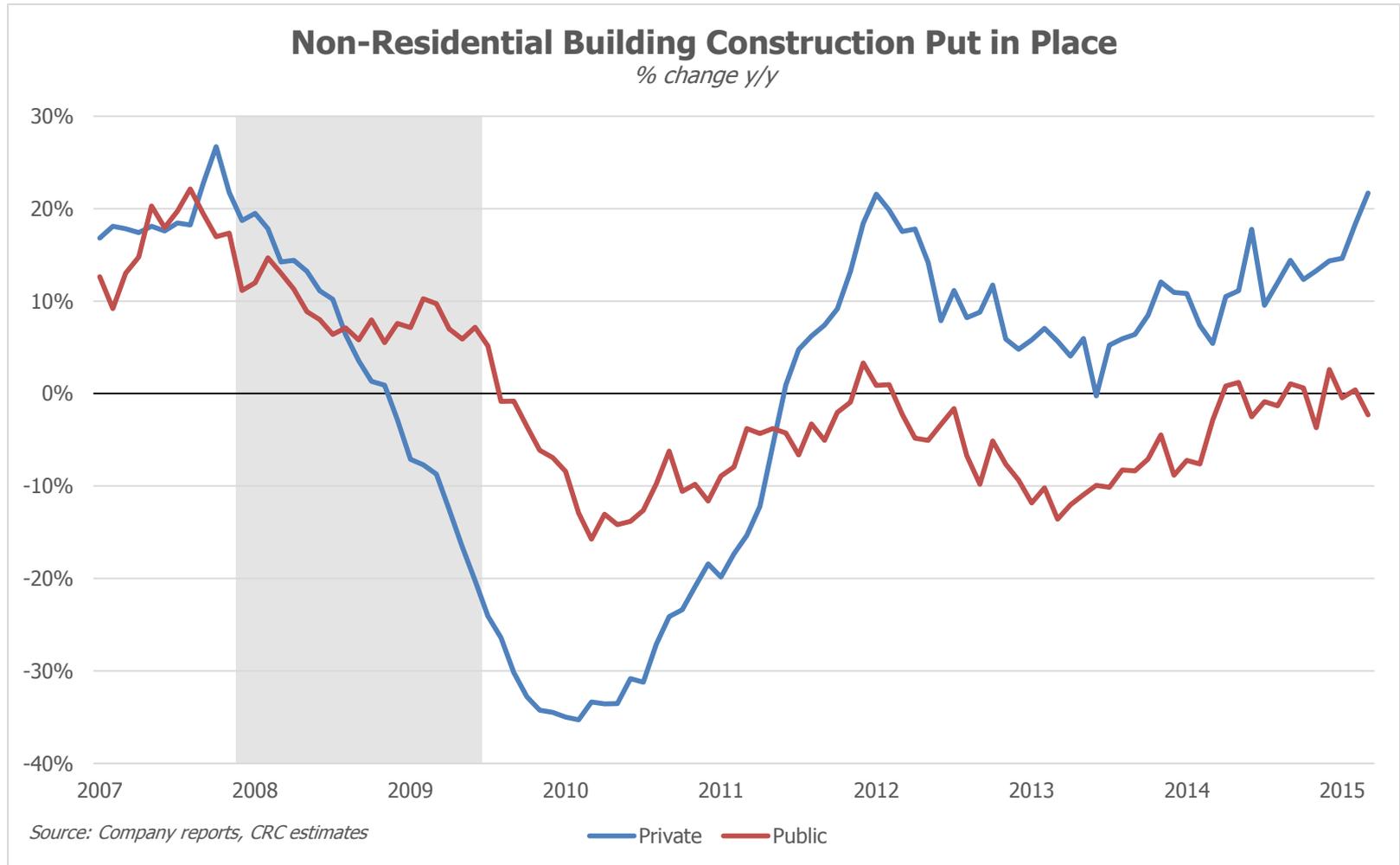
# Construction / Construction Equipment

*Residential & Non-Residential – long cycles*



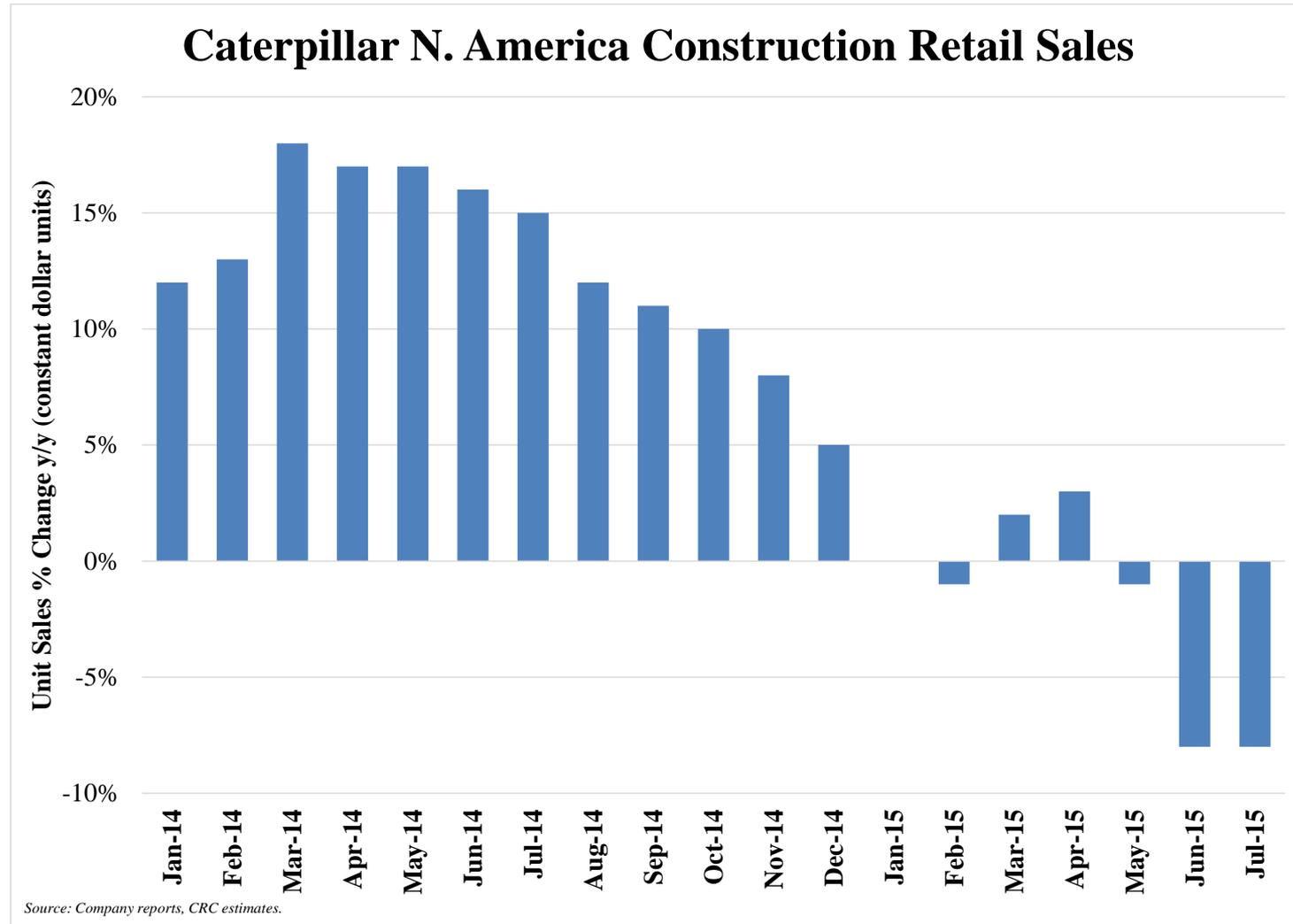
# Construction / Construction Equipment

*Non-Residential - acceleration in 2015 driven by private investment*



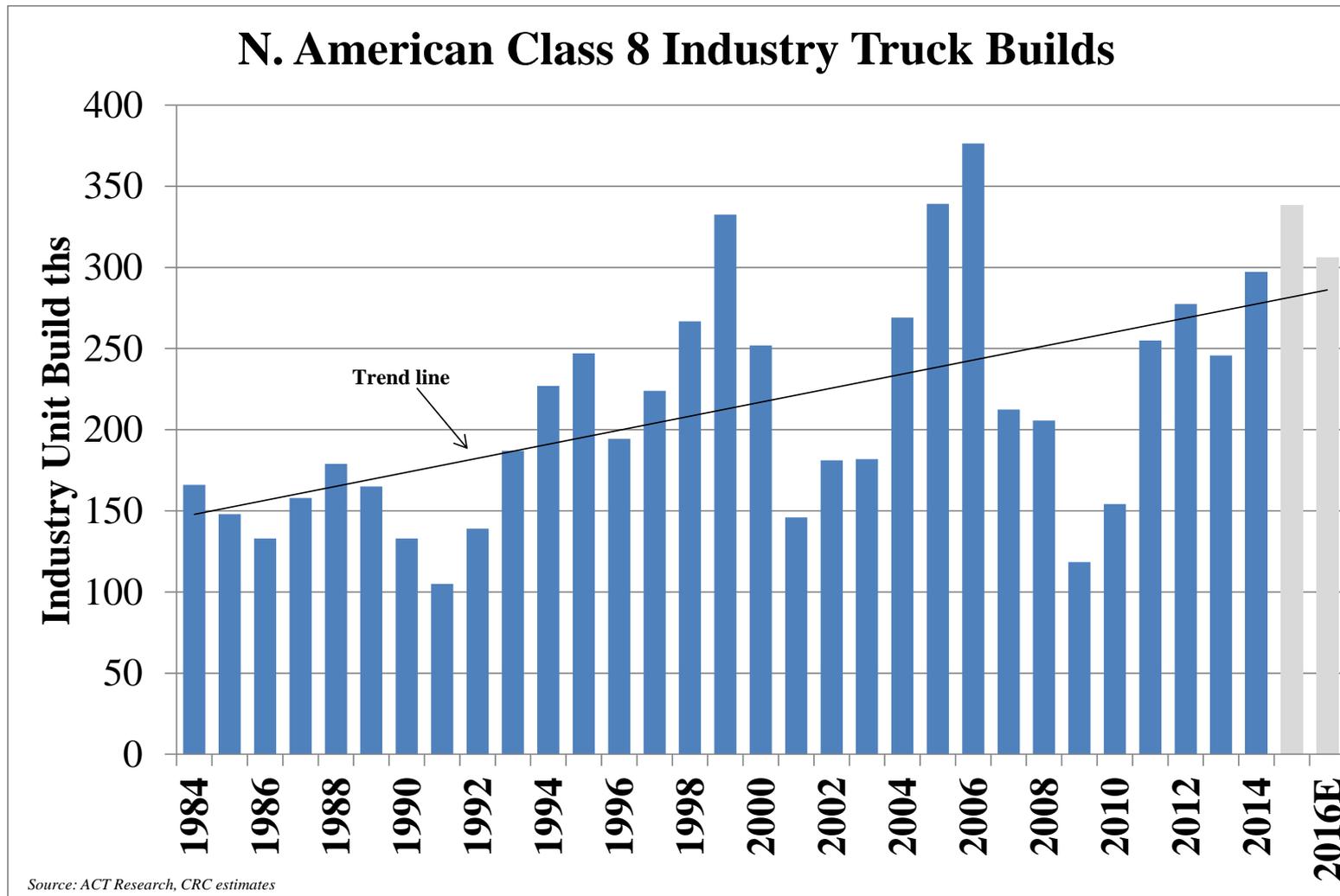
# Construction Equipment

*Oil & gas weighing on otherwise healthy market*



# Heavy-Duty Truck

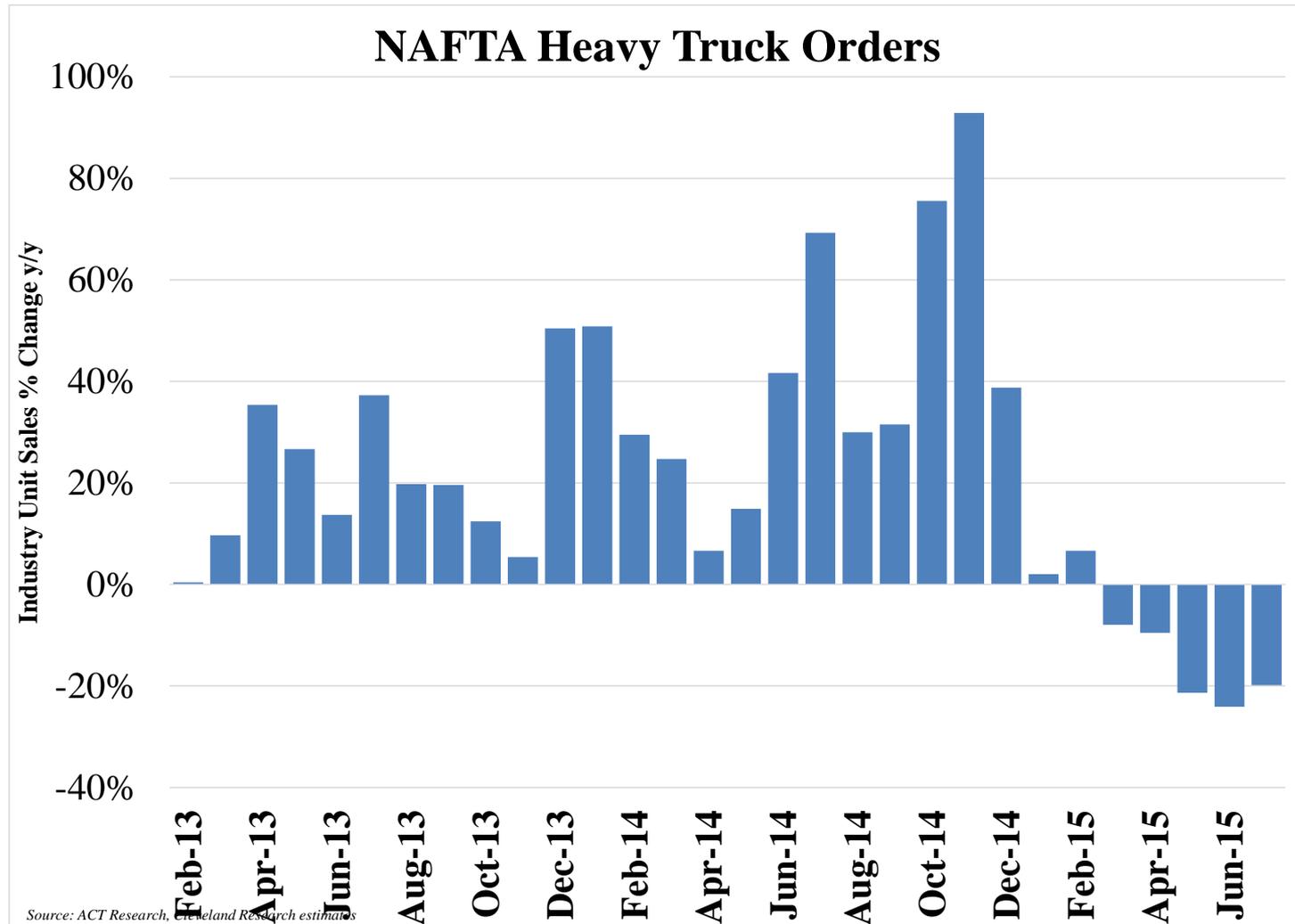
*Builds to grow 10% this year...*



Source: ACT Research, CRC estimates

# Heavy-Duty Truck

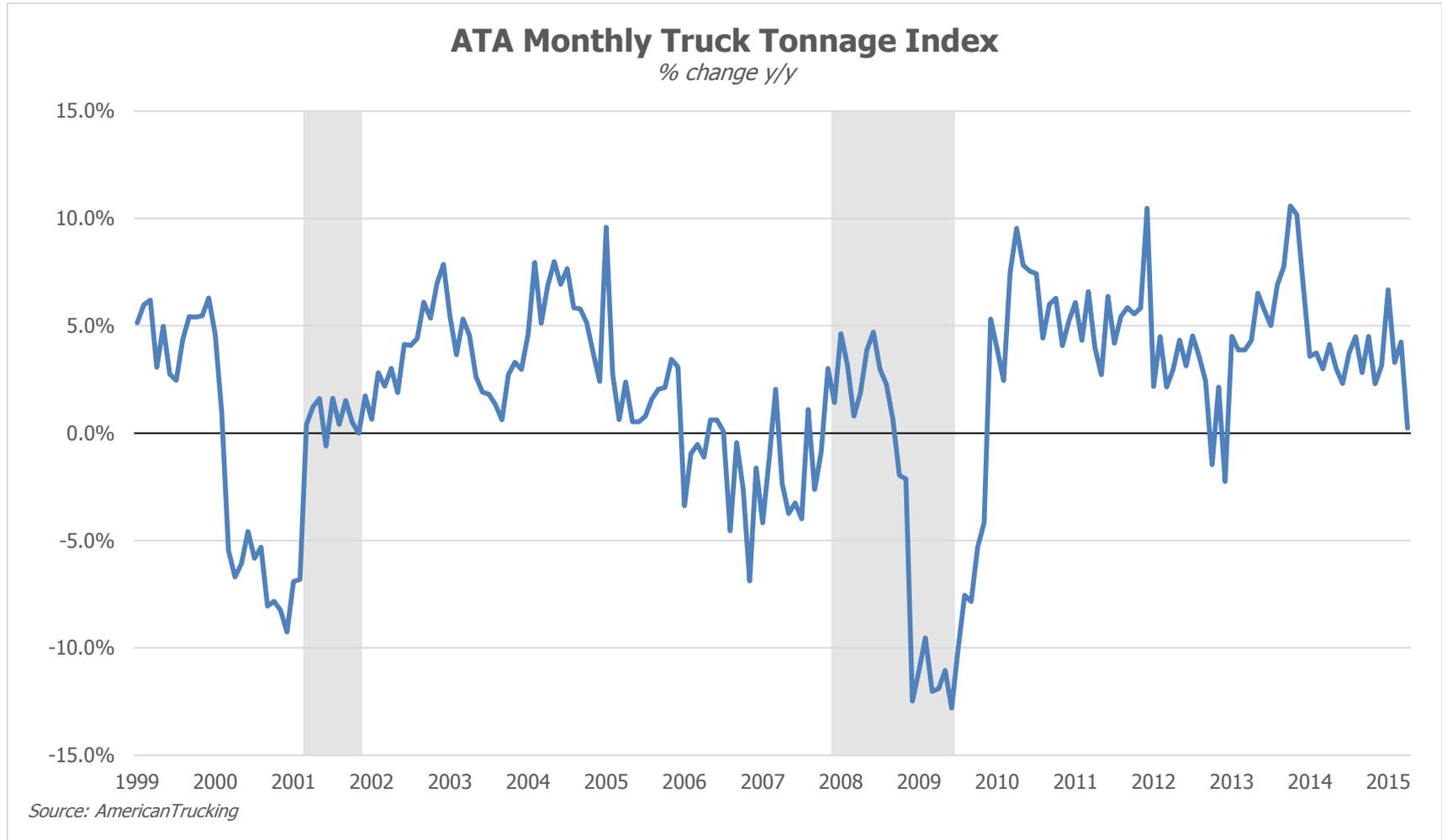
*...but +20% order declines mean 2016 will be a down year.*



Source: ACT Research, Cleveland Research estimates

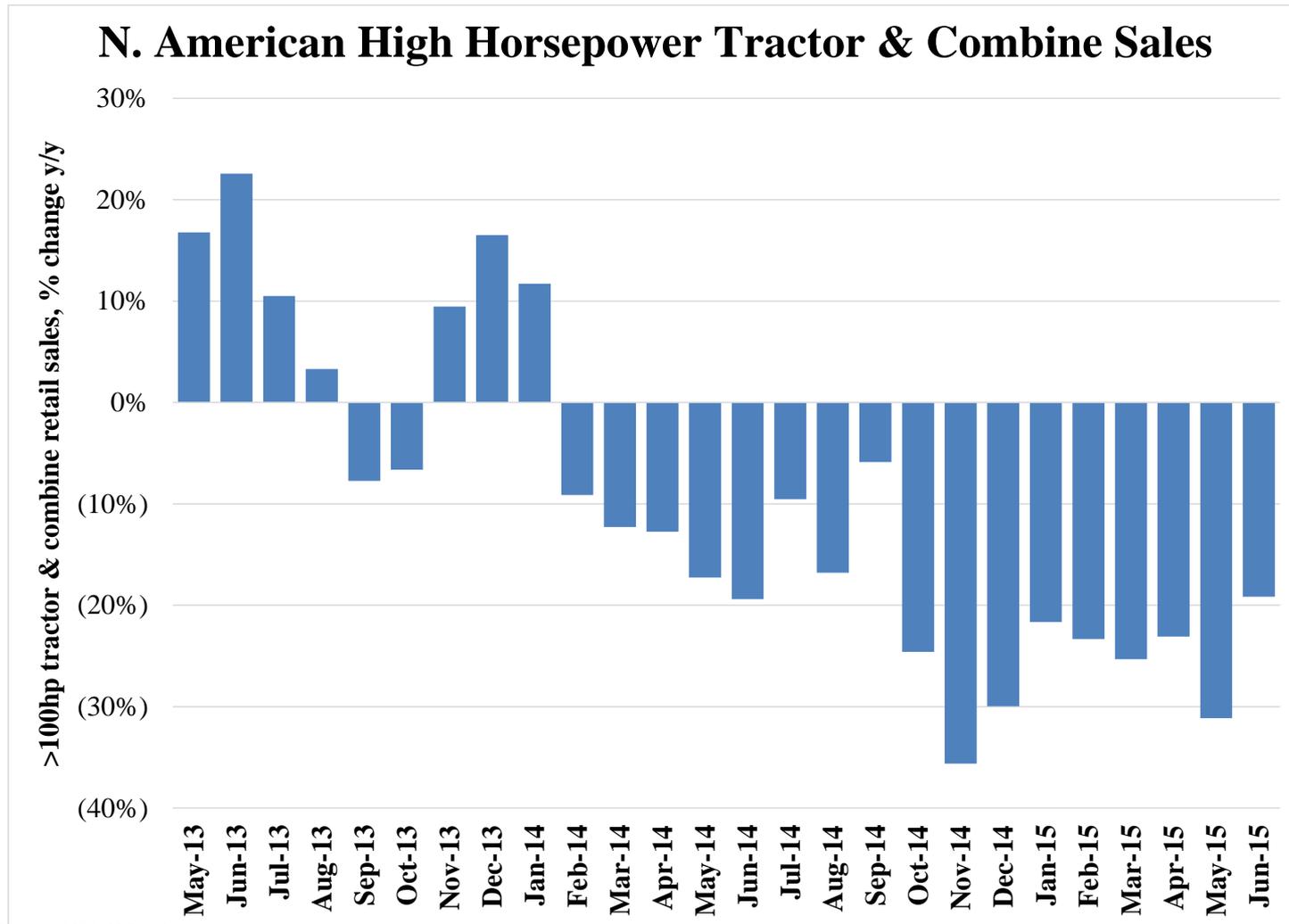
# Transportation

*ATA data confirming weakness*



# Ag Equipment

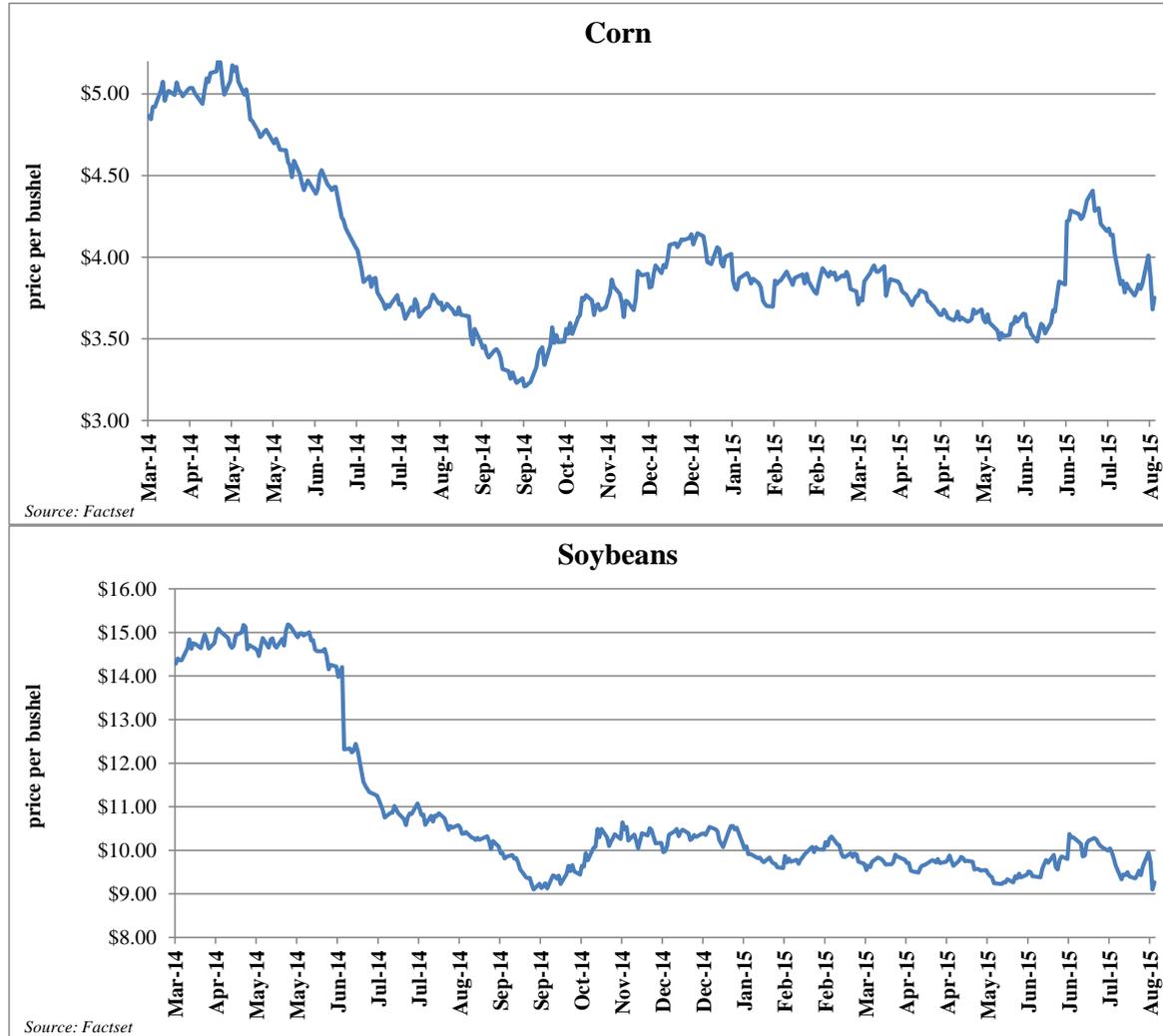
2015 sales to decline 25-30%...



Source: AEM, CRC estimates

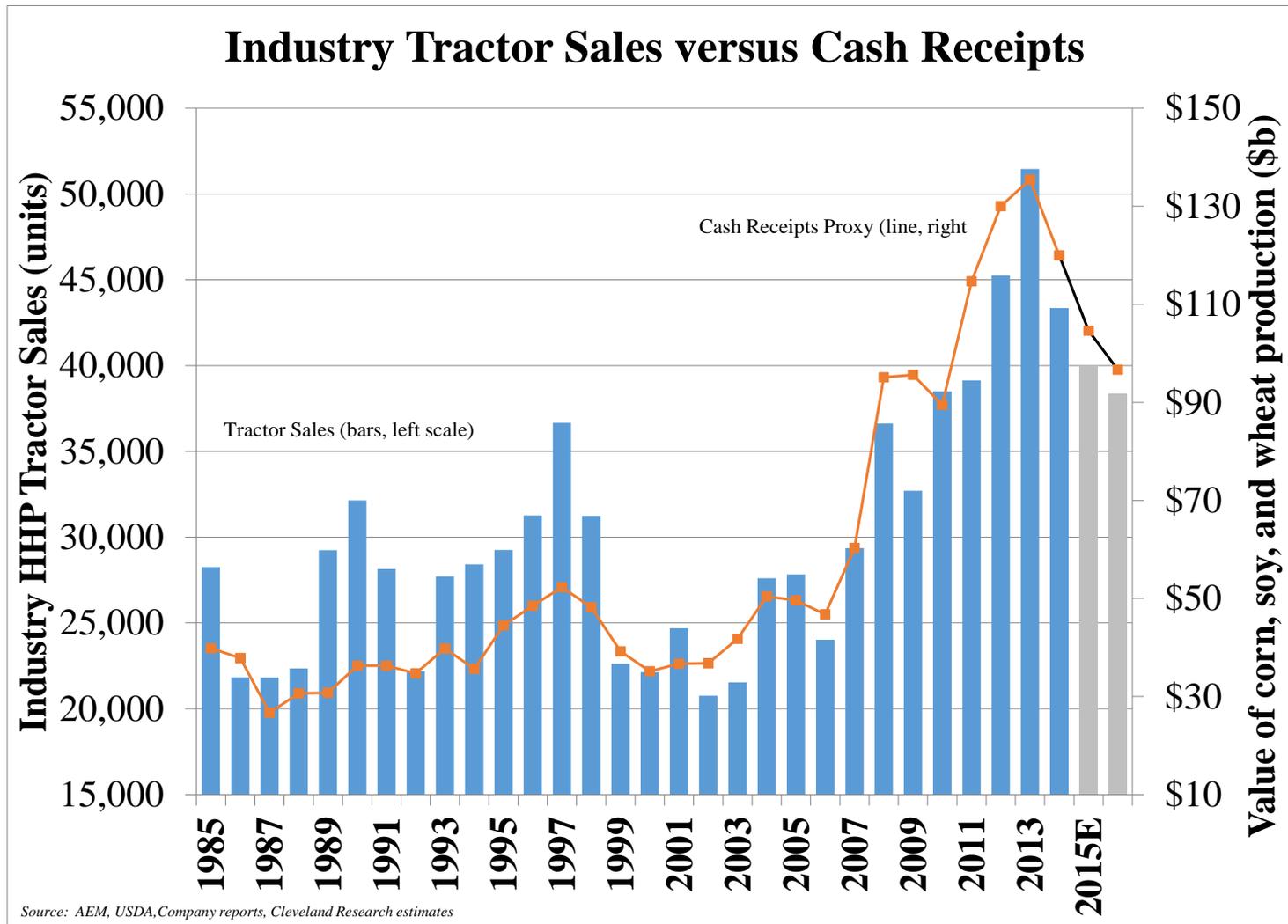
# Ag Equipment

*...as corn & soybean prices drift lower...*



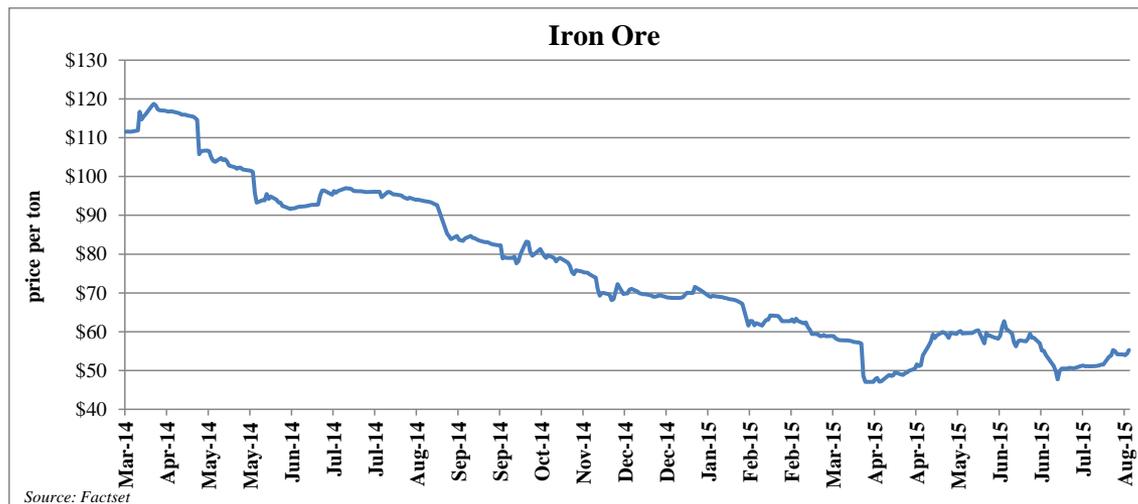
# Ag Equipment

*... and 2016 will be a down year as well*



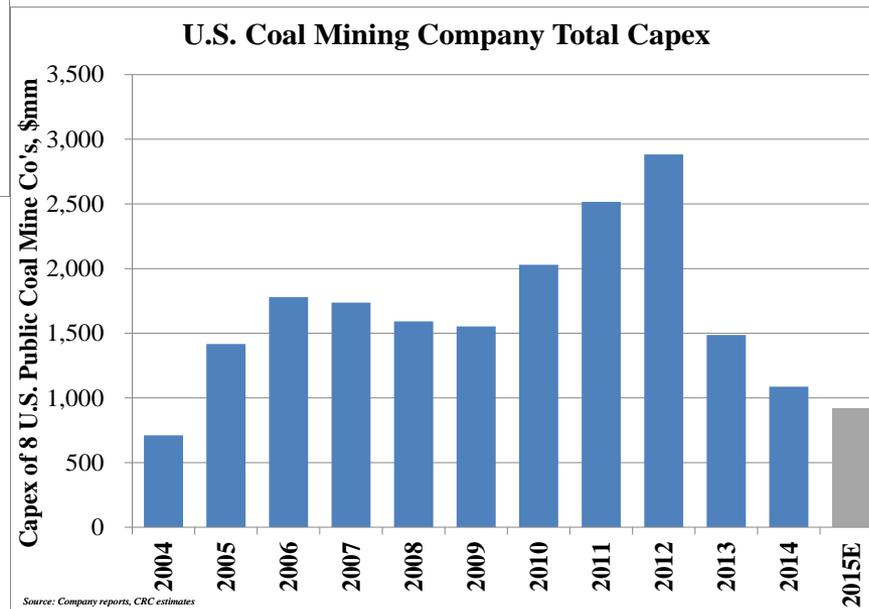
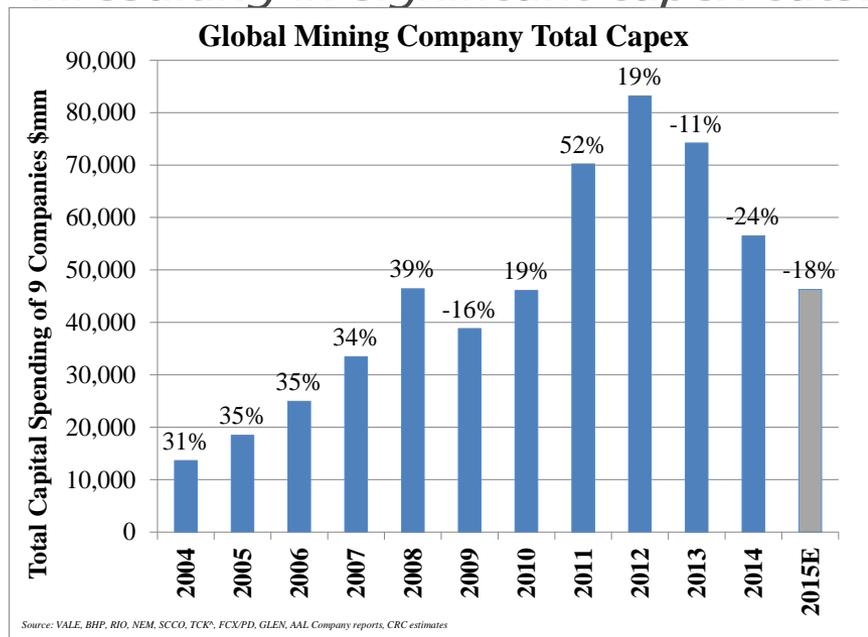
# Mining Equipment

*Mining - weak China demand impacting mined mineral prices...*



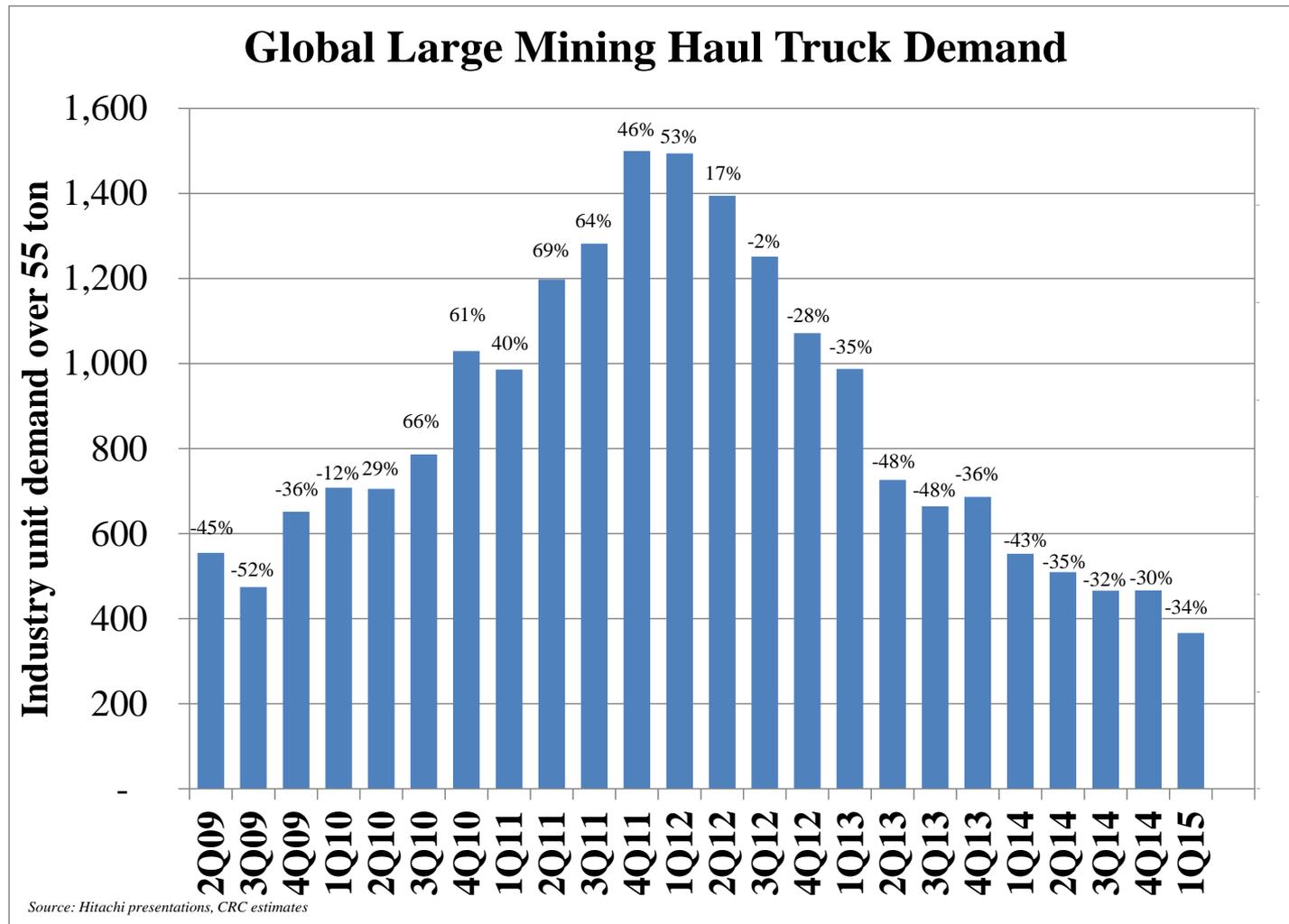
# Mining Equipment

*...resulting in significant capex cuts...*



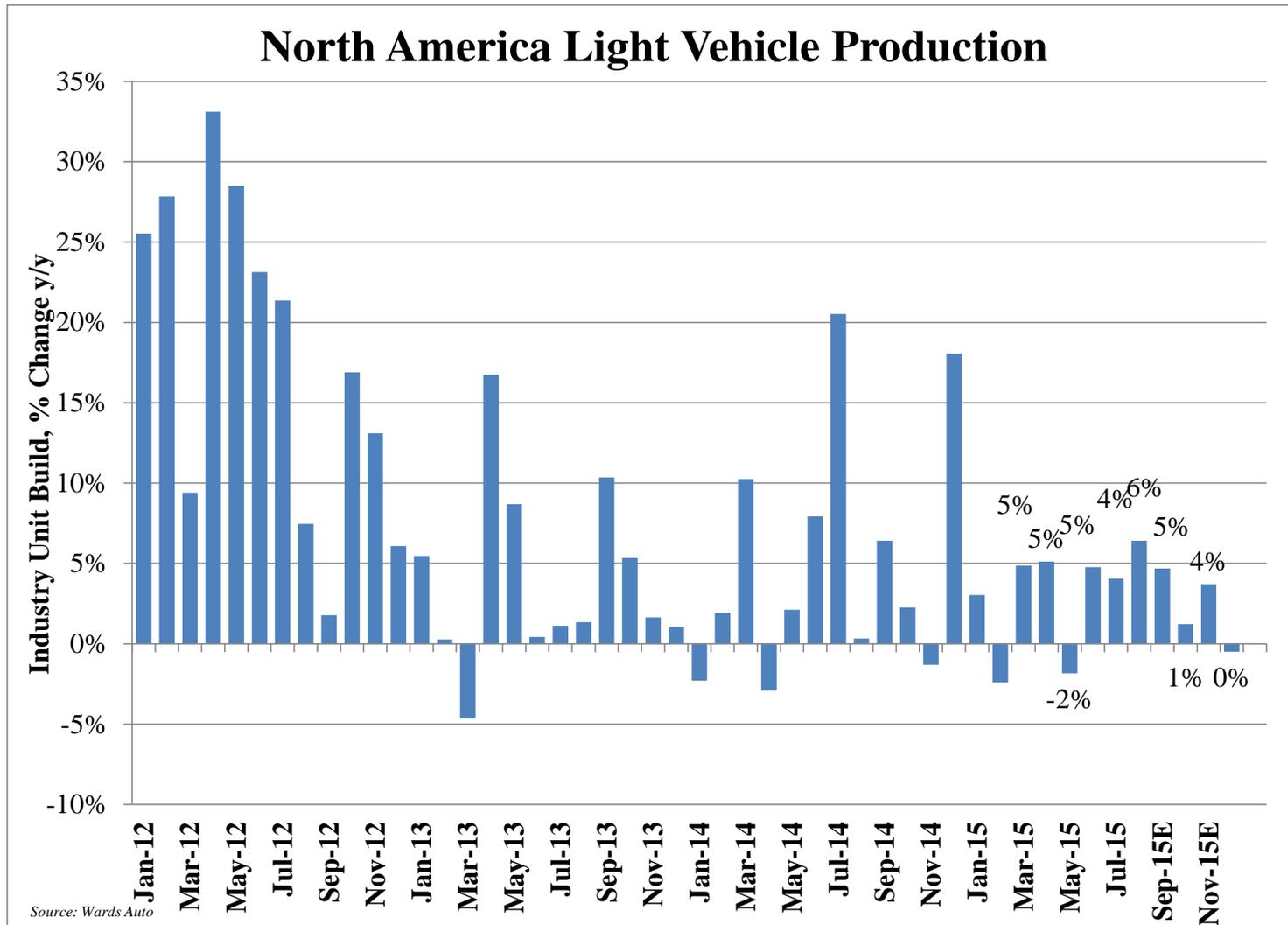
# Mining Equipment

*and significant equipment demand deterioration.*



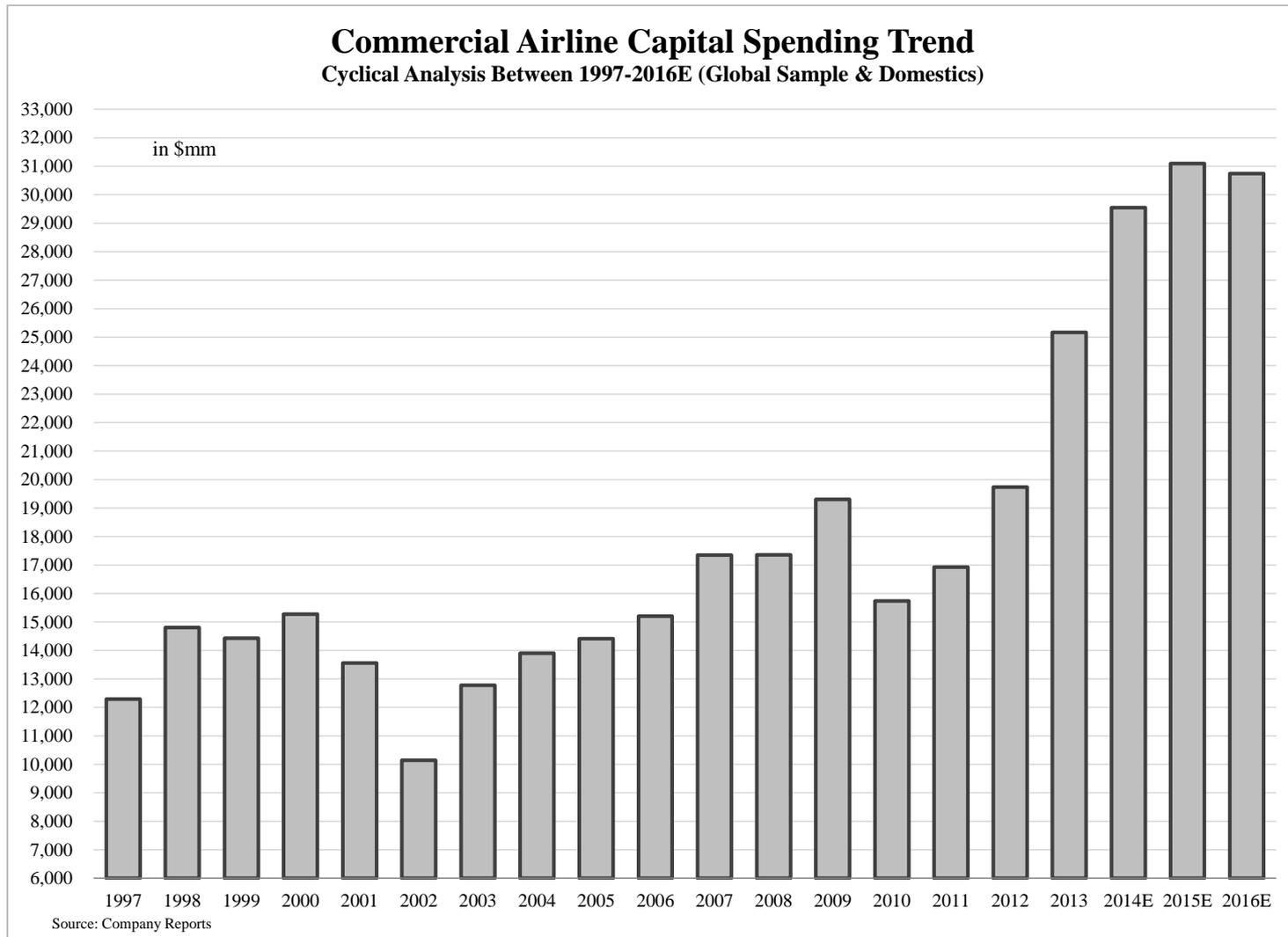
# Few bright spots

*Still strong auto production*



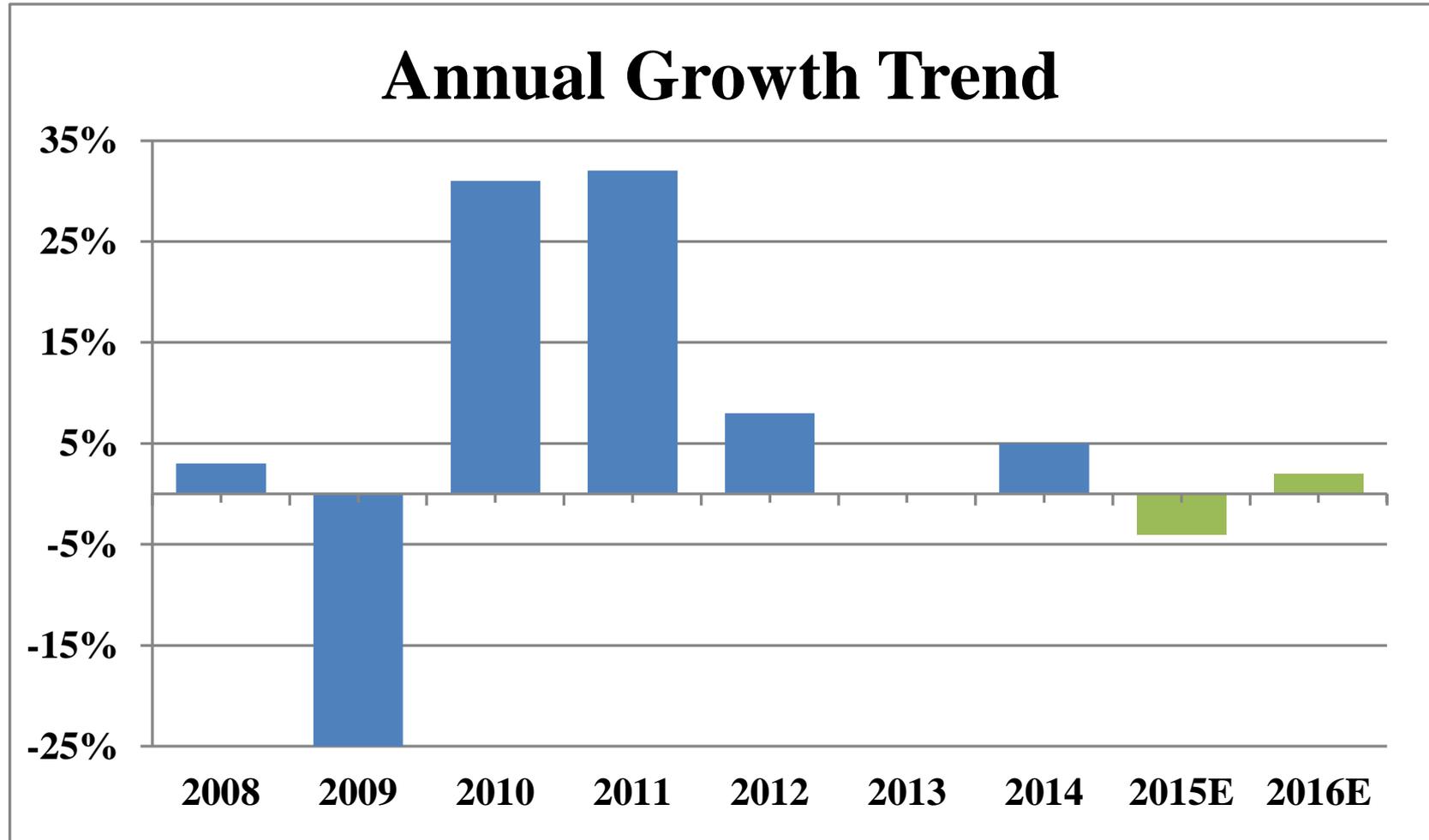
# Few bright spots

*Aerospace outlook still favorable*



# Initial 2016 Outlook

*See sluggish growth with downside risk*



# Q&A

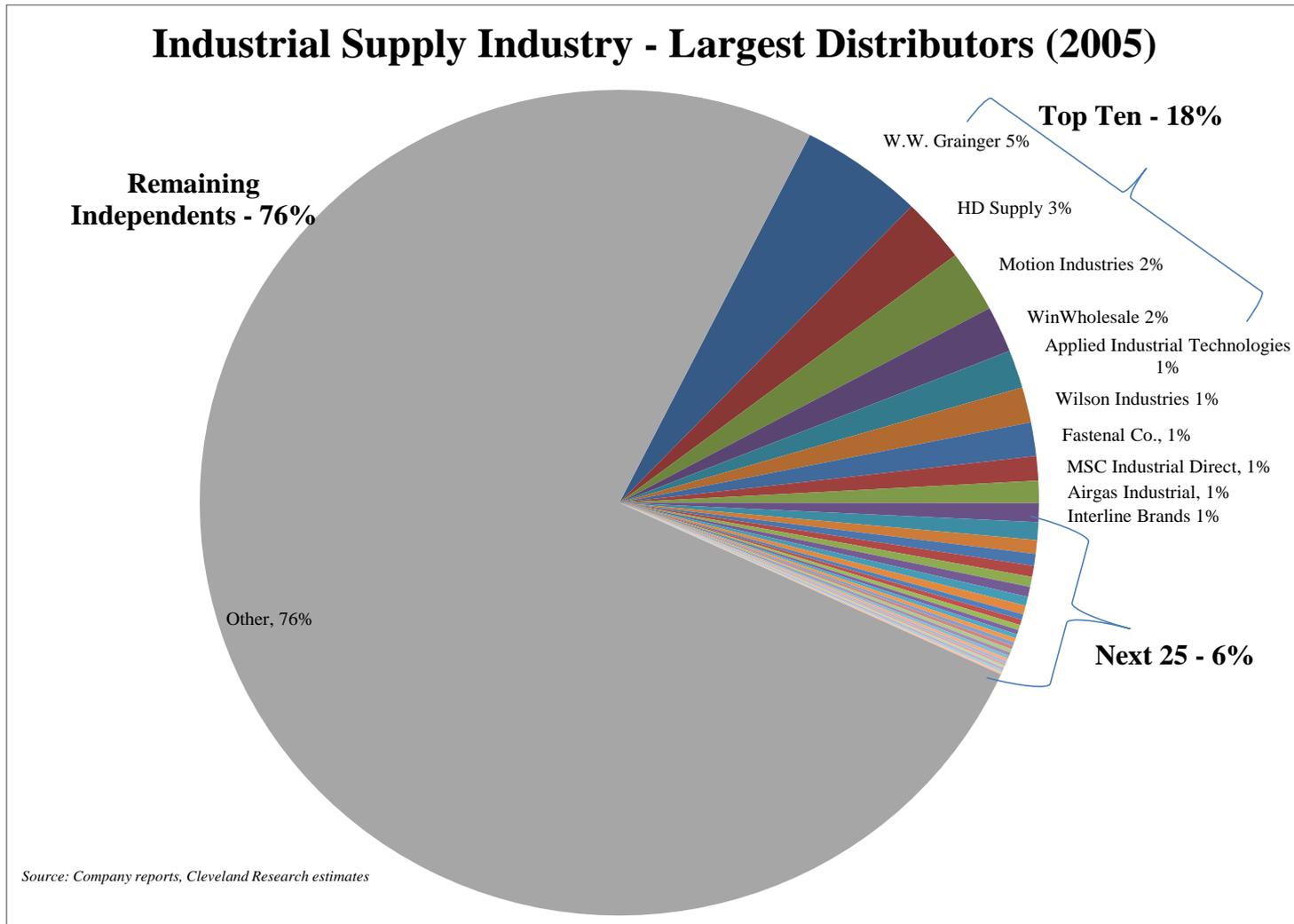


# Industrial Distribution Trends



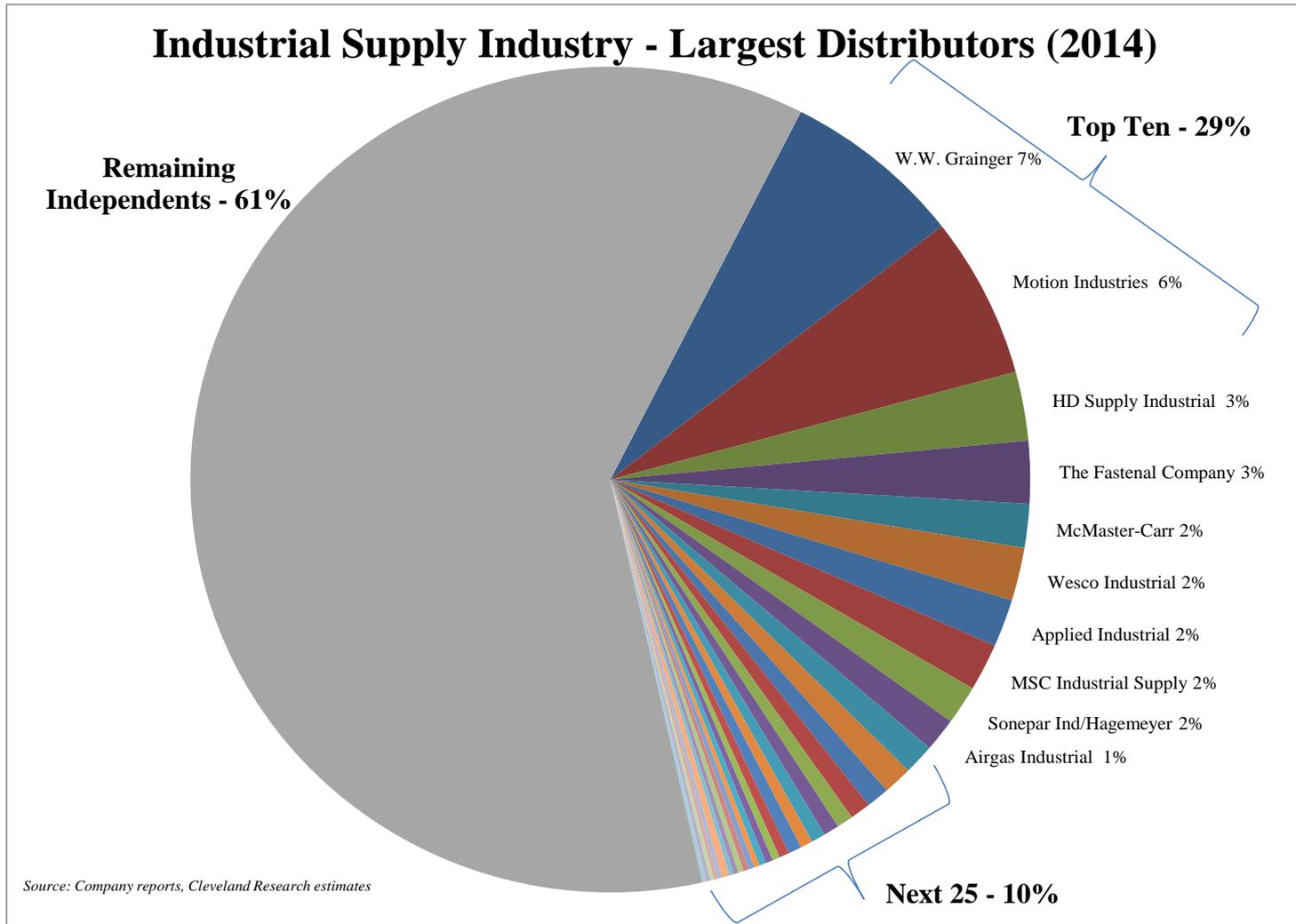
# Key Trends In Industrial Distribution

*Top Distributors in 2005...*



# Key Trends In Industrial Distribution

*Top Distributors in 2014 - ~\$150 billion market*



# New Entrants



# New Entrants

## The Home Depot Announces Agreement to Acquire Interline Brands

### Bill Lennie Named EVP of Outside Sales and Service

ATLANTA, July 22, 2015 /PRNewswire/ – The Home Depot®, the world's largest home improvement retailer, today announced its entry into a definitive agreement to acquire Jacksonville, Fla.-based Interline Brands, Inc., a leading national distributor and direct marketer of broad-line maintenance, repair and operations (MRO) products.

Under the terms of the agreement, The Home Depot will acquire Interline for \$1.625 billion in cash, subject to customary adjustments. The acquisition, which has been approved by the shareholders of Interline, is expected to be completed during The Home Depot's fiscal third quarter, which ends on November 1, 2015. The deal is subject to applicable regulatory approval and other customary closing conditions.



# New Entrants

*It doesn't always go right...*



## AmazonSupply is now closed.

AmazonSupply has been upgraded to Amazon Business, a new marketplace for businesses on Amazon.com. Customers who visit AmazonSupply are now redirected to Amazon.com

Source: Amazon.com



# Key Trends in Industrial Distribution

## *Expanded Product Offering*

### **Purchasing Magazine Survey - What is Most Important to MRO Buyers**

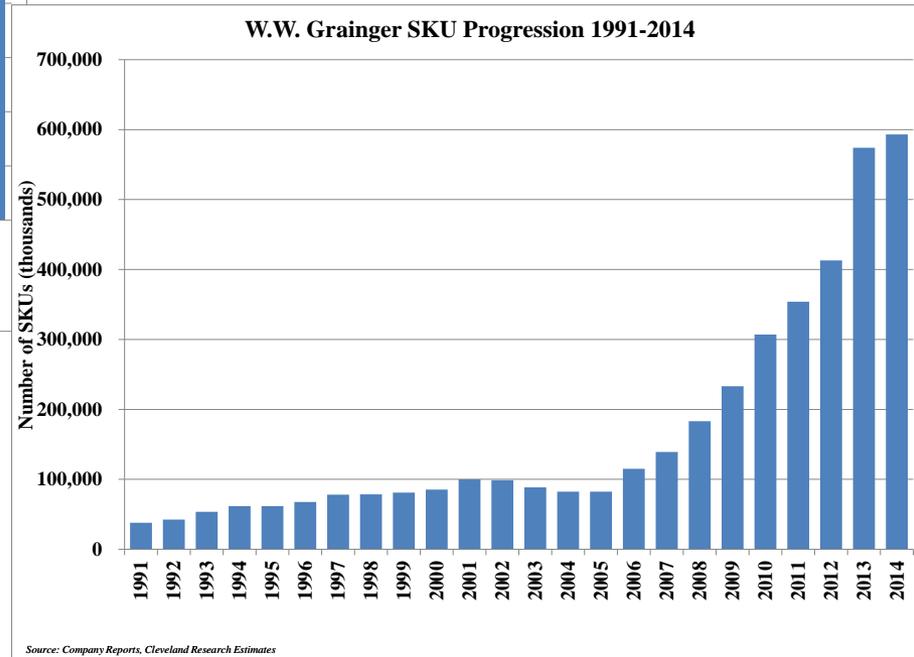
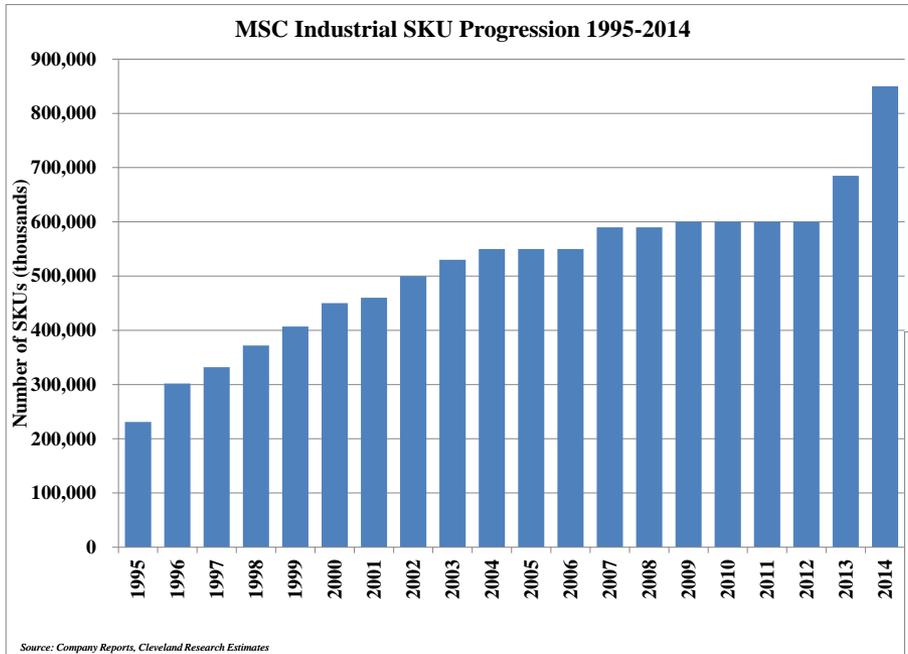
<b>Ranked On Scale of 1 to 10 (Highest)</b>	<b>2008</b>
Availability	7
Total cost	6
Quality	6
Price	5
Service	5
Technical assistance	4
Ease of doing business	4
Emergency assistance	3
Inventory assistance	2
Brands carried	2

*Source: Purchasing Magazine*



# Key Trends In Industrial Distribution

## Expanded Product Offering



# Key Trends In Industrial Distribution

*Inventory Management Services - \$20-25b Market*



## Applied Industrial Technologies Expands Maintenance Supplies & Solutions Capabilities with Acquisition of Parts Associates, Inc.

CLEVELAND, Dec. 21, 2012 /PRNewswire-FirstCall/ -- Applied Industrial Technologies (NYSE: AIT) today announced it has acquired Parts Associates, Inc. (PAI) of Cleveland, Ohio. PAI is a distributor of maintenance supplies and solutions, including fasteners, fluid flow, paints, chemicals, electrical, shop supplies, and related assortments. Terms of the sale were not disclosed.

## Applied Industrial Technologies Acquires Atlantic Fasteners

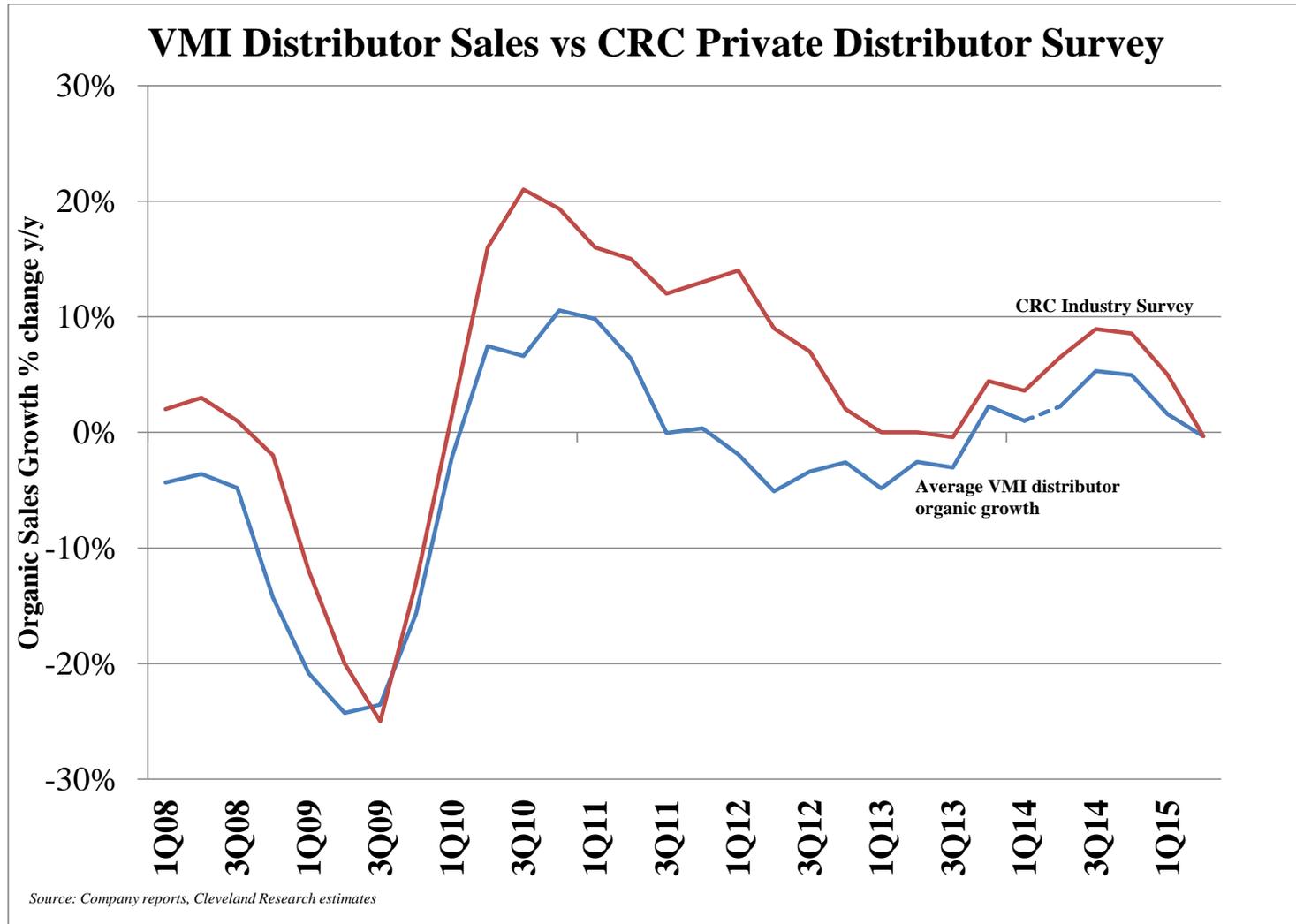
### Further Strengthens Maintenance Supplies & Solutions(SM) Offering

CLEVELAND, Aug. 4, 2015 (GLOBE NEWSWIRE) -- Applied Industrial Technologies (NYSE:AIT) today announced it has acquired Atlantic Fasteners, a distributor of C-Class consumables located in Agawam, MA. Terms of the sale were not disclosed.



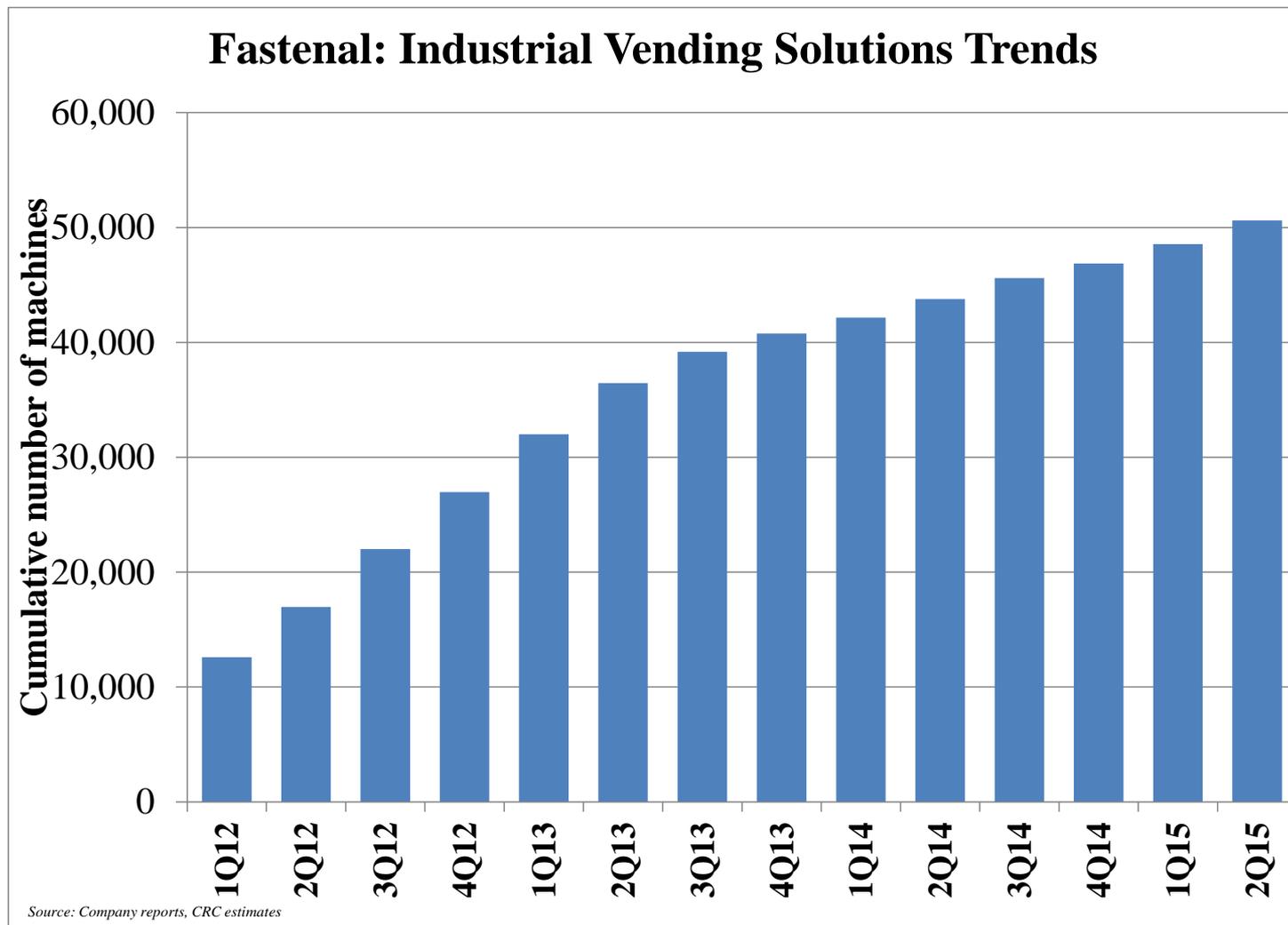
# Key Trends In Industrial Distribution

*Inventory Management Services – Flat for a While*



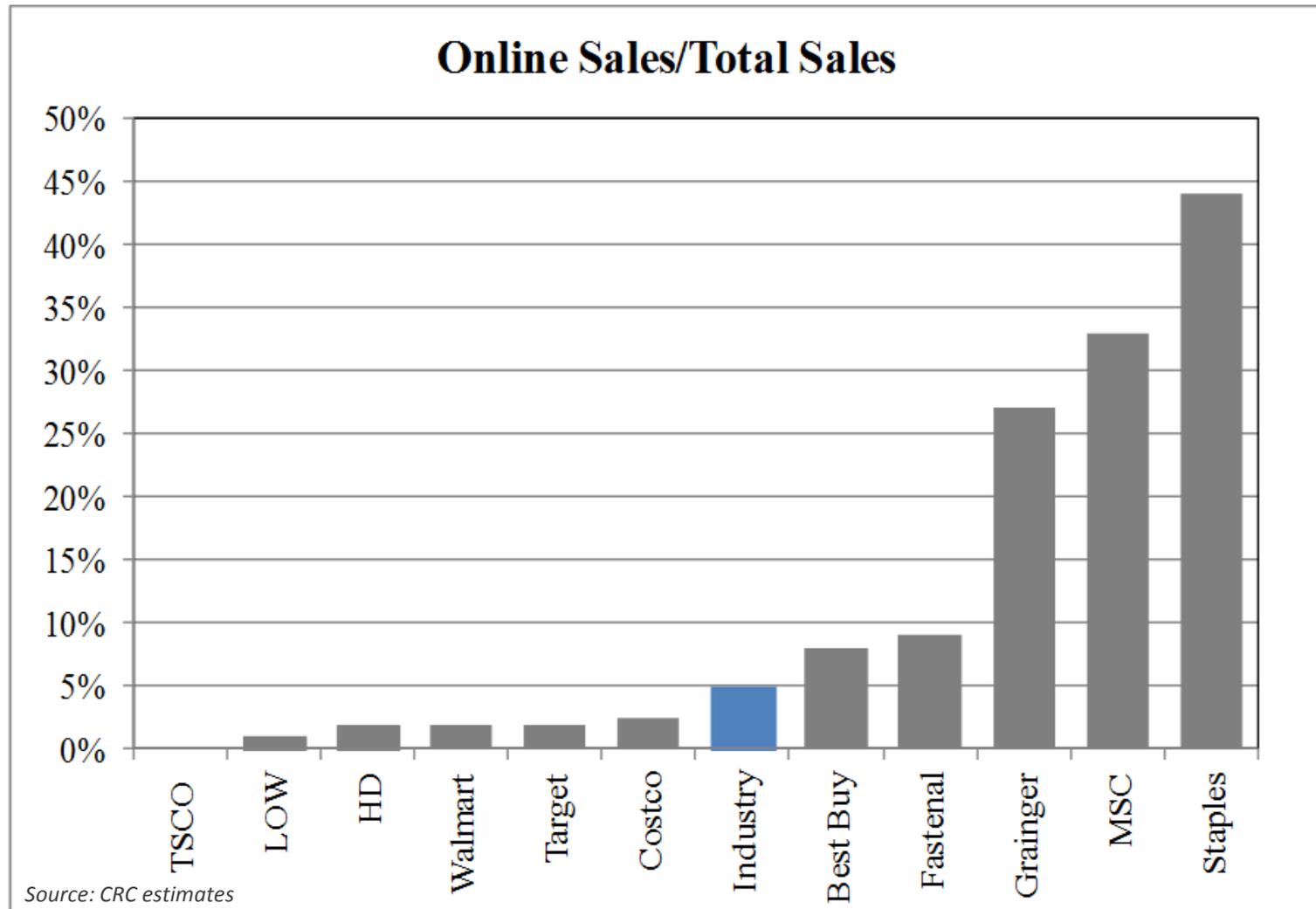
# Key Trends In Industrial Distribution

## *Inventory Management Services*



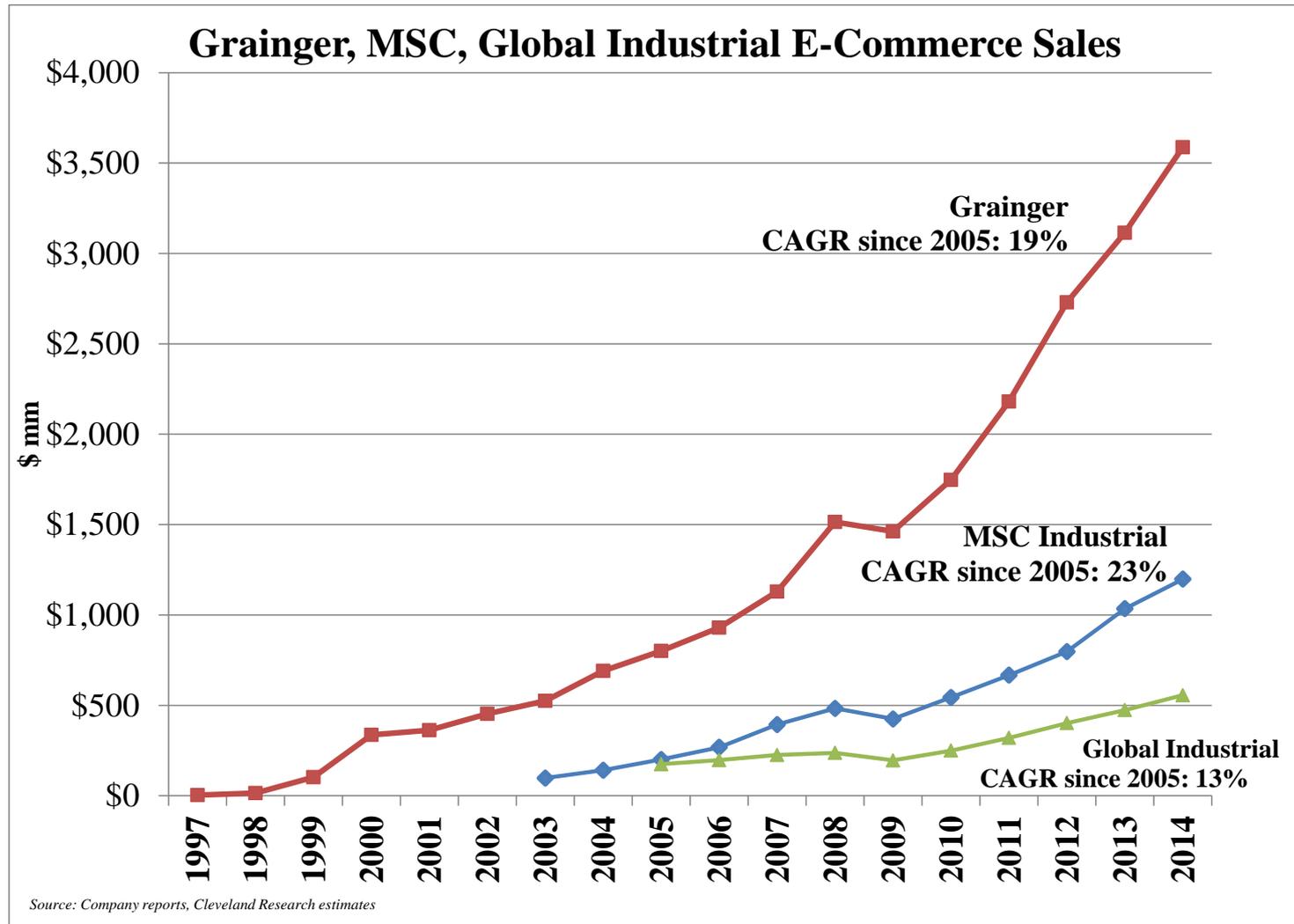
# Key Trends In Industrial Distribution

*eCommerce*



# Key Trends In Industrial Distribution

*eCommerce*



# Key Trends In Industrial Distribution

*What We Are Seeing at*



- Zoro.com
  - Primary channel to reach small customers (5% of sales, 1/3 of market)
  - \$300 million in revenue, ~9% EBIT margin vs ~18-19% for GIS
- Salesforce Hiring Slowed
  - TSR plan halted, account managers hired instead
  - Slowing hiring plan from 400 to several hundred (from 8% to less than 5% y/y growth)
- Medium Sized Customer Pricing Strategy Changing
  - Trial greater discounts to stem sales declines with these customers
  - Pricing overall remains our key concern for the company
- Cromwell Acquisition
  - \$440mm UK based distributor acquired for 11x EBITDA. Provides Europe infrastructure.
- Restructuring Fabory Acquisition; Brazil Ops Closed; Investing in Clean Coal
- Court Carruthers Out, DG Macpherson now COO



# Key Trends In Industrial Distribution

*What We Are Seeing at*



- Vending
  - Hit 50,000 unit mark, providing 3-5% growth tailwind to sales YTD
  - Over \$500mm business, running below prior lofty expectations, but goal is \$1.5 billion in vending sales.
- Salesforce Hiring Slowed
  - Headcount growth cut from 3,000 to 1,600 (15% growth to 7%)
- National Accounts
  - Key focus is winning new customers; 43% of sales today
- Lee Hein returns to COO role from CEO; Will Oberton now CEO
  - Board to name new CEO soon (internal promotion)



# Key Trends In Industrial Distribution

*What We Are Seeing at*



- **Salesforce Growth**
  - Headcount plan cut from 8-10% growth to 2% for the year
  - Managed to demand growth going forward
- **Barnes Distribution Integration (CCSG)**
  - Integration moving forward post significant salesforce turnover (+30%)
  - Cross selling efforts under way (added 3-4% to CCSG sales)
- **National Accounts/Government**
  - 4-5% growth contribution over the last year, all of its growth in May quarter
  - 30-35% of sales, goal to expand further
  - Mix headwind to gross margins (GM peaked at 46.5% in 2011 vs 45% this year).
- **New CFO in Place, Still Recruiting Chief Customer Office (VP sales)**



# Key Trends In Industrial Distribution

*What We Are Seeing in the industry:*

- Home Depot - *\$1.6b acquisition of Interline Brands, getting back into industrial supply*
- Sonepar – *acquisition of IDG, diversifying outside electrical*
- Blackhawk – *founded in 2009, already a significant player*
- Stellar – *multiple acquisitions building regional player*
- HD Supply – *divest Power Solutions to Anixter*
- Anixter – *divest Fastener distribution segment to private equity*



# Disclosures

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