mdmpremium monthly AUGUST 2024

IN THIS ISSUE

1 **MDM Research:** Distributors Report Challenging Margins, Market Competition.

2 **Datum:** Wholesale Inventories in Growth Mode.

3 **Industry News Digest**

6 **How to Navigate Labor Challenges in Distribution:** Three tech experts share three ways automation can help.

7 **MDM Research:** The State of Labor Turnover in Wholesale Distribution.

9 **New Details Emerge on QXO's Go-to-Market Plans:** A new report and exclusive MDM interview shed light on the splash-making platform distributor.

11 **MDM Forecast:** August Annual Outlook is Weakest of 2024.

13 **How Ferguson has Worked Wonders with "Channel Drifting":** Part 1 of this series examines the distributor's growth through diversification.

17 **Stubborn Demand Softness Prompts Macroeconomic Context:** We examine executive commentary and economic indicators to make sense of business conditions.

19 **Fastenal Details Rollout of Internal AI Tools:** An AI-upgraded chatbot and a sourcing tool are primed to help the company's staff.

20 **Inside Ferguson's Private Brand Strategy:** Part 2 of this series examines the company's exclusive brands that have been a key market accelerator.

23 **Market Profile:** Valves.

MARKET ANALYSIS

MDM Data: Distributors Report Challenging Margins, Market Competition

By Vesna Brajkovic

More than half of respondents in the 2Q24 Baird-MDM Distribution Survey indicated they characterized 2Q24 as slightly or much more competitive than a year earlier. **Click for web version with original graphics**

Industrial distributors across several verticals are beginning to report pressure on margins as competition ramps up amid a softer demand. In our 2Q24 Baird-MDM Distribution Survey, conducted in early July with over 500 respondents representing a combined annual revenue of approximately $100 billion, 20% identified "aggressive competitive behavior/loss of market share" as the most significant risk to their outlook for the second half of the year.

Approximately 60% of respondents identified as representing a distributor, 30% as a manufacturer and 10% as other.

Commentary by respondents indicated challenging margins and steeper competition. Here's just a handful of examples:

- "Market has become much more competitive and the economy is slowing in multiple sectors."
- "Market is slowing down, our customers are using less product, more competition smaller cake."
- "We have been emphasizing [gross profit percentage] increase in the business. However, pressure from desperate competition exists."
- "Receiving price resistance from customers as supply chain lead times have normalized. Holding margin may be more challenging in the second half of the year."
- "Continued hesitancy regarding overall economy resulting in cautious spending while competition buys business with price cuts."

More than half of the respondents said they considered the second quarter's business environment as more competitive than a year earlier and compared to the recent past.

Continue on page 5

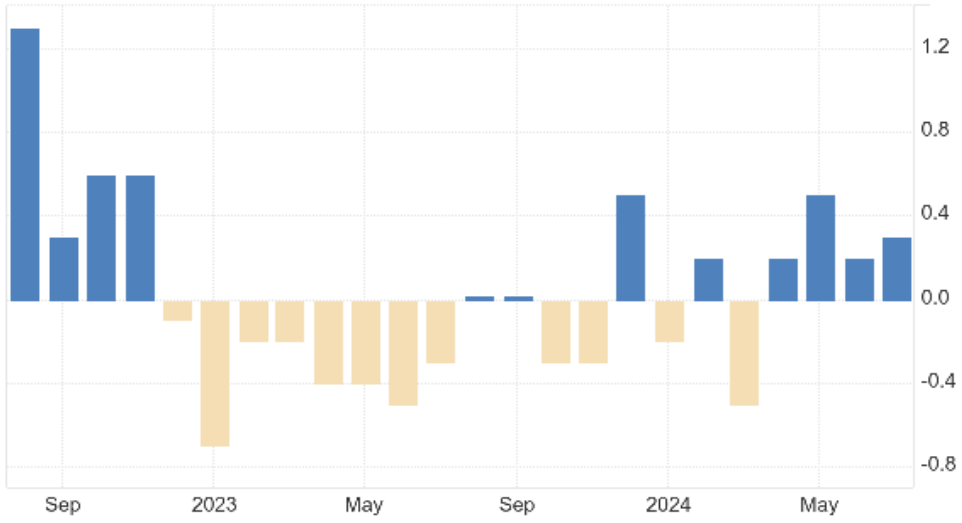
DATUM

Wholesale Inventories in Growth Mode

After slimming down throughout 2023, wholesale inventories have predominantly bulked up in 2024.

The U.S. Census Bureau's August Wholesale Trade report showed that wholesale inventories recorded their fourth straight monthly increase in July, which was the sixth gain out of the past eight months going back to December 2023.

U.S. Wholesale Inventories - Monthly % Change



This inventory resurgence followed a period from December 2022 to November 2023 in which inventories decreased in 10 of those 12 months — a notable inventory sell-off as industrial demand softened during that same period. They've climbed since, even though industrial demand hasn't through the summer of 2024.

Inventories tend to pick up seasonally in July-September in advance of holiday season orders — illustrated by modest bumps in August-September 2023 (from declines to flat) — but 2024's gains appear to precede this seasonality.

We'll keep watching to see if this leads to an inventory glut, or if demand will accelerate to match it.

This trend corresponds with U.S. retail inventories, which have likewise improved in six out of the past eight months going back to December 2023.

Source: **Trading Economics via U.S. Census Bureau**

mdmpremium monthly

MDM Premium Monthly (ISSN 0544-6538) is published monthly by Modern Distribution Management, a brand of the National Association of Wholesaler-Distributors (NAW), 1325 G St NW, Suite 1000, Washington DC 20005. Annual MDM Premium Membership price is $395; this individual use license provides access to MDM Premium Monthly, exclusive industry reports and discounts on MDM's other proprietary market intelligence and conferences.

Site licenses and multi-user pricing are available for those who wish to distribute MDM Premium Monthly and Premium reports throughout their firms. Contact us for details at **info@mdm.com**, call (202)-872-0885 or visit our website at **www.mdm.com**.

Mike Hockett, Executive Editor
Vesna Brajkovic, Senior Editor
Anna Debiec, Associate Editor
Tish Drake, Publisher
Tom Gale, Strategic Advisor
Hadley Fable, Operations
Marlyn Forberg, Customer Service

This PDF is licensed for individual use only.
All other distribution prohibited without permission.

© 2024 Modern Distribution Management. All rights reserved. Individual use license only.

MDM Editorial Advisory Board

Chester Collier, SVP, Walter Surface Technologies
Ted Cowie, VP of Sales, Safety & Industrial Products, Motion (retired)
Larry Davis, Operating Advisor for Tenex Capital Management
Julia Klein, Director, Federal Reserve Bank of Philadelphia
Ted Stark, Division Advisor, Dalco Enterprises (retired)
Michelle Pecak, Sr. Director of Strategic Pricing, Nature's Touch Frozen Foods
David Ruggles, President, Martin Inc.
Terry Albrecht, Founder & CEO, Packer Fastener
Robyn Pollina, CEO, Palmer Donavin
Dennis Shaw, Manager of Strategic Planning, Graybar
Craig Osborne, Former President & CEO, Singer Industrial

INDUSTRY NEWS DIGEST

Distribution News

Melbourne, FL-based **Military Fasteners** — an eCommerce mil-spec fasteners distributor — was privately acquired by private equity firm Montage Partners and David Ficadenti was appointed as its CEO.

Specialty building materials distributor **GMS** acquired Orlando, FL-based stucco, exterior insulation and finishing system supplier **R.S. Elliot Specialty Supply**.

Fastener and other hardware distributor **Hillman Solutions** said COO Jon Michael Adinolfi ("JMA") will become President and CEO on Jan. 1, 2025, succeeding current CEO Doug Cahill, who will transition to executive chairman. The company also acquired Atlanta, GA-based wiping cloths, consumable rags and cleaning textiles supplier **Intex DIY, Inc.**

Building materials distributor **Builders FirstSource** acquired Delaware-based **Wyoming Millwork Co.** — an independent lumber and building material distributor.

Building materials distributor **Kodiak Building Partners** acquired **San Antonio Masonry and Steel** — a masonry, stone, stucco and steel products provider.

Healthcare and pharmaceutical distributor **McKesson** is set to acquire a controlling interest in business and administrative services organization Core Ventures for $2.5 billion.

Flat-rolled carbon steel, stainless steel and aluminum distributor **Mill Steel Co.** appointed industry veteran Scott Hauncher as CFO.

Mid-market private equity firm **Inflexion** acquired U.K.-based cutting tool distributor **Cutwel**.

Automotive aftermarket parts providers Advance Auto plans to sell Newark, CA-based **Worldpac Inc.** — an equipment and quality aftermarket replacement parts importer and distributor — to global investment firm **Carlyle**.

Pharmaceuticals, medical and laboratory products distributor **Cardinal Health** opened a new distribution center in Walton Hills, OH.

Canton, MA-based **BSC Industries** acquired fellow bearings and power transmission products distributor Hopkinton, MA-based **Warren Pike**.

Industrial air compressor manufacturer and distributor **Hitachi Global Air Power** acquired Longview, TX-based **Air Power Sales and Services** — a provider of air compressors, air treatment products, accessories and related equipment.

Food and foodservice distributor **Performance Food Group** is set to expand its presence in the U.S. Southeast by acquiring Riviera, FL-based **Cheney Brothers, Inc** — a foodservice distributor currently owned by private equity firm Clayton, Dubilier & Rice — for $2.1 billion.

Irving, TX-based residential building products distributor **PrimeSource** acquired Montreal, Canada-based **Cobra** — a manufacturer of hollow wall, universal and masonry anchors.

Birmingham, AL-based MRO replacement parts distributor **Motion** will acquire Windsor, Canada-based **LSI Supply Inc** — a bearing, seals, power transmission, fluid power components and industrial supplies distributor and its sister company 273 Ontario. Motion is also set to open a new **Motion Repair & Service** location in Houston by September.

Virginia-based independent distributors holding group **Legacy Food Group** (LFG) acquired Madison, AL-based **Halsey Foodservice** — a family-owned distributor of food products.

Commercial door, frame and hardware distributor **Cook & Boardman** acquired Hutto, TX-based **Brymer Communication Services (BryComm)** and Denver, CO-based **Architectural Doors, Inc.** (ADI).

Rosemont, IL-based **Wynnchurch Capital, L.P.** acquired MRO supplies master wholesaler **ORS Nasco** from One Equity Partners.

Ohio-based fasteners distributor **AFC Industries** appointed Joe Shoemaker as VP for Marketing for North America and Chris Lloyd as **VP of Operations for Aerospace - North America**.

Industrial and MRO parts distributor **Global Industrial** appointed Lisa Armstrong as Chief Marketing Officer.

Brillon, WI-based fasteners distributor **Endries International** appointed Jeff Poulos as its Executive Vice President of Operations.

Metalworking and industrial products distributor **BlackHawk Industrial** appointed Perry Atchley to the newly-created position of Fasteners Implementation Manager, and Bob Miller **to the role** of General Manager of Fasteners. The company also **acquired** New Britain, PA-based Tri-State Industrial Supplies.

Waterworks and industrial supplies distributor **Core & Main** will acquire Juliette, GA-based **GroGreen Solution Georgia** — an erosion control and geotextile products provider. Infrastructure supplies distributor. The company also added Fort Worth, TX-based **Green Equipment Company** — a damage prevention, utility locating and wastewater equipment distributor.

Mount Sterling, IL-based food industry redistributor **Dot Foods** opened its 13th U.S. distribution center in Manchester, TN.

© 2024 Modern Distribution Management. All rights reserved. Individual use license only.

Foodservice, packaging supplies, industrial products and janitorial supplies distributor **Imperial Dade** acquired **Phoenix, AZ -based Excell Direct** — a distributor of foodservice and janitorial products and **Reno, NV-based Inland Supply** — a janitorial supply, food service products and facility maintenance supplies distributor.

Appliance repair parts and HVAC distributor **D&L Parts Company** acquired **Cashwell Appliance Parts** — an HVAC and appliance parts distributor based in Fayetteville, NC.

Chino, CA-based industrial flow control products distributor **Harrington Process Solutions** acquired Tulsa, OK-based **Control Process Systems** — a distributor of corrosion-resistant flow control products.

Roofing, exterior and interior products distributor **ABC Supply** acquired Los Angeles, CA-based **American Building Materials** — a distributor of steep- and low-slope roofing and waterproofing.

Roofing, waterproofing and related exterior products distributor **Beacon** announced a pair of acquisitions on Aug. 2: Canadian-based **SSR Roof Supply** — a supplier of roofing materials and accessories and Clifton, NJ-based **Passaic Metal and Building Supplies (PAMPCO)** — a distributor of exterior and interior building materials.

Chicago, IL-based industrial metals processor and distributor of **Ryerson** acquired Monroe, CT-based **Production Metals** — a distributor of aluminum, stainless and specialty steels.

Dallas, TX-based industrial rubber and fluid power distributor **Singer Industrial** acquired Winnipeg-based **MEP Brothers** — a supplier of industrial and hydraulic hose, gaskets and environment spill response products.

Fluid power, automation and industrial supplies distributor **Motion & Control Enterprises (MCE)** acquired **Air Automation Engineering (AAE)** — a Fridley, MN-based distributor of automation products and automated tooling solutions.

Specialty building materials distributor **US LBM** acquired **L.D. Mullins Lumber** — a Riveria Beach, FL-based building products distributor and **appointed former** Wesco executive Jeff Wood as SVP of Supply Chain.

Plumbing, HVAC, appliances and lighting to PVF, water and wastewater solutions distributor **Ferguson**'s corporate redomiciliation to the U.S. is final, with its headquarters now officially in Newport News, VA. **The company also acquired** Buffalo, NY-based **Gerster Equipment Co.** and **Santa Ana, CA-based United Water Works, Inc.**

Manufacturer News

Houston, TX-based precision safety sealing and attachment solutions supplier **Lamons** acquired **Auge Industrial Fasteners (AUGE)**, a manufacturer of engineered and critical fastening solutions.

Electrical wire and cable manufacturer **Southwire** opened its Dallas Fort Worth (DFW) Customer Service Center (CSC) on Aug. 22.

Brockton, MA-based electrical manufacturer representative **Yanow, Inc** acquired Syracuse, NY-based **Robert H. Schaub & Associates** — an agency that served the Upstate New York market for over 40 years.

Belgium-based plastic piping systems manufacturer and distributor **Aliaxis SA** will acquire the manufacturing assets of Huntsville, AL based **Johnson Controls CPVC** — a pipe and fittings supplier.

Clarence, NY-based pneumatic hand tools and surface treatment solutions manufacturer **Dynabrade** launched a new subsidiary named **Autobrade**.

Pittsburgh, PA-based metalworking products manufacturer **Kennametal** appointed David Bersaglini as President of its Metal Cutting segment, effective Aug. 26.

Ladders, safety equipment and tool storage maker **WernerCo** has rebranded itself as ProDriven Global Brands.

North Canton, OH-based **Timken** is set to to acquire Carson City, NV-based **CGI Inc.** — a manufacturer of drive systems serving automation markets with a focus in medical robotics.

Sweden-based manufacturer **BUMAX** announced the appointment of its new master distribution partner, New Jersey-based **Star Stainless Screw Company**.

Association/Buying Group/Co-op/Service Provider News

Distributor data work automation service provider **WrangleWorks** received a $1M investment from Tampa, FL-based **The Eisenhower Group, Inc.**

Amazon's Fulfillment by Amazon service launched a **"Returnless Resolutions"** program that will allow some sellers using its platform to receive product refunds without customers having to physically return the item.

Toyota recalled 33,848 vehicles in North America due to incorrect load-carrying-capacity stickers used by Houston, TX-based automotive accessories distributor **Gulf States Toyota**, affecting 22 models that cover essentially the automaker's entire North American portfolio.

© 2024 Modern Distribution Management. All rights reserved. Individual use license only.

Continued from page 1

About 64% of respondents indicated they characterized 2Q24 as either slightly more competitive (38%) or much more competitive (26%) than a year earlier, while 36% say the competitive environment was similar compared to 2023. Virtually no one (1%) considered the current business environment less competitive than a year ago.

When asked to compare 2Q24's competitive environment with typical (or "normal") levels in the recent past, 58% of respondents considered the competitive environment to be slightly more competitive (43%) or much more competitive (15%). About 37% consider the competitive environment 2Q24 similar to "normal" levels, and 4% consider it slightly less competitive than the normal.

How would you characterize the current competitive environment vs. last year and vs. normal/longer term?

A rotating question in the 2Q Baird-MDM Survey asked more than 500 distributors to characterize the competitive business environment in mid-2024 compared to last year and typical (or "normal") levels historically.

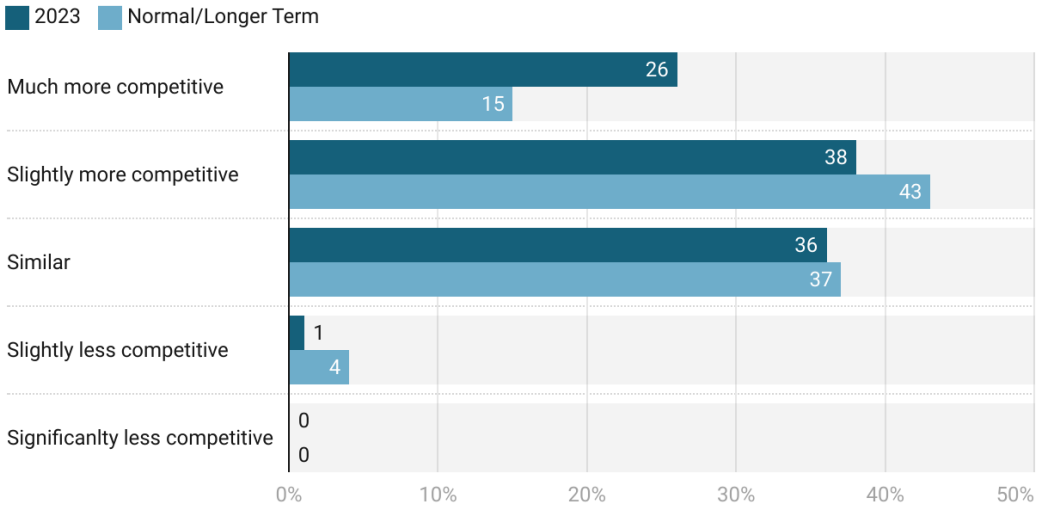


Chart: MDM • Source: 2Q Baird-MDM Survey • Created with Datawrapper

When analyzing the respondents' general comments, some common threads emerge in reference to competitive margin pressures driven by price cuts and customer demand. See below selected comments, broken down by industry vertical, which seem to support this sentiment.

Electrical — *Respondents say competitive margin pressures are evident.*

- ***"Margin pressure by more competitive market affecting overall revenue and profitability."***
- ***"Demand feels stable, margins are still under pressure due to raw material inflation and higher labor costs in Mexico."***

Plumbing/HVAC — *Respondents say the market is very competitive.*

- ***"Still pressure on margins but [not] nearly what it was last year, we should see some recover in the second half. Competitive pressures are felt but not big impact on margins…yet."***

Building products — *Key takeaways from respondents indicate competitive pricing and notable margin erosion.*

- Wallboard/gypsum: ***"Prices deflate as everyone grabs at the customers base with price focused selling."***
- Pool & Spa/Landscape Supplies: ***"July-August are historically slower but more so this year than last year. We are offering discounts to encourage spending. We are competing against luxury cruises, vacations and Disney this year — much more than in recent (3-4) years."***
- Pool & Spa/Landscape Supplies: ***"No pricing changes from 2023 resulting in some gross margin erosion."***

Pipes, Valves & Fittings — *Respondents characterize demand as "hesitant."*

- ***"Continued hesitancy regarding overall economy resulting in cautious spending while competition buys business with price cuts."***
- ***"Revenue and margins are flat. Activities related to new opportunities are down."***
- ***"Pricing is under some pressure, but not much more than 2H23. That said, we expect margin to improve (2H24 vs. 2H23) as a result of more price increases in 2024, but more importantly suppliers are much more hungry for business and willing to discount to get it."***
- ***"Sales revenue is basically flat with additional margin pressure."***

© 2024 Modern Distribution Management. All rights reserved. Individual use license only.

TECHNOLOGY

How to Navigate Labor Challenges in Distribution

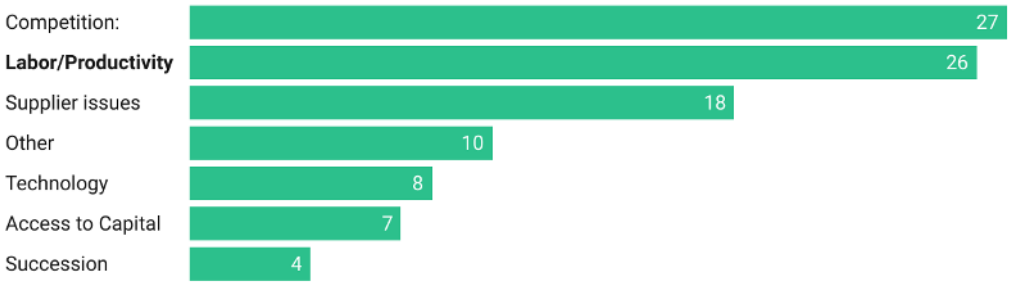
By Vesna Brajkovic

As distributors look to add to their headcount in a challenging labor market, tech experts share three ways automation can help. **Click for web version with original graphics**

Most distributors consider market competition and labor/productivity to be their businesses' biggest risk, outpacing supplier issues, technology and access to capital.

Distributors across the country have mentioned difficulty finding qualified workers, lack of motivation among employees, an aging workforce, a tight labor market and rising wages, among other labor-related challenges, as risks to their businesses, according to a **Baird-MDM Distribution Survey** conducted in early April of this year, which polled more than 500 respondents — distributors as the vast majority.

What do you consider to be the biggest risk or concern for your business regardless of the economic or political climate?



In April 2024, Baird and MDM surveyed 500 people, mostly distributors, about the impact of geopolitical issues on their supply chain operations. Results of this and other questions are featured in the Baird-MDM 1Q24 Distribution Survey, available to MDM Premium subscribers.

Many believe technology will be the answer to the labor challenges for its potential to streamline processes (and make workforces more efficient) and enhance productivity (and retain the current workforce). By creating a culture of digital innovation, distributors may be able to attract higher-quality candidates to their workforces.

Read below three ways companies can navigate labor challenges in distribution.

Streamline Processes to Make the Most of Your Workforce

Some say the fastest way to make your business more efficient without increasing your workforce is through automation.

In a recent MDM Webcast, "**Thriving in Change: How to Navigate Labor Challenges**," the Practice Director of Net at Work's Acumatica enterprise resource planning (ERP) platform, Chris Cleary, detailed how he has seen those efficiency increases firsthand.

In one example, Cleary shared automation implementation allowed a distributor to reduce the number of accounting employees tasked with manually inputting accounts payable bills into the system per week.

"This client had what they called AP Mondays, where two accounting staff members would spend the entire day entering bills that were sent to them from all different branches across the organization," he said during the event. ***"With AP automation in place, they were able to reduce that down to a single person spending two hours reviewing the inputted AP bills."***

By accessing business processes and identifying those with a high level of manual and/or reoccurring steps, Clearly said it becomes clear where automation can make the biggest impact and allow businesses to free up their teams to focus on higher priority tasks.

Most distributors Cleary works with have expressed that they expect to add headcount and grow their business in coming years, and he says the most impactful, least costly hires are ones that complement automation processes.

"We want them to take advantage of these automation processes and the efficiencies that they gained so that as they add headcount, they're doing it in the most efficient manner," Cleary said. ***"They're doing it in the places they need it the most."***

Enhance Productivity to Keep Your Workforce Engaged

While streamlining processes allows distributors to reallocate the workforce away from manual positions, it also allows staff to

© 2024 Modern Distribution Management. All rights reserved. Individual use license only.

be freed up for more fulfilling tasks. Having employees engaged in their work can be the key to a business's success or failure, explains Daniel Edwards, Net at Work's NetSuite Practice Director, during the webcast.

"We're seeing the transformation of positions throughout the organization from being full of these tedious time-consuming manual tasks to more fulfilling tasks that lead to better engagement from your team," Edwards said.

When employees have streamlined processes and efficiencies increase, a workforce can shift to more strategic thinking. Instead of being stuck in daily, monotonous tasks, they have to time and resources to ask questions, look at processes critically and find ways to improve and expand the business, Edwards added.

Create a Culture of Digital Innovation to Attract High-Quality Employees

As distributors look to add to their headcount, Basil Malik, Net at Work's customer relationship management (CRM) Practice Director, said attracting the right talent to complement a digital-focused, innovative company is crucial.

To do so, Malik suggested ensuring your company is represented as having a culture that supports and encourages digital innovation. To create this culture, consider the following three practices.

1. **Implement cloud AI automation technologies in as many aspects of your business as possible.** Malik: *"You want to ensure that you're reaching people who are gradually becoming more and more technology literate, and making sure that they see you as a company that will remain relevant for however long they plan to stay in the workforce."*

2. **Invest in skills development and training that align with positions within your business.** Malik: *"Applicants are looking for continuous education and career advancement opportunities. Providing those to your current workforce creates those internal advocates that you need for your online reputation. … Training and advancement make them more capable of contributing to your organization by promoting them into positions that allow them to leverage these new skills."*

3. **Encourage innovations from all employees.** Malik: *"Your frontline workers are usually the first to recognize opportunities to change but may not always feel like they can question the status quo or go against the grain. Businesses have to look for opportunities to motivate and reward innovation."*

During the webcast, Malik shared a number of mechanisms to deploy this strategy. **View the full conversation for free here**.

The Final Word

The answer to how to navigate labor challenges in distribution? According to this panel of tech experts who aim to help distribution clients make their businesses more efficient, distributors should use automation technology to reduce manual and repetitive tasks to free up their current workforce. As the workforce embraces digital innovation, the key is marketing that culture to attract more quality candidates. In the end, businesses will have streamlined processes, a more efficient workforce and room for growth.

HUMAN RESOURCES IN WHOLESALE DISTRIBUTION

Research: The State of Labor Turnover in Wholesale Distribution

By Mike Hockett

While anecdotal evidence points to industry improvement in hiring and retention, we polled hundreds of distributors about their turnover rate over the past year across leadership/management and frontline roles. **Click for web version with original graphics**

Alongside the economy, labor is perhaps the most evergreen topic of discussion within wholesale distribution. With seemingly endless factors at play, companies in this industry each have their own recipe for attracting the talent they need, and getting it to stay.

Now several years removed from the peak job-hopping seen in the immediate post-pandemic environment as firms in all industries figured out how to offer flexibility to their staff, distributors have had plenty of time to refine their talent strategy.

That doesn't mean everyone is doing well on this front. As MDM's research continues to indicate, the diverse spectrum

© 2024 Modern Distribution Management. All rights reserved. Individual use license only.

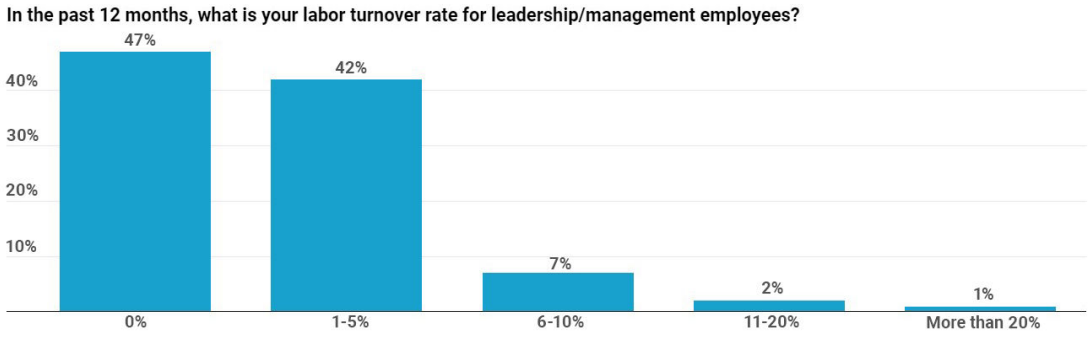
that is wholesale distribution has some distributors "killing it" today while others are still struggling to find and/or retain staff.

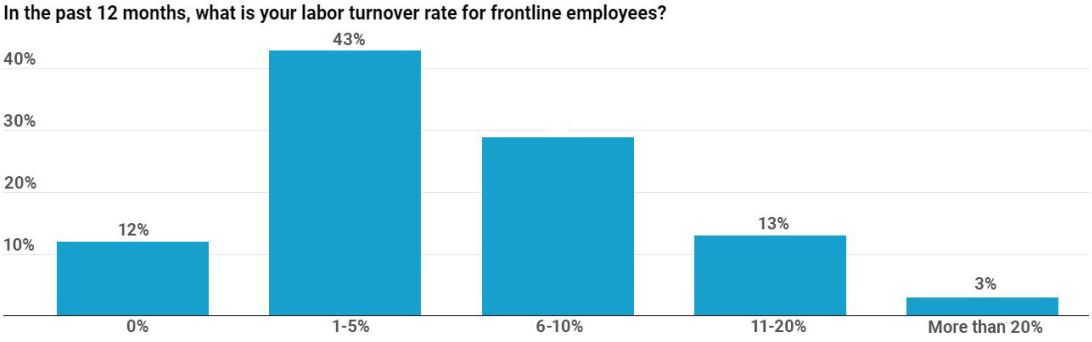
To keep a pulse on this topic, we included a rotating question in the 2Q24 Baird-MDM Distribution Survey to ask its more than 500 respondents about their turnover rate between leadership/management staff and frontline staff. About 60% of respondents represented distribution firms; 76% were U.S.-based. About 58% represented companies with less than $50 million in annual revenue, with the single-largest chunk of respondents — 27% of them — with less than $10 million.

Here's the question we asked our survey respondents:

"In the past 12 months, what is your labor turnover rate for leadership/management employees and frontline employees?"

We asked respondents to indicate in separate polls for each of those staff categories, and here's how the results panned out:





Nearly half of respondents said they've had no turnover at the leadership/management level, with another 42%. That left a combined 11% that have seen between 6-20% turnover for those senior-level employees, with just 3% seeing more than 10% turnover.

In the past 12 months, what is your labor turnover rate for frontline employees?

About one in eight respondents said they've seen no frontline turnover over the past year, while the biggest chunk (43%) have seen 1-5%, with another 29% seeing between 6-10% turnover. It's difficult to pick what turnover percentage would mean a distributor is struggling with turnover — as it's all relative — but those having to constantly replace more than 1 in 10 employees were at 16% of our respondents.

This survey question came nine months after our similar 3Q23 Baird-MDM Distribution Survey question that asked respondents how difficult it was to fill frontline positions compared to a year earlier, **with its results indicating solid progress on that front**.

MDM will look to benchmark these figures a year from now to see the industry's turnover rate continue to evolve.

Economic Context

Anecdotally, most distributors MDM have spoken with during 2Q24 and through July have indicated that hiring has slowly but consistently improved since at least the start of 2023. Part of that could be influenced by U.S. unemployment's rise from 3.4% at the start of 2023 to 4.1% in June of 2024, but more proactively, it could also be the result of the industry improving its hiring and retention strategy in the post-pandemic world.

According to the MDM Forecast, the U.S. wholesale distribution industry ended 2023 with 5.6 million employees — up 2.5% annually after a 4.7% increase in 2022 as distributors recovered from pandemic-driven shocks to the labor pool. At the start of April 2024, the industry's employment stood at 5.65 million — up 1.2% year-to-date.

U.S. Bureau of Labor Statistics data showed that June industry employment was likewise up 1.2% year-over-year and up 0.2% from May. Both growth figures are considerably higher than that of the manufacturing sector, which had a flat 0.03% June increase year-over-year and a 0.06% decline from May.

© 2024 Modern Distribution Management. All rights reserved. Individual use license only.

Meanwhile, BLS data shows that wholesale trade's average annual job opening rate was 4.2% in 2023, a notable decline from 2022's 4.9% and ahead of 2019's 3.5%. Distributors would like to see it return to that 2019 level or lower, which would indicate fewer job openings to fill. The 2023 figure was better than industries of retail trade (4.5%), transportation, warehousing and utilities (6.2%), manufacturing (4.5%), construction (4.6%), mining and logging (4.6%).

Note: BLS' wholesale trade data represents agents and brokers, distributors, manufacturer's sales branches and offices, importers and exporters. Meanwhile, the MDM Forecast data focuses exclusively on distributors.

BUILDING MATERIALS/CONSTRUCTION

New Details Emerge on QXO's Go-to-Market Plans

By Mike Hockett

Through a new report and an interview with someone close to QXO, MDM gleaned insights about which building materials verticals the splash-making distributor is targeting. **Click for web version with original graphics**

It's only been nine months since news broke that QXO was forming as a force in the building materials distribution space, and while it has yet to make its first platform acquisition, the suspense has the new company as a hot talking point in the industry.

Formed by serial entrepreneur Brad Jacobs — the billionaire behind third-party logistics providers XPO Logistics, XPO spinoffs RXO and GXO Logistics, United Rentals and United Waste — QXO **announced its arrival on Dec. 11**, but officially launched this summer.

QXO formerly existed as Silversun Technologies before Jacobs Private Equity and co-investors bought it, rebranded it and gained more than $5 billion in private placement as of late July. With Jacobs as CEO, the organization **filled out its leadership team** predominantly with other former XPO execs for its chief strategy, investment, human resources, communications, transformation, finance and executive vice president positions and a **Barclays veteran as its CFO**.

That seed funding will be used to grow the business via acquisitions, but few insights had been shared about what kinds of companies QXO is targeting — much less which specific building materials markets.

Until now.

A new initial coverage article from equity research firm Oppenheimer shed light on some of the company's go-to-market strategy. These details come on the heels of The Home Depot's $18.5 billion acquisition of specialty building materials distributor SRS Distribution, **which closed in June**.

QXO's 12 Target Verticals

The report, provided to MDM, shared that QXO is eyeing the following 12 specific verticals and that it will likely make one or two acquisitions in them within the next six months:

- Access Control
- Construction Supplies
- Doors & Windows
- Electrical
- HVAC
- Infrastructure
- Lumber
- Plumbing
- Roofing
- Siding & Decking
- Wallboard & Ceiling Tiles
- Waterworks

This means that QXO's acquisition path is set to include more than just what are widely considered to be "building materials" distributors, rather looking at those adjacent categories for any product vertical typically involved with the complete construction of residential or commercial building — with the exception of pools and landscaping.



© 2024 Modern Distribution Management. All rights reserved. Individual use license only.

This go-to-market strategy would enable QXO to serve the cross-transactional customer who is simultaneously shopping across multiple adjacent building supply categories and looking to consolidate their purchase.

Overall, it would position QXO as a one-stop-shop for these complex pro buyers.

And QXO hasn't been coy about its aspirations. Its goal is to become the largest and most shareholder value-created building materials distribution company in the world — and in just the next 10 years.

A person familiar with QXO's plans — who elected to remain anonymous — shared with MDM that the company's leadership team began its market prospecting about a year ago, when it estimated that there are 20,000 building materials supply companies across North America (13,000) and Europe (7,000).

On the company's website, QXO notes the industry has had a 7% compound annual revenue growth over the past five years and a U.S. homebuilding shortfall of about 3 million units that will continue to drive demand. Needed upgrades and maintenance for U.S. public transportation, utility and communication systems, along with reshoring, were also cited as market tailwinds.

"These market dynamics offer a significant opportunity to unlock QXO's growth potential through scale and technology," the company states. ***"National distributors can serve large customers across multiple geographies and project types with standardized efficiencies, providing consistent, data-driven customer services across a broad operating scope."***

QXO's acquisition targets are likely to be of the large variety, with the Oppenheimer report inferring that the company is in discussions with at least a short list of up to a dozen companies as of early August.

The company now has more than $5 billion of private placement now in its war chest, and Oppenheimer noted that QXO could certainly QXO make its first big splash in the form of acquiring one or two distributors that have combined annual revenues of $5 billion to $8 billion.

So it's likely that the companies QXO ends up acquiring are currently on **MDM's 2024 Top Distributors Lists** for the respective verticals noted earlier.

Meanwhile, QXO has been touting its technological capabilities just as much as its goals to gain scale in product verticals. The company's website homepage leads off by stating that QXO plans to become a tech-forward leader in the $800 billion building products distribution industry.

And QXO sees tech as an opportunistic area of improvement for the organization to provide, as the person familiar with the company told us that QXO saw plenty of room for industry technology improvement alongside numerous tailwinds.

"Bigger is Better"

XPO Logistics had a gradual acquisition ramp-up once Jacobs Private Equity became the majority shareholder in 2011 — seven of its first 10 acquisitions represented less than $50 million in annual revenue each before four of the next seven had approximately $600 million or more (three were $1 billion or more).

Conversely, QXO doesn't plan to start slow. The person familiar with the company told MDM that QXO is leaning into the economies of scale in building products distribution and a "bigger is better" mentality, given the bargaining power that large nationals have versus smaller firms when it comes to value-added services, volume strength and order accuracy.

"The job site is crying out for the big players to come in and essentially improve the inner workings of how distribution works, and that's happening in the market," the person shared with us. ***"So you'll end up seeing a very fragmented industry become a consolidated one over the next 10 years, and QXO wants to be part of that journey."***

Industry Reception

So with QXO making its presence and intentions known, what has been the industry's reception to it? While the new platform could be viewed by some as a disruptor, our source said QXO is being viewed by others as an opportunity.

"There's been a warm welcome from both the top and bottom end of the industry by those who want to be part of something that is extremely high-growth, tech-forward, something that's going to be a consolidator in the space and they see Brad's track record," the source explained.

What's Still Uncertain

While all the above provides valuable context as to where QXO's future acquisition investments may land, we'll get a much better picture once the new company announces its first one. What that first acquired company will be is still a guessing game, but at least now we have some relative parameters to expect it to align with. We'll be sure to keep you posted.

© 2024 Modern Distribution Management. All rights reserved. Individual use license only.

ECONOMIC TRENDS

MDM Forecast: August Annual Outlook is Weakest of 2024

By Mike Hockett

Month-to-month, all but two of the U.S. wholesale trade's 19 sectors saw further regression in our August forecast.

Click for web version with original graphics

The latest MDM Forecast saw considerable regression in August from a month earlier, which is unsurprising after numerous key economic indicators and publicly traded distributor commentary suggest continued soft demand conditions in most industrial product verticals.

Our August forecast calls for 2024 U.S. wholesale trade revenues to increase 2.1% annually vs. 2023, down from the 2.8% in July's edition and down 1.2 percentage points from June's. The August update marked the weakest 2024 forecast so far this year.

To start the year, our January forecast called for 3.6% revenue growth in 2024, but industrial economic conditions have relegated since.

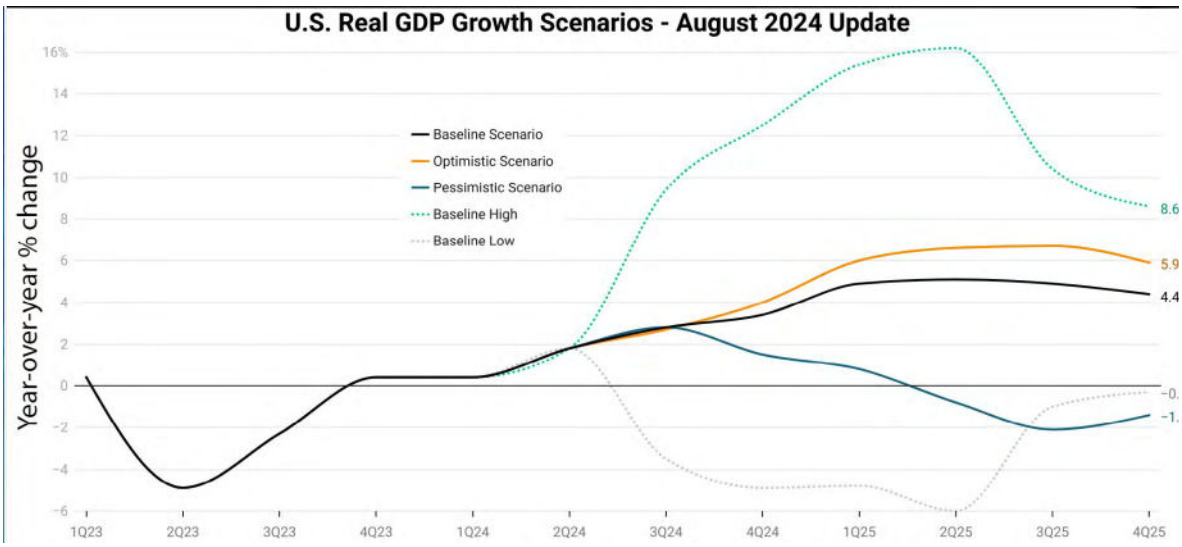
On the bright side, our projection forecasts 2025 revenues to increase 4.8%, up from 4.6% projected a month earlier. MDM's forecast model uses the Bureau's revenue data but strips out the broader inclusions of agents and brokers, manufacturer's sales branches and offices, importers and exporters — focusing exclusively on wholesale distributors.

MDM Forecast - August 2024: U.S. Wholesale Distribution Revenue Expectations by Sector

	2020	2021	2022	2023	2024	2025
Oil and Gas Products	-29.8%	61.8%	38.8%	-11.3%	0.8%	4.4%
Pharmaceutical	6.0%	7.9%	10.3%	12.8%	7.4%	7.4%
Grocery & Foodservice	-1.5%	13.1%	13.3%	1.5%	2.6%	2.9%
Electrical & Electronics	1.1%	18.7%	12.8%	0.1%	7.7%	8.0%
Industrial Supplies	-3.2%	12.1%	17.3%	5.7%	-1.1%	0.8%
Motor Vehicles & Parts	-8.7%	11.0%	13.4%	8.1%	7.0%	8.3%
Miscellaneous Durable Goods	7.9%	31.3%	3.6%	-9.4%	0.5%	2.9%
Other Consumer Products	2.0%	16.0%	14.1%	-5.2%	-2.4%	2.8%
Computer Equipment & Software	1.1%	9.7%	4.8%	-8.3%	2.2%	6.0%
Commercial Equipment & Supplies	-2.9%	13.3%	5.7%	1.5%	5.7%	3.4%
Agricultural Products	2.9%	29.1%	22.3%	-10.1%	-13.2%	1.6%
Metal Service Centers	-19.5%	53.3%	18.4%	-10.5%	-7.6%	4.0%
Building Material & Construction	5.2%	29.6%	13.6%	-13.3%	-3.1%	3.5%
Hardware, Plumbing & Heating Equipment/Supplies	2.6%	18.6%	12.9%	-0.1%	5.3%	3.5%
Beer, Wine & Liquor	7.5%	9.4%	2.3%	-1.7%	1.6%	8.3%
Apparel & Piece Goods	-22.2%	25.0%	6.7%	-9.0%	2.0%	4.4%
Chemicals & Plastics	-8.5%	26.0%	16.4%	-7.3%	-0.5%	3.4%
Furniture & Home Furnishing	-1.4%	15.7%	2.9%	-5.0%	-3.7%	0.5%
Office Product & Paper	-6.8%	9.4%	12.6%	-7.0%	-1.6%	2.9%
Total Wholesale Distribution	**-4.5%**	**20.5%**	**15.1%**	**-1.7%**	**2.1%**	**4.8%**

Source: MDM Research • Created with Datawrapper

© 2024 Modern Distribution Management. All rights reserved. Individual use license only.



See the full one-month changes for all industry verticals in MDM's August Forecast for wholesale trade revenues below:

Our forecast for U.S. wholesale distributors would still outperform the latest real GDP growth scenarios from Moody's Analytics, which forecasts baseline U.S. economic growth of 1.8% and 1.5% in 3Q and 4Q of 2024, respectively, and continued level growth of 1.6% to 1.7% throughout 2025.

See your specific sector wholesale distribution vertical trends and forecasts for 2021-2025 in the table below. Data for the MDM Forecast is compiled by the Business Research Division at the Leeds School of Business of the University of Colorado Boulder.

August's 2024 Month-to-Month Differences

Of the 19 wholesale trade major verticals that the MDM Forecast tracks (like the U.S. Census Bureau), all but two moved more pessimistically month-to-month in August. The industry's largest sector — Oil & Gas — regressed another 2.3 points month-to-month in August after a 1.9-point slide in July, with that vertical now forecasted to have 0.8% growth vs. 2023. The industry's biggest mover in August was Miscellaneous Durable Goods, which fell 2.4 points, while Apparel & Piece Goods slid 2.2%.

The only sector to move more optimistically in August was Electrical & Electronics, which bumped up 0.5%, while Furniture & Home Furnishings was flat.

August's 2025 Month-to-Month Differences

Looking further out, 12 of the 19 sectors likewise trended downward in August. However, Oil & Gas's 2.3-point improvement for 2025 negated its 2024 decline. The next biggest mover for 2025 was Industrial Supplies at -0.9; Office Products at -0.7; and Furniture & Home Furnishing at +0.7.

Wholesale Distribution Vertical (largest to smallest)	2024 Revenue Forecast: August vs. July	2025 Revenue Forecast: August vs. July
Oil & Gas Products	-2.3%	+2.3%
Pharmaceuticals	-0.1%	-0.4%
Grocery & Foodservice	-0.4%	-0.2%
Electrical & Electronics	+0.5%	+0.6%
Industrial Supplies	-1.4%	-0.9%
Motor Vehicles & Parts	-1.4%	-0.1%
Miscellaneous Durable Goods	-2.4%	+0.5%
Other Consumer Products	-0.9%	-0.1%
Computer Equipment & Software	-0.1%	+0.1%
Commercial Equipment & Supplies	-1.0%	-0.4%
Agricultural Products	-0.6%	-0.2%
Metal Service Centers	-1.4%	-1.3%
Building Materials & Construction	-0.2%	-0.5%
Hardware, Plumbing & Heating Equipment/ Supplies	-0.2%	+0.2%
Beer, Wine & Liquor	-1.4%	+0.1%
Apparel & Piece Goods	-2.2%	-0.2%
Chemicals & Plastics	-1.9%	-1.3%
Furniture & Home Furnishing	0.0%	+0.7%
Office Products & Paper	-1.2%	-0.7%
Total Wholesale Distribution	**-0.9%**	**+0.2%**

© 2024 Modern Distribution Management. All rights reserved. Individual use license only.

STRATEGY

How Ferguson has Worked Wonders with "Channel Drifting"

By John Gunderson

The first of this three-part series examines the plumbing, HVAC and industrial supplier's scaled diversification that has put it at or near the top of many of MDM's Top Distributors Lists. **Click for web version with original graphics**

Ferguson is the leader in channel expansion in North American construction and industrial distribution.

The company has steadily grown into one of the largest distributors in North America over the past 20 years. **Now separated from U.K.-based Wolseley plc**, Ferguson's roots were in plumbing, but the company has evolved to become a company with $30 billion in annual revenue that has expanded into multiple industrial supply channels.

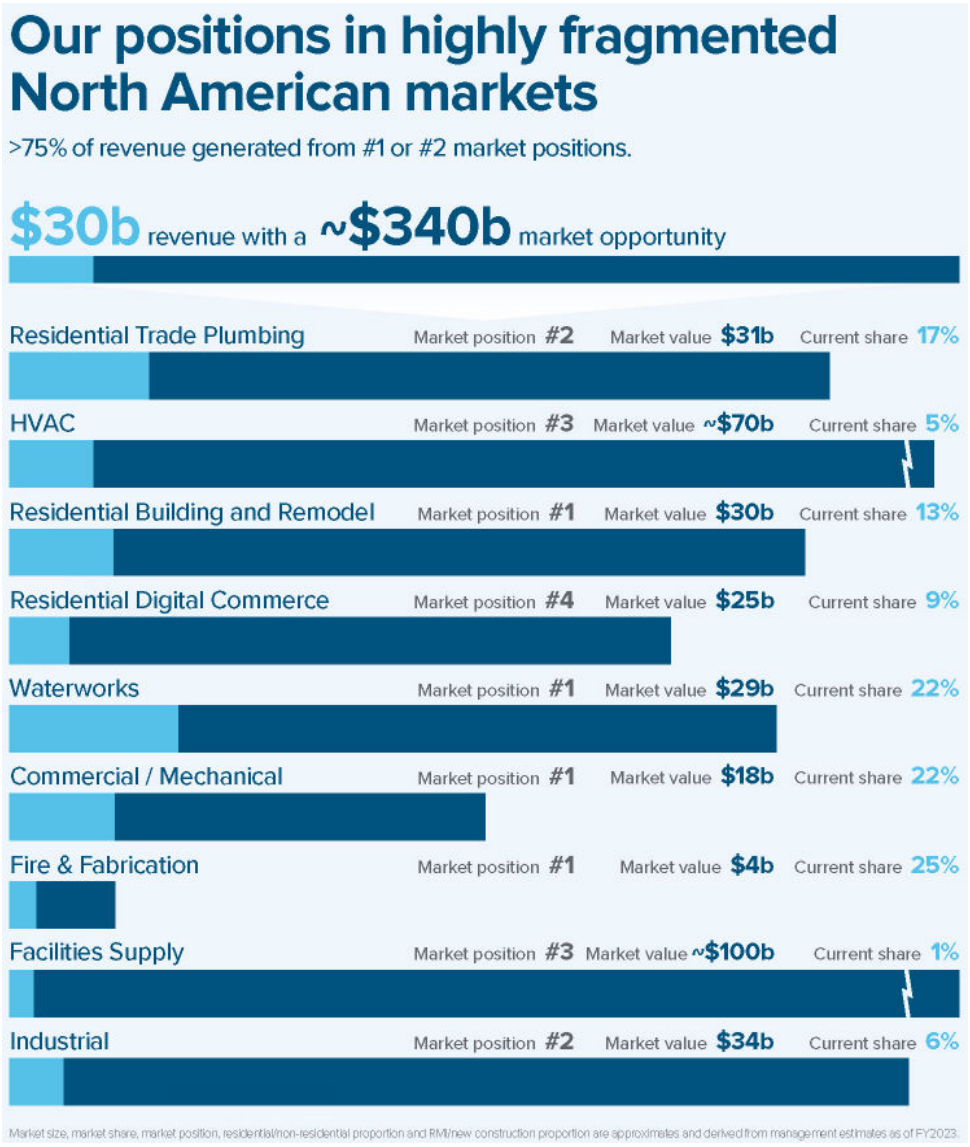
I have been terming this trend of distributors that enter new channels as "channel drifters." To me, a channel drifter is a distributor that started in one distinct channel and was predominantly linked with one industry association such as NAED, ISA, HARDI, ASA, etc. At some point, this distributor entered another channel (usually through acquisition) and this drift was often to a similar, adjacent channel like plumbing is to PVF/waterworks or HVAC.

Ferguson is, in my opinion, the most successful of these "channel drifters" and now is a channel leader in many distinct channels — plumbing, HVACR, residential remodel, waterworks, fire protection, industrial supplies and more.

This is exemplified by **MDM's 2024 Top Distributors Lists**, on which Ferguson appears seven times. Based on its fiscal 2023 revenues within each sector, Ferguson ranked No. 1 on Plumbing; No. 2 on HVACR, No. 2 on Industrial PVF; No. 3 on Industrial Supplies; No. 3 on Building Materials/Construction; No. 9 on JanSan/Packaging/Disposables; and No. 11 on MRO.

I have worked for and with Ferguson veterans and have been an avid observer of the company's continued growth. Ferguson has undergone aggressive expansion both organically and via numerous acquisitions across multiple distribution channels.

If you are in construction and/or industrial supplies distribution, you are probably competing with Ferguson on some level today, and if you are not, there is probably much to learn from how the company approaches its various markets.

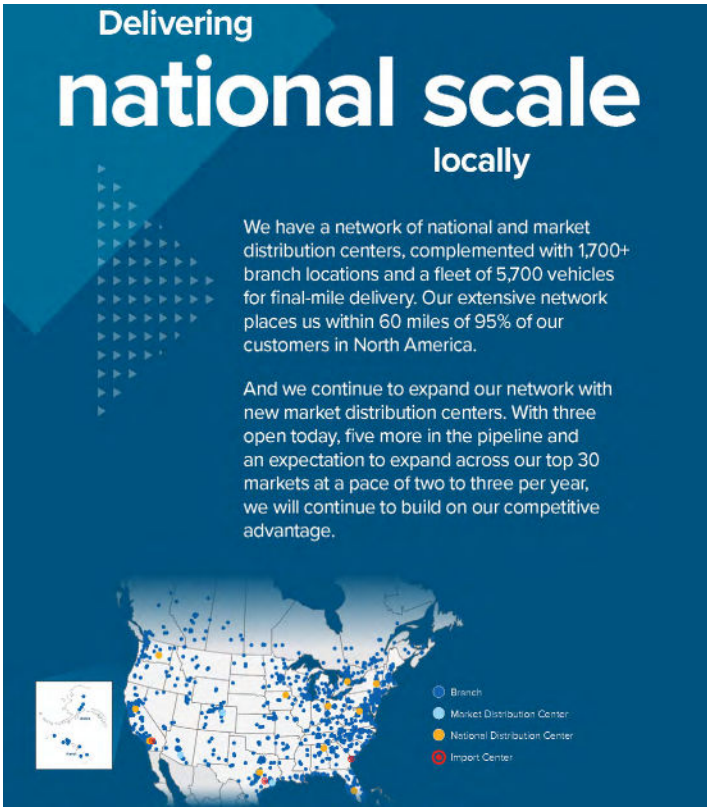


Source: Ferguson 2023 Annual Report

© 2024 Modern Distribution Management. All rights reserved. Individual use license only.

The above graphic from Ferguson's 2023 Annual Report highlights the company's estimated market position and potential by channel. This graphic and market-by-market available data is unique to Ferguson as a publicly-traded North American distributor. Fastenal, Grainger, Wesco, MSC Industrial, ADI and others do not similarly report market share and total addressable market available in each of the different channels they serve. What strikes me is Ferguson's diversification (nine channels) while remaining focused on the customers they serve.

In its fiscal 2023 — which ended July 31, 2023 — Ferguson achieved just shy of $30 billion in annual sales in an estimated $340 billion North American market on the strength of its more than 1,700 branches and 35,000 associates from coast to coast in the United States and Canada. At its core, Ferguson is a branch-based distributor that has material placed close to the end customers and construction projects that rely on its products and services.



Source: Ferguson 2023 Annual Report

As the old distribution mantra says, Ferguson is serving its end customers with an approach that delivers "What you want, where you want it, when you want it, at an agreed-upon price."

This Ferguson graphic shows the company has inventory placed within 60 miles of 95% of its end customers, supported by market and national distribution centers and import centers.

The company's distribution network (branches and DCs) occupied nearly 57 million square feet with $3.9 billion total inventory value as of July 31, 2023. Its fiscal 2023 sales-per-square-foot were roughly $524, and the sales-per-employee-ratio was close to $850,000.

Ferguson is a distributor that excels in serving a customer base largely comprised of contractors. Of course, it also serves end user industrial customers like Fastenal and Grainger do, but most of its business is contractor-based.

Being a contractor-focused distributor requires same-day inventory near where the customer does new construction and remodel work, supported by next-day inventory.

You can't become a $30 billion distributor without excelling at delivery and support while having local and next-day inventory, so Ferguson obviously performs well in those areas.

How is Ferguson's Branch-Based Model Evolving?

The end customers Ferguson serves are evolving and changing, and the company is likewise adjusting to that change.

1. The Residential Market is Evolving

Ferguson estimates that $30 billion of the $100 billion addressable residential trade plumbing and HVAC market is being served by dual-trade plumbing and HVAC professionals.



Source: Ferguson 2023 Annual Report

© 2024 Modern Distribution Management. All rights reserved. Individual use license only.

Ferguson has adjusted to this customer change with its acquisition strategy. Ferguson has made more than 50 acquisitions in the last five years — **including 10 in its fiscal 2024** — and in my opinion, it has strategically chosen acquisitions in part to serve this changing dual-trade contractor. The same trend is also happening in commercial construction.

When you look at many of Ferguson's acquisition announcements over the past two years, this focus on the dual-trade contractor is apparent. Here are two recent announcements that stood out.

"S. G. Torrice is a distributor of HVAC equipment, parts and supplies in the New England region. Founded in 1958, it is headquartered in Wilmington, MA and has 15 locations in Maine, Massachusetts, New Hampshire, Rhode Island and Vermont. With the closing of this previously announced acquisition, Ferguson can further serve dual-trade plumbing and HVAC professionals in the New England region." — **Aug. 2, 2023 news release**

"Airefco, joining Ferguson will support our dual trade strategy for the plumbing and HVAC contractors and will help us accelerate the geographic expansion of our HVAC business in the Pacific Northwest. It will also provide us with a larger multi-brand footprint and an opportunity to expand the Carrier network in the region's growing residential and commercial markets." — Kevin Murphy, Ferguson CEO in **Dec. 2, 2022 news release**.

This Ferguson graphic from its 2022 annual report gives more detail on the company's acquisitions. As noted earlier, the aggressive pace continued throughout its fiscal 2024 Ferguson with another 10 deals closed. If you project out from the above 2022 statistic to today on 15% percent of associates joining through acquisition, it is possible that close to 20% of all Ferguson associates have joined the company as an acquisition.

2. Ferguson Continues to Evolve its Support and Fulfillment of End Customers

It is rare to find a company that shares public data on how it serves and fulfills customers by order type, but Ferguson's 2022 annual report (released Oct. 27, 2022) and a January 2022 investor day presentation shared some information about order fulfillment that I found fascinating.

I find the "How we fulfill orders" stats very interesting. I suspect these numbers may have moved slightly since that presentation.

The order control that Ferguson has is at a high level, with only 16% of orders sent as direct shipments from its suppliers (please note these are order volume stats, not order value/ percentage of sales).

Ferguson has added additional distribution center support to evolve this level of fulfillment. The why behind Ferguson's delivery support evolution is apparent in the graphic. As customers are evolving how they order, how they want to track it and how they need the product delivered, Ferguson is changing its support in lock-step.



3. Ferguson Understands How and Why its Customers Buy from it

In 2022, Ferguson released the following data point:

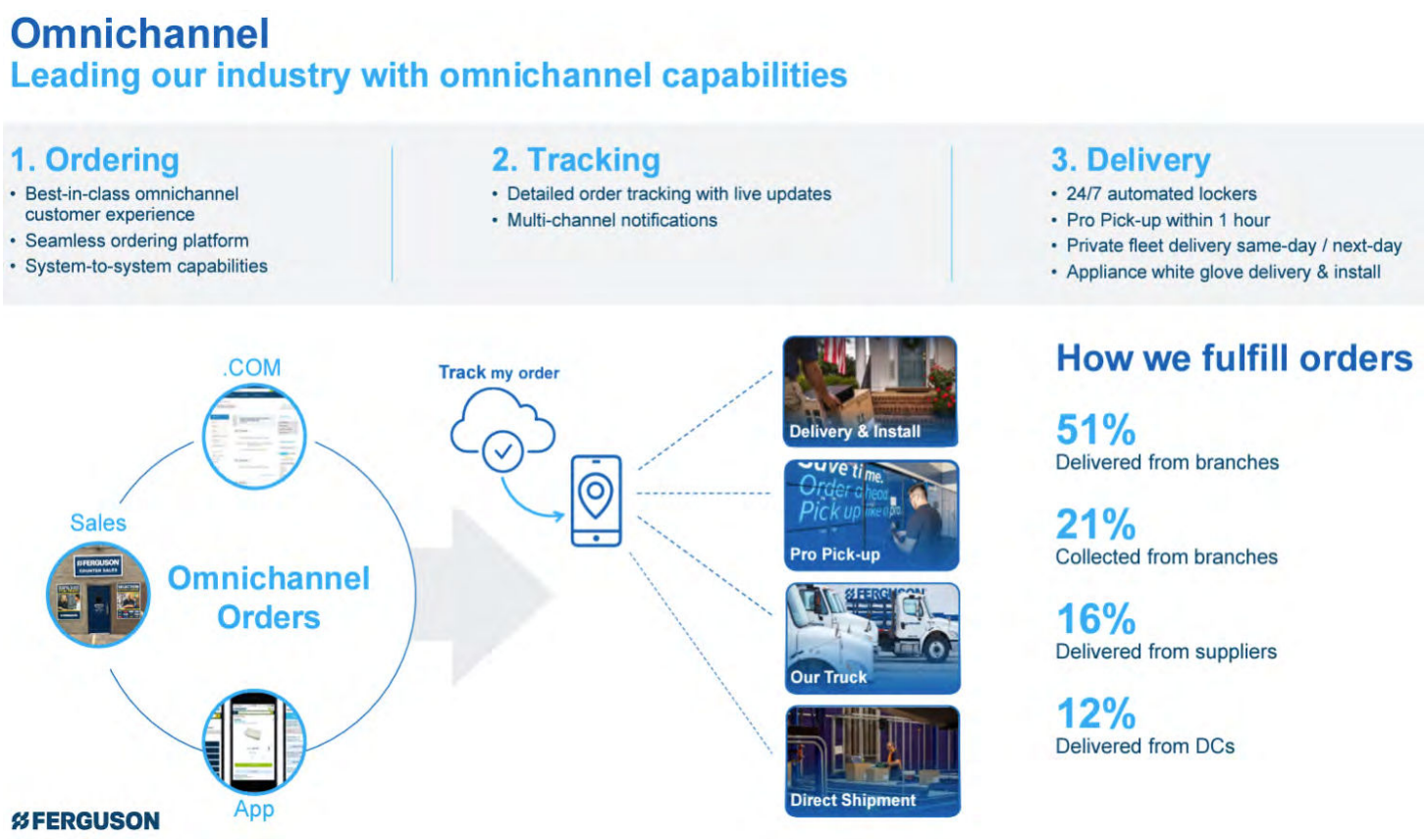
"How customers buy from us" (% of group revenue)

- 68% in branches
- 21% via eCommerce
- 11% in showrooms

In later parts of this series, we will dive deeper into the eCommerce numbers and their impact. What I found interesting about the above

Source: Ferguson 2023 Annual Report

© 2024 Modern Distribution Management. All rights reserved. Individual use license only.



Source: Ferguson 2023 Annual Report

statistics isn't just the level to which Ferguson is tracking how customers buy. While the majority of its orders are branch orders (call-, email-, counter-type orders), eCommerce and showroom orders combined account for nearly one-third of the total.

What this indicates to me is that as eCommerce orders grow — and they likely have since this number has been published based on the buying trends we're seeing elsewhere in the industry — Ferguson will always be close enough to its customers to have the right tools developed to meet their needs.

So, What Can You Take Away from this Part of the Ferguson Story?

Channel drifting can be a very effective approach to growth. Understanding how and why your customers buy and changing your business to meet those needs leads to growth.

In my opinion, the information Ferguson has released shows that it has a deep understanding of data and excellent customer research. Ferguson has nine channels identified and a detailed market share and total addressable market estimates for each of them. The only way to do that work is to have a data focus. It also indicates that Ferguson is surveying and getting feedback from its customers, associates and supplier partners on how to continuously serve end customers better.

The questions of "What tools do our customers need today?"; "What tools will our customers need tomorrow?"; and "How can we develop better tools and support to take share from the competition?" are all likely part of the Ferguson mantra. I imagine those words or some similar version are probably written on a strategy whiteboard at Ferguson's headquarters in Newport News, VA.

Does your strategic messaging reflect the same?

© 2024 Modern Distribution Management. All rights reserved. Individual use license only.

MARKET ANALYSIS

Stubborn Demand Softness Prompts Macroeconomic Context

By Mike Hockett

With demand softness lasting longer than any industrial distributor would prefer, we examine recent executive commentary and numerous economic indicators to make sense of business conditions. **Click for web version with original graphics**

Another quarterly financial reporting period has come and gone, and it wasn't pretty for industrial distributors.

By and large for publicly traded distributors of general industrial, MRO and electrical supplies, results covering April through July reflected continued demand softness that most in the industry expected to flip to accelerated growth by this time of the year. Based on the numbers and commentary provided in July-August's financial statements and earnings calls with analysts, most firms are still seeing sluggish business conditions that have many of them loweirng their full-year revenue forecasts.

This is also supported by commentary in the 2Q24 Baird-MDM Industrial Distribution Survey, of which the results are illustrated in our 2Q24 MarketPulse Report, which Premium subscribers can find on their Premium dashboard and others can find **in the MDM Store**.

Of course, there are always exceptions to any broad-based economic impact assumption.

Despite most economic indicators trending negative in recent months, there are pockets of distribution that have seen healthy gains. **AD member sales during the first half of 2024 increased 7% from a year earlier** to a record $40.4 billion across the industrial and contractor supplies buying group's 14 divisions and three countries. Likewise, distributor members of HVACR association **HARDI saw June sales increase 2.5% year-over-year**, and likely closer to 12% when factoring in two fewer billing days vs. a year earlier.



So, perhaps there's a discrepancy between what smaller, independent distributors are seeing on the demand side compared to their large, national counterparts and competitors.

On the latter, let's examine the top-line sales figures and macroeconomic commentary provided by some of the largest industrial distributors MDM covers:

Grainger

2Q sales growth was 3.1% year-over-year, with daily, organic sales up 5.1%. Gross margin of 39.3% was flat YoY.

- **D.G. Macpherson, Chairman & CEO, on Aug. 1:** ***"What we're seeing is what everybody is seeing. If you look at sort of the general demand environment, it's pretty slow. It's consistent, though. There's not a lot of panic. There are certain industries that have had significant challenges this year — pockets of automotive, pockets of other. I won't get into too many details about those, but certainly, there are pockets of weakness that have been significant and some pockets of strength. And I think that just continues to be the case. I think we came in thinking that volume this year would be flat in our market, roughly something like that, and it's probably going to be down 1(%) now. That's probably the biggest change we have in our projections."***

Wesco

2Q sales were down 4.6% year-over-year, with organic down 0.8%. Gross margin of 21.9% increased 30 basis points YoY.

- **John Engel, Chairman, President and CEO, on Aug. 1:** ***"Our second quarter results were somewhat below our expectations for a low-single digit decline in reported sales, and this was against a continued mixed and multi-speed economic environment. Results improved, however, as we moved through the quarter." "While we remain confident in the long-term growth of our utility and broadband solutions business, we do expect the next economic environment and customer purchasing delays in our UBS business to continue through the second half of 2024."***
- Wesco noted that while it hasn't seen any utility project cancellations, it has seen delays. It attributed those delays to a slowdown in purchases that have extended longer than expected, driven by inflation impacting capital spending and projects stretching out without new ones kicking in.

© 2024 Modern Distribution Management. All rights reserved. Individual use license only.

- Engel will be featured in a Fireside Chat during **MDM's 2024 SHIFT Conference, Sept. 11-13 in Denver**.

Fastenal

2Q sales growth of 1.8% year-over-year (**its weakest since 2Q21**), with gross margin down 30 basis points year-over-year to 45.3%. July daily sales growth fell to 0.5% YoY, **which was the company's weakest such figure in 38 months**.

- **Holden Lewis, CFO, on July 13:** ***"Our ability to gain traction has improved, but the macro environment remains challenging. We are encouraged by our customer acquisition efforts, but I don't have many green shoots at the macro level." "The overall level of activity hasn't changed much, but customers are making cost adjustments due to the prolonged downturn. We don't have a clear view on how the macro environment will evolve, especially with the upcoming elections." "We continue to experience sluggish business activity that has persisted long enough at this point to be spurring an uptick in layoffs and shift reductions. There were more and longer shutdowns around the July fourth holiday. Some of those, frankly, are continuing. And overall industrial production continues to exhibit modest declines as we saw in April and May with the key machinery component being weaker than the overall index. And we're feeling that."***

Applied Industrial Technologies

4Q (April-July) sales were up 0.2% year-over-year, with organic daily sales down 2.0%.

- **Neil Schrimsher, President & CEO, on Aug. 15:** ***"Consistent with broader industrial datapoints in recent months, we saw a greater than expected slowdown in end-market demand as the quarter played out. Similar to last quarter, organic sales declines were greatest within the fluid power operations of our Engineered Solutions segment reflecting ongoing inventory destocking and reduced production across OEM customers. In addition, billing activity within our Service Center segment was more mixed as customers conservatively managed MRO spending within the uncertain business environment. Softer demand conditions have sustained into early fiscal 2025 with organic sales through mid-August trending down by a mid-single digit percent compared to prior-year levels."***
- Schrimsher also noted ***"an ongoing muted demand backdrop."***

That's the Qualitative, What About the Quantitative?

As for economic indicators, the numbers speak for themselves, and they're not positive. Essentially all of the top economic metrics MDM follows and that distributors regularly cite in their financials have trended negatively throughout the summer. Here's a glance at some of the most recent ones:

- **The Conference Board's July 2024 Leading Economic Index** fell by 0.6% from June and fell a total of 2.1% in the six months ending July. The board also expects U.S. real GDP to decelerate from its healthy 2.8% growth in 2Q24 to just 0.6% in 3Q24 and 1.0% in 4Q24.
- **July's manufacturing PMI** hit an eight-month low in July, recording a fourth-straight monthly deceleration to a reading of 46.8% (anything below 50.0% indicates contraction). It's been in contraction territory for 11 of the past 12 months.
- **July U.S. industrial production fell 0.6% month-to-month** on weak automotive output and early month shutdowns due to Hurricane Beryl. However, that followed gains of 0.3% in June and 0.8% in May.
- **July U.S. durable goods orders** fell 6.7% month-to-month
- **June U.S. cutting tool consumption fell 2.9% from May** and was down 4.2% year-over-year
- **June metalworking machinery orders** were up 4% month-to-month, but down 11% year-over-year
- **June U.S. construction spending** continued its unexpected slide in June, down 0.3% from May but up 6.2% year-over-year. It remained hamstrung by a weak housing market as June housing starts were at their fewest since May 2020 during the height of COVID-19.

It's also important to note that the U.S. isn't alone in this industrial softness. China's factory output slowed for a third straight month in July, and Eurozone industrial output likewise fell for a third straight month in June.

Economic Context to Keep in Mind

Amid all of this 'softness' and 'weaker-than-expected' talk, the sky certainly isn't falling in industrial supply by any means. There's a reason why distributors' commentary about 2Q and current business demand doesn't sound overly concerning. There is some important economic context to keep in mind when seeing all of these latest financial figures and executive sentiment.

Yes, flat or modest declines in year-over-year sales are never good for business. But distributors and manufacturers are still facing tough financial comparables against a 2023 that continued to see tailwind benefits from **inflationary pricing that regulated** throughout 2023 and further throughout 2024. Yes, those tailwinds were far less than in 2021-2022, but still a factor. For example, the industrial supplies sector of U.S. wholesale distribution saw a 5.7% annual revenue increase in 2023 — well above its historically low single-digit average.

Overall, U.S. wholesale distribution sales are indeed lower than most anyone would've expected at this point of 2024. Most outlooks at the start of the year — including the MDM Forecast — projected relatively flat revenues through the first six months of 2024 before accelerating through the second half and into an even better 2025.

© 2024 Modern Distribution Management. All rights reserved. Individual use license only.

The latter of that is still expected, evidenced by a **modest August uptick in 2025 expectations from the MDM Forecast**. But the expected acceleration we were "supposed to" be in right now hasn't materialized and continues to push further into 2024.

This past January, the MDM Forecast called for healthy 3.6% annual revenue growth in 2024 for U.S. wholesale distributors, coming off a 1.7% decline in 2023. But that forecast had downsized to 3.3% in June, 2.8% in July and down to 2.1% in July. Still an improvement from 2023 — but trailing expectations from eight months earlier.

If economic indicators like the PMI, construction spending and durable goods orders continue their overall sluggishness in the next couple of months, we could certainly see the MDM Forecast revise further down.

The Final Word

As shown in the commentary above, sentiment shared in financial earnings calls across July-August suggests that the current business 'softness' may keep pushing through at least the end of 3Q24.

In the end, 2024 may end up being a disappointing revenue year for many distributors largely based on what expectations were in January. Yet, outperformers are sprinkled throughout the industry. And while revenue, margin and EBITDA growth are the bottom-line goals for everyone, many firms are undoubtedly finding ways to position themselves to capitalize when demand eventually does rebound — be it through acquisition, technology investment or other business innovation.

TECHNOLOGY

Fastenal Details Rollout of Internal AI Tools

By Mike Hockett

Fastenal launched an AI-upgraded chatbot in June, and is currently building a sourcing tool — both intended to help its staff. Get the details here. **Click for web version with original graphics**

Industrial and construction supplies distributor Fastenal has never shied away from innovation. The obvious example that comes to mind is its ever-growing vending offerings that position the company closer to its industrial and commercial customers — detailed in our **"Fastenal: The Big Pivot that Paid Big Dividends"** MDM Case Study — along with its **FASTPOD** jobsite inventory solutions that rolled out in 2016.

On the technology innovation front, the company is launching AI tools aimed to help its staff serve customers faster and more efficiently.

In Fastenal's second quarter earnings call on July 12, CEO Dan Florness unpromptedly shared details about two AI projects that the company has either just launched or is currently in the process of doing so.

The first is a general information tool that utilizes Fastenal's chatbot, Blue, which it created about five years ago. Blue originally had 130,000 to 140,000 question-and-answer pairs and could only provide answers that were a probability match for one of those pre-programmed answers.

The new version — launched on June 28 — provides well-thought-out answers and tells you the source of the information. Florness said Fastenal employees are using it today, and he recounted his impressions from when he tested it in early June.



"What amazed me — it's scary good what this technology can do," he told analysts on the call after beginning with a congratulations to Fastenal's technology team.

Just don't refer to it as AI to the team or to Florness. He was specific in the call about how he prefers to call it "FI," as in "Fastenal Intelligence" because the source of Blue's data is in-house data.

© 2024 Modern Distribution Management. All rights reserved. Individual use license only.

"It's a really robust system that we decided to go out and build," Florness said. *"It's great information on general supply chain questions."*

That Fastenal Intelligence includes embedding company founder and former CEO Bob Kierlen's 1997 book *"The Power of Fastenal People"* — published in more than 30 languages — into the chatbot.

"So, there's great leadership inside," Florness detailed. *"It's like you're asking Bob a question."*

Next Step: Sourcing Tool

The next "FI" piece that Fastenal is working on is an AI-assisted sourcing tool for its staff to use. Conceptually, Florness detailed that what the company is looking to provide is a way for a staff member to use a digital tool to identify an item that a customer is asking for, and rationalize substitution possibilities depending on how immediate the item is needed. Perhaps the item a customer is seeking isn't available for three days, but Fastenal has three alternative items that could substitute, Florness illustrated.

Set to deploy later in 2024's third quarter, the tool will help staff understand the current supply chain situation for any given item with indications of "This is readily available," or "This is difficult to get."

From there, that staff member can have that supply chain discussion with the customer.

Additionally, the tool can help with understanding the market for that particular item in terms of what its pricing is in the market and what Fastenal can expect a customer to pay for it — especially helpful if it's a product the company hasn't sold before.

It's a tool that's being built and going to roll it out in the third quarter," Florness noted. *"We're excited about it, and we'll see how it goes from there."*

"But it's Fastenal Intelligence, not artificial intelligence," the CEO ended that segment with.



Dan Florness

STRATEGY

Inside Ferguson's Private Brand Strategy

By John Gunderson

The second of this three-part Premium series examines the plumbing, HVAC and industrial supplier's exclusive brands that have been a key market accelerator. **Click for web version with original graphics**

In the first of this three-part MDM Case Study series, we reported on Ferguson's growth strategy in the channels it serves from plumbing to HVACR. The company's growth as one of the most successful "channel drifters" has made it a channel leader across plumbing, HVACR, residential remodel, waterworks, fire safety, industrial and more.

Here in Part 2, we will dive into a key accelerator of the growth in each category — Private Label (White Label) — and preview how this all comes together in the company's digital strategy (build.com and Ferguson digital).

Ferguson's Private Brand Strategy – Ferguson Exclusive Brands

For many distributors, finding public data on private label is difficult because of the sensitivity of the effort. Private label (Ferguson uses the term exclusive brands) can be a key market accelerator, but it also can be a sensitive subject to manage with your manufacturer partners. As a distributor, you must balance your branded manufacturer partnerships carefully to avoid alienating the branded partners that you need with private label effort.

On the distributor teams I was part of earlier in my career, we generally viewed private label opportunities on two scales.

The first is what we called the "technical/specified" scale. If you were considering a private label initiative for a product, the less technical the product, the more likely we might be able to execute a private label strategy. For example, for a large commercial HVAC installation, the very large HVAC equipment on the roof is very technical and specified by an engineer from an established manufacturer brand. It is not a realistic product to have as a private label, but the tools and accessories to install it are not as highly specified and might effectively be excellent exclusive/private label products.

© 2024 Modern Distribution Management. All rights reserved. Individual use license only.

The second scale we used was the classic "good, better, best" product scale. Private label products are usually most effective in distribution at the "good" and "best" quality and price ranges. Of course, this is not a 100% hard and fast rule, but the most successful private label programs in distribution have been very "move the fence programs." In this type of program, it starts with one product set that is sourced/private labeled. If it is successful, the distributor will move the fence and add another product, and so on.

In Ferguson's recent annual reports and an investor day presentation, Ferguson shared data that gives some insight into the company's exclusive brand approach.

From its 2021 Annual Report:

> ***"We have a focused product strategy that includes both branded and own brand offerings, and with over a million products across nine specialist customer groups, our extensive range can meet every customer's need. Own brands, which represent 8.6% of revenue, offer customers high quality, 'on trend' products at competitive prices with excellent availability and industry-leading warranties. For the business, own brands offer higher gross margins. As such, our customers, associates, and the business all do well when we sell own brand products."***

Ferguson, like many distributors, keeps specific information on its expansion plans close to the vest and, as a public firm, it is crucial to do so. One clear thing is that the Ferguson branded product (private/white label) approach is still a key company initiative.

Ferguson's 2023 annual report states in its business risk section: "As we expand our own brand product offerings organically and through acquisitions, we may become subject to increased risks due to our greater role in the design, sourcing, marketing and sale of those products."

During Ferguson's 2022 Investor Day Webcast (Jan. 13, 2022), CEO Kevin Murphy shared that the marketing of these 22 Ferguson brands represented about 9% of the company's total annual revenue. This part of Ferguson's product strategy is used to "give us exclusivity and a better chance to secure the project," Murphy noted.

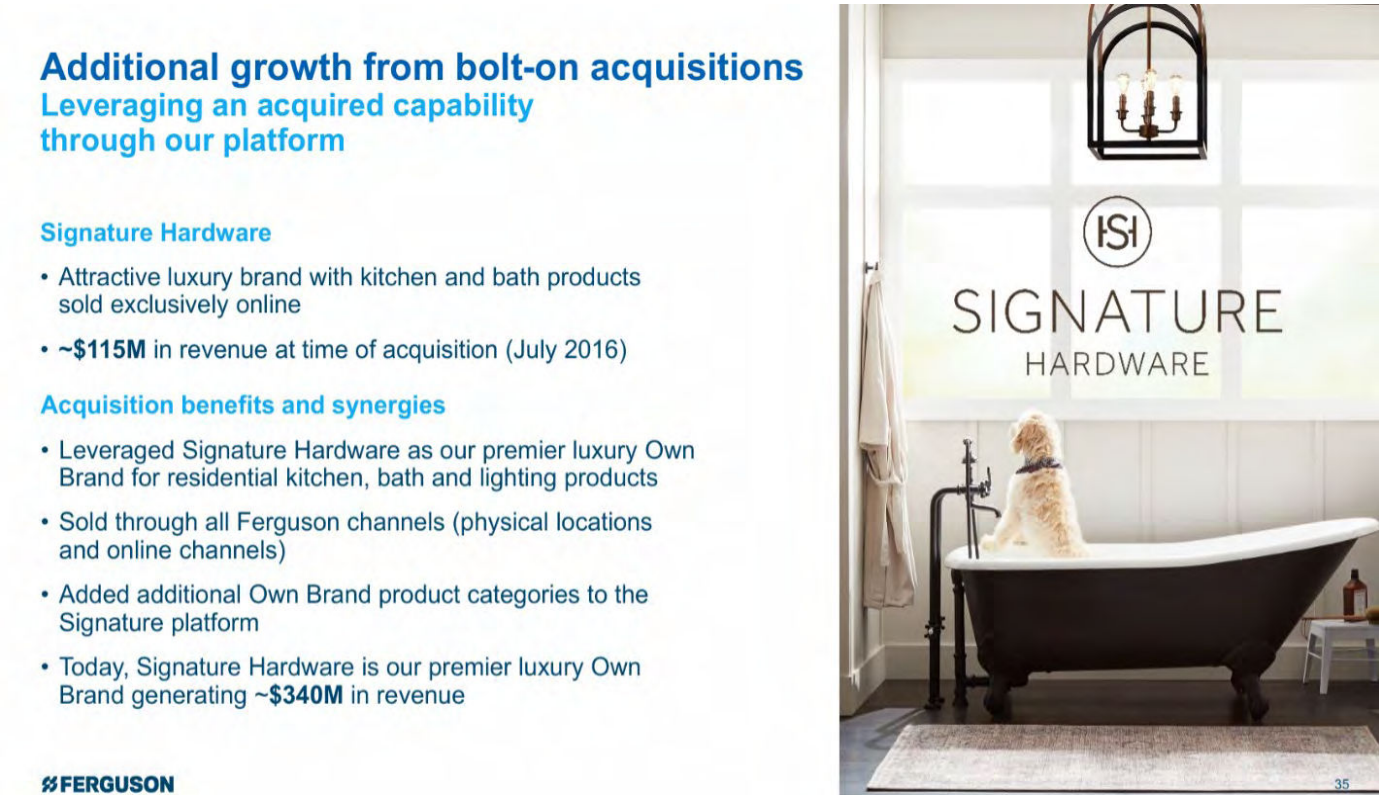
Ferguson currently lists many of its Ferguson Exclusive brands on Ferguson.com, with its **dedicated webpage for that**.

"Shop an expansive offering of brands available exclusively from Ferguson," the website states. "All of our brands are backed by our commitment to world-class customer service."



Credit: Ferguson 2022 Investor Day Presentation — Jan. 13, 2022

© 2024 Modern Distribution Management. All rights reserved. Individual use license only.



Credit: Ferguson 2022 Investor Day Presentation — Jan. 13, 2022

I found the additional slide above from that investor day presentation enlightening as it shows the results of just one of the company's many Ferguson brands. The sales growth of Signature Hardware pre-acquisition from $115 million in 2016 to $340 million in 2020 — nearly 300% in four years — is impressive, and it shows the strength of the Ferguson Exclusive Brands program.

There are risks with this product strategy, but it appears that Ferguson understands and manages those risks effectively. The company continues to share that it is expanding Ferguson brands organically and through acquisition.

The investment and results from Ferguson brands allow the company to "use the margin profile to invest in our specifying capabilities, bringing us closer to stakeholders like end users, engineers, architects, designers, and end users," Murphy said in the presentation.

So, What Can You Learn from Ferguson's Exclusive Brand Approach?

As a manufacturer for every distributor you serve in your channel(s), you need a deep understanding of your product strategy for the categories you offer. Where does your branded product fit in the "good, better, best" category by distributor and category? What exclusive brand risk do you have today and in the future? With annual planning and good account level intelligence, you can be better prepared and make better decisions. If you understand where your channel distributors are today (with their product strategy) you will have a better idea of where they are headed in the future.

From a distributor's view, exclusive brands may or may not be a fit. If they are not feasible due to your size and scale, I believe much can still be learned from the Ferguson model.

If exclusive brands are not feasible for you today, it is crucial that you still have a good (acceptable quality at lower cost) partner where you maximize margin dollars and the appropriate "better" and "best" product manufacturer partners for each category. Often you may only need two partners to cover all three levels (good, better, and best), but it is important that you have a clear strategy.

By becoming more important to fewer partners and having a clear product strategy, it is the foundation to improving your profit pull-through. Ferguson is obviously becoming more important to fewer supplier partners, and by following its playbook, you can do the same.

If you do not have a clear product strategy you will find your team might be pricing higher cost "better" and "best" products at lower good sell price margins to win orders. If that is happening — it happens all the time with many distributors — you will compress margins to maintain sales volume and take less profit to the bottom line.

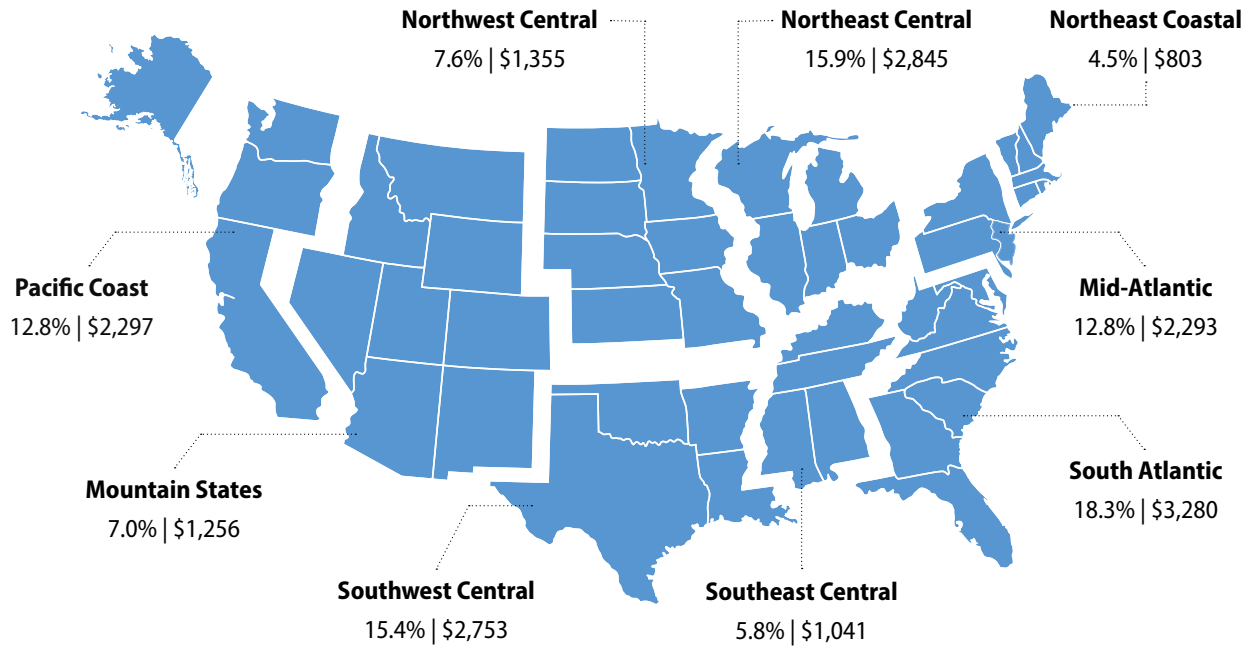
© 2024 Modern Distribution Management. All rights reserved. Individual use license only.

U.S. MARKET PROFILE

Valves - Industrial

The estimated demand for industrial valves in the U.S. in 2024 is $17.9 billion, according to MDM Analytics data. Estimates are end-user demand, in U.S. dollars, including distributor margin.

U.S. END-USER MARKET DEMAND FOR BEARINGS BY REGION, $ MILLIONS (2024 EST.)



mdmanalytics

U.S. END-USER MARKET DEMAND FOR VALVES - INDUSTRIAL: TOP 10 END MARKETS

NAICS	Customer Segment	Estimated Demand	Number of Accounts
238220	Plumbing, Heating, and Air-Conditioning Contractors	$5,728,083,565	195,970
236220	Commercial and Institutional Building Construction	$790,542,774	56,794
325412	Pharmaceutical Preparation Manufacturing	$703,577,507	11,127
211120	Crude Petroleum Extraction	$611,830,966	5,018
322120	Paper Mills	$572,443,737	2,139
325211	Plastics Material and Resin Manufacturing	$551,157,185	3,251
324110	Petroleum Refineries	$440,077,964	1,665
326199	All Other Plastics Product Manufacturing	$388,312,657	10,629
325180	Other Basic Inorganic Chemical Manufacturing	$365,185,885	3,233
325620	Toilet Preparation Manufacturing	$273,829,724	6,220

This market profile and segmentation was compiled by MDM Analytics, Niwot, CO. Learn more about MDM Analytics at **www.mdm.com/analytics**.
Source: **www.mdm.com/mdm-analytics.** © 2024 MDM Analytics. All rights reserved. Permission to reprint/share: **info@mdm.com**

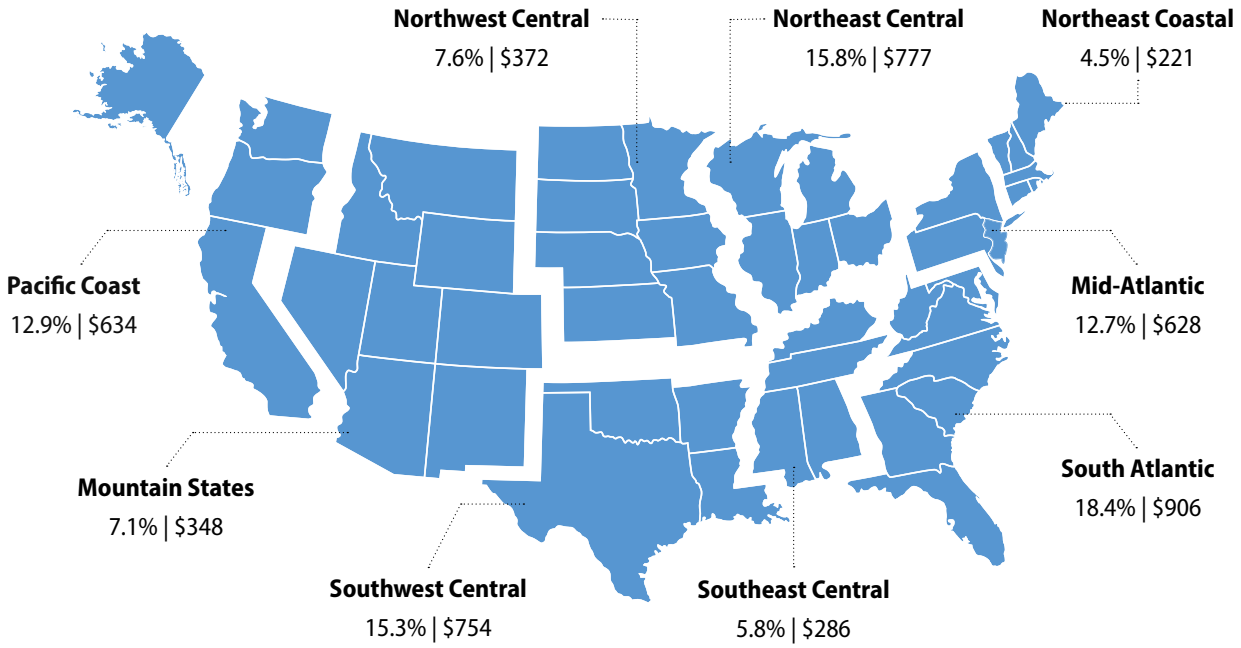
© 2024 Modern Distribution Management. All rights reserved. Individual use license only.

U.S. MARKET PROFILE

Valves - Control

The estimated demand for control valves in the U.S. in 2024 is $4.9 billion, according to MDM Analytics data. Estimates are end-user demand, in U.S. dollars, including distributor margin.

U.S. END-USER MARKET DEMAND FOR BEARINGS BY REGION, $ MILLIONS (2024 EST.)



mdmanalytics

U.S. END-USER MARKET DEMAND FOR VALVES - CONTROL: TOP 10 END MARKETS

NAICS	Customer Segment	Estimated Demand	Number of Accounts
238220	Plumbing, Heating, and Air-Conditioning Contractors	$1,629,367,452	195,970
236220	Commercial and Institutional Building Construction	$224,977,564	56,794
325412	Pharmaceutical Preparation Manufacturing	$188,116,095	11,127
211120	Crude Petroleum Extraction	$163,581,978	5,018
322120	Paper Mills	$153,295,120	2,139
325211	Plastics Material and Resin Manufacturing	$147,367,130	3,251
324110	Petroleum Refineries	$117,591,038	1,665
326199	All Other Plastics Product Manufacturing	$103,856,132	10,629
325180	Other Basic Inorganic Chemical Manufacturing	$97,608,053	3,233
325620	Toilet Preparation Manufacturing	$73,219,739	6,220

This market profile and segmentation was compiled by MDM Analytics, Niwot, CO. Learn more about MDM Analytics at www.mdm.com/analytics.
Source: www.mdm.com/mdm-analytics. © 2024 MDM Analytics. All rights reserved. Permission to reprint/share: info@mdm.com

© 2024 Modern Distribution Management. All rights reserved. Individual use license only.