

3Q11 Survey: Signs of Uncertainty

MDM/Baird results show ongoing growth, despite economic concerns

Robert W. Baird & Co., in partnership with Modern Distribution Management, conducted a survey of nearly 500 distributors and manufacturers to gauge business trends and the outlook for the distribution industry in diverse sectors. Here is a summary of third-quarter results.

On average, respondents to the latest quarterly MDM/Baird survey said third-quarter revenues were up 8.9 percent year-over-year. In the second-quarter survey, respondents indicated sales were up 9.7 percent.

Respondents expect the positive trend to continue through the end of 2011. The average forecast for respondents is revenue growth of 5.7 percent in the fourth quarter. Respondents also expect average growth of 5.7 percent in 2012.

Despite expectations for growth, however, many respondents were skeptical about the state of the economy. About 60 percent expect flat growth in the economy in the near term, and just 1 in 5 expect

growth in the overall economy in 2012. Half of respondents report they have already taken some sort of cost-saving action in anticipation of economic weakness.

In the third quarter, 40 percent of respondents increased inventory levels in the third quarter, up slightly from the same period a year ago.

Here is an overview of results by sector:

Industrial supply distributors, including MRO, fasteners and cutting tools in this survey, experienced flat-to-lower growth rates in the third quarter versus the second quarter.

Cutting tools distributors again saw the most positive third-quarter trend, with average revenue growth of 12.6 percent. Fasteners posted the lowest average growth at 4.4 percent. MRO sales were up 9.1 percent.

Many said that though there has been talk of a slowdown, they haven't actually

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Commentary: New Reality vs. the New Normal

What we hear in the national media doesn't jive with the recovery many distributors are seeing.

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E-Commerce Evolves for Distribution

Technology advancements have resulted in more options online.

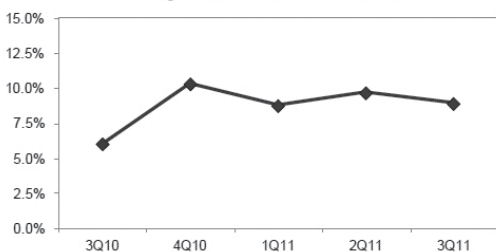
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Survey: The State of E-Commerce in Distribution

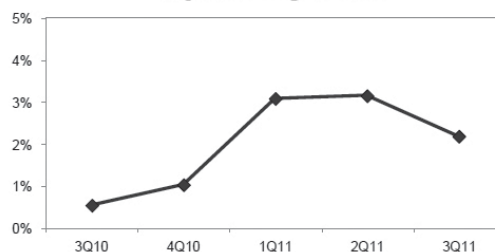
MDM survey highlights how distributors use e-commerce.

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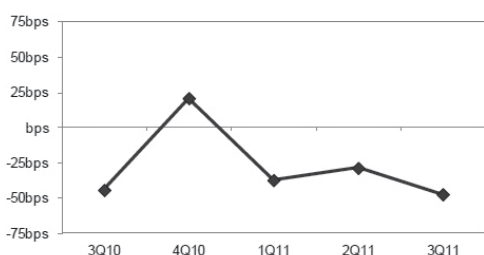
3Q11 Revenues +8.9%



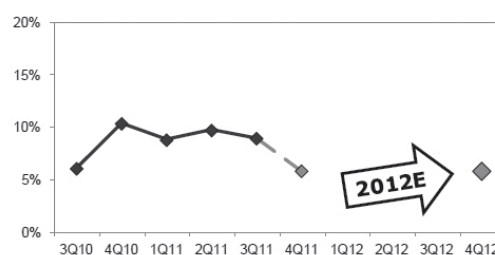
3Q11 Pricing +2.2%



3Q11 Gross Margins -48bps



4Q11/2012 Revenue Outlook +5.7%/+5.7%



MDM-Baird 3Q Survey
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seen a slowdown in sales yet. “This is a busy time for our company,” said one respondent. Still, there is concern, and market confidence is falling. “When all of the news is bad, the perception becomes reality and the markets contract.”

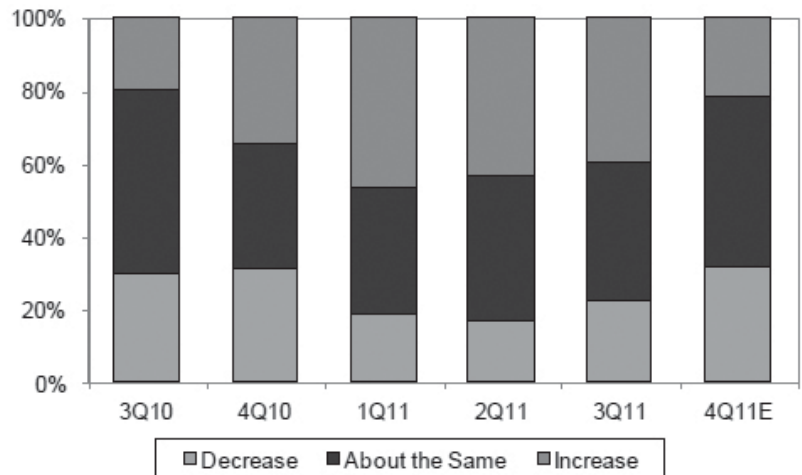
Pricing increases ranged from 1 percent to 4 percent on average in industrial. Respondents reported that past price increases are holding, but that they don’t expect additional increases. “The velocity or severity has certainly slowed,” wrote one. “I suspect putting through increases next year will be much tougher than it was six months ago,” said another.

Forecast growth for the fourth quarter in the MRO segment is 5.4 percent. Cutting tools and fasteners are predicting average growth of 7.9 percent and 2.9 percent, respectively.

In **gases and hardgoods**, hardgoods growth continues to outpace gases, and the gases growth rate fell somewhat versus the second quarter 2011.

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Inventory Levels, Historical and Expected



Inventory trends flexed up in line with normal seasonal trends in the quarter, as 40 percent of respondents reported increased inventory levels - up slightly vs. the same period last year. While there is natural pressure on inventory levels going into the seasonally weaker fourth quarter, the number of distributors looking to add inventory has fallen to levels not seen since 2009. This highlights the significant uncertainty we are seeing in the distribution market.

Current and Expected Revenue and Pricing Levels by Sector

	3Q 2011 Sales Change	3Q 2011 Pricing Change	4Q 2011 Sales Forecast	2012 Sales Forecast	Commentary from Robert W. Baird & Co.
Building Materials	1.2%	1.4%	0.1%	2.1%	Resi construction activity remains near lows
Cutting Tools	12.6%	1.3%	7.9%	7.0%	Consistent top-quartile revenue growth in 2011
Datacomm	13.6%	4.4%	6.5%	6.5%	Data centers a consistent source of strength
Electrical	12.1%	2.9%	7.8%	6.6%	Declining copper prices significant concern
Fasteners	4.4%	3.6%	2.9%	4.5%	ITC ruling on Nucor case seen as non-issue
Gases/Cylinder Rental	6.6%	1.9%	3.9%	5.1%	Gases trends remain very steady overall
HVAC	9.1%	2.3%	5.4%	6.6%	Full impact of R-22 “dry-ship” units seen in 3Q11
Jan/San	4.8%	2.0%	2.0%	4.8%	Pricing among highest in survey again in quarter
Mechl/Power Trans	3.3%	4.0%	2.7%	7.3%	Revenue trends unchanged vs. +10.0% q/q
MRO	10.0%	1.5%	5.6%	5.1%	Overall healthy activity levels persisted in 3Q11
Plumbing	2.2%	-0.1%	0.4%	3.6%	3Q11 revenue growth up substantially vs. +3.5% q/q
Pool & Spa	14.9%	2.1%	13.6%	6.4%	Revenue trend has eased slightly through 2011
PVF	8.4%	4.2%	6.3%	7.5%	Oil & gas is strength, questions of sustainability
Rental Eqmt	7.0%	0.5%	0.5%	1.2%	Lackluster construction trends weighing on growth
Roofing	9.5%	10.1%	6.3%	9.5%	Storm activity supports resi volume and pricing
Safety	7.8%	0.9%	6.5%	6.7%	Most steady expectations in industrial products
Water & Sewer	0.8%	2.1%	0.4%	4.7%	Lowest current-quarter revenue growth
Welding Hdgds	11.9%	2.3%	6.2%	4.5%	Consistently outperformed gases in 2011
Overall	8.9%	2.2%	5.7%	5.7%	

Hardgoods revenue grew 11.9 percent in the third quarter, compared with gases revenue growth of 6.6 percent. Overall, respondents reported continued improvement, and some are optimistic sales will return to 2008 levels. However, as with industrial supply and other segments, respondents report uncertainty.

Both categories saw higher prices in the third quarter 2011 versus the prior-year period. Surcharges are coming down slowly, and some expect price decreases on commodity-driven hardgoods.

Hardgoods distributors are forecasting average growth of 6.2 percent for the fourth quarter, while the gases segment is forecasting 3.9 percent growth.

Results for the **building products** segment, including building materials, roofing products, HVAC, pool and spa, and plumbing, were below the overall survey average. Roofing was the exception, posting average revenue growth of 9.5 percent. "Roofing sales are being driven by storm damage," one respondent explained.

Average revenue increase for building materials in the second quarter was 1.2 percent, while HVAC companies reported average growth of 4.8 percent. Pool & spa and plumbing segments saw average revenue growth of 3.5 percent and

8.4 percent, respectively.

Outlook for the building products segment is mixed across segments. Average revenue forecasts for the fourth quarter 2011 ranged from declines of -2 percent (pool & spa) to 6.3 percent (both plumbing and roofing).

Underlying trends for HVAC remain lackluster, as sales were not as robust as many expected given the hot weather. Many respondents expect dry-ship R22 to have a big impact on the market going forward.

Industrial wire & cable reported revenue growth above average survey results, but the trajectory for electrical and datacomm are down from the second quarter 2011. Average sales growth for electrical was 12.1 percent and for datacomm was 13.6 percent. Current quarter pricing was up moderately for both, with datacomm slightly better. Respondents reported concern about a steep decline in copper.

Industrial markets remain the strongest, especially OEM. Commercial construction however is slow. Pockets of strength include solar, lighting retrofits and data centers.

Revenue growth is expected to continue through the end of 2011, with electrical forecasting average growth of 7.8 percent and datacomm forecasting growth of 6.5 percent.

■ *Emerging Technologies Series, Part 5*

E-Commerce Evolves for Distributors

More options than ever exist to meet industry-specific e-commerce requirements

This is the fifth and final article in MDM's Emerging Technologies Series. This article examines trends in e-commerce and how distributors are approaching the challenges associated with implementing an effective e-commerce strategy.

By Jenel Stelton-Holtmeier

Often when e-commerce is mentioned, Amazon.com comes to mind. And while that model is extremely successful in the business-to-consumer market, it's a stretch for some to see how that model can be applied to business-to-business.

"It's all a question of: What do you mean by 'e-commerce'?" says Roman Bukary, head of manufacturing and distribution industries at NetSuite, a Web-based business software provider. "If what you mean is Amazon.com, then absolutely it may not be relevant.

"However, if you think of it in the broad

sense of doing business on the Internet – the ability to have self-service, schedule service, check an order, etc. – then there is no industry, no segment of the marketplace where e-commerce is not relevant."

Distributors are on all different levels when it comes to being online, says Kelly Squizzero, director of product management for Infor Distribution. Some simply have company information with some high level product information, while others have developed highly interactive user environments for their customers.

As the general public has become more computer and Internet savvy, so have the customers of distributors. "The web presence is important," says Gene Nusekabel, worldwide industry lead – wholesale distribution, Smarter Commerce, IBM Software Group.

"A lot of people look to the Web first to find things."