

The DISC Report

July 2009

- The electrical wholesale industry continues to struggle in the face of a withering economic environment.
- The reality has set in and what we're looking for now is when will it end and how will it end?
- What about the stimulus package? We've factored this into our calculations in developing our industry forecast. The Recovery Act is designed to stop the downturn and accelerate the recovery. It does little to directly increase demand for electrical industry products *at this time*. Not all of the funds will be spent this year. One-third of the funds is tax cuts. One third is relief to states and individuals and one-third is for infrastructure --- highways, bridges, creation of clean energy jobs, etc.
- First, tax cuts do not directly translate into additional industry revenue. Second, nor does relief to states and individuals. Third, infrastructure investment is primarily in the public arena not private. The most important factors increasing demand for electrical products are in the private sector – private construction both residential and nonresidential and business investment in machinery and equipment. So there can't be an industry recovery until the private sector invests in private projects and only then will we see a meaningful increase in industry revenues and on the road to profitable margins.
- An overall economic recovery is realistic by the end of this year but any recovery in the electrical industry is a good 18 months away. Sooner if you mainly serve the distributor industrial market but about 18 months if you serve the distributor contractor market.
- We are a construction driven industry and the forces driving the construction sector are different from those driving the overall economy. Vacancy rates are high and rising. Credit is still very tight. Factory operating rates are falling, and unemployment is still rising. Until these indicators turn don't expect positive growth in office construction and don't expect expansion in shopping malls any time soon.

Sources of Aggregate Demand

- Let's put the influence of the key components of aggregate demand into more perspective.
- The combination of double digit negative growth in both private investment indicators this year will drive electrical industry sales to decrease 31%. The electrical industry depends on the business sector for its strength. When the business sector recovers the electrical industry will recover, even though the overall economy is already in recovery.

Source of Demand in the Overall Economy

Percent Change

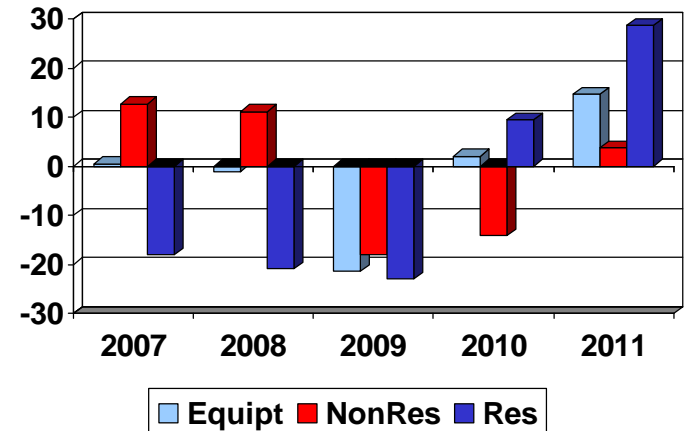
	2007	2008	2009	2010	2011
GDP	2.0	1.1	-2.8	1.5	3.1
Consumer	2.8	0.2	-0.6	1.6	2.0
Private Non Res Investment	5.3	4.0	-19.8	-5.2	10.2
Private Res Investment	-17.9	-20.8	-22.6	9.2	28.3
Federal Gov't	1.6	6.0	4.5	1.3	-3.7

Global Insight

Key Economic Indicators

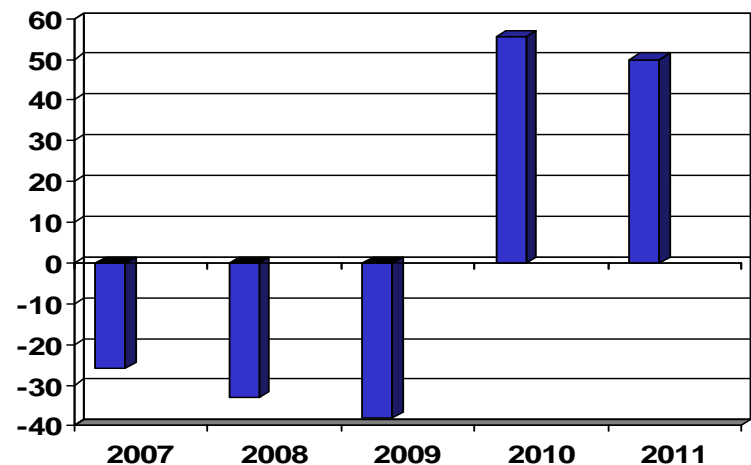
- The mainstay of the industry in 2007-2008 has clearly been non-residential construction. Residential construction led the industry into the downturn and will lead us into the upturn.
- We expect non-residential construction to tank until 2011 mainly because of double digit decreases in commercial construction and other buildings.
- This year there is strength in industrial construction up better than 20%, driven by new plants in bio-fuels and MRO in petrochemicals. Spell that “opportunity”. But next year industrial construction is expected to decline by 30%.
- If there is a leading indicator for distributor served contractor industry sales in this cycle it has to be housing starts. We expect the residential market to expand before the non-residential market so watch housing starts for initial clues.
- Don’t get euphoric over the 50% gain in 2010 because we are only at 865 thousand units compared to 1342 thousand in 2007. The level of activity is important as well as the growth rate.

Key Indicators, % change



Housing Starts
% Change

Global Insight; DISC

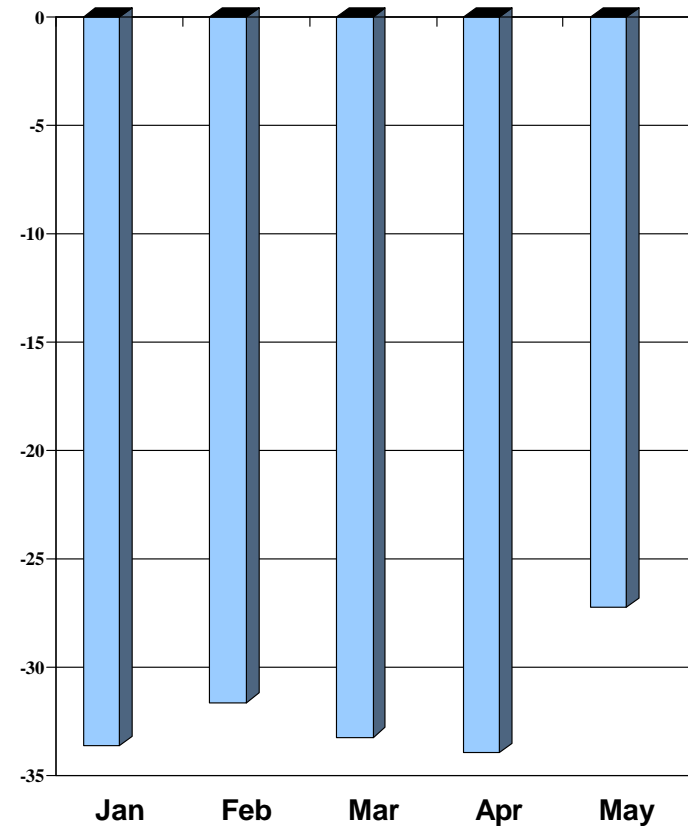


Another Leading Indicator

- Along with housing starts as a leading indicator we track non-defense capital goods new orders as a leading indicator of near term equipment investment plans.
- Investment in equipment is fundamentally important to electrical industry performance especially in the distributor serve industrial market.
- So we look carefully at both of these -- housing starts and new orders for nondefense capital goods -- in tracking industry performance.
- New orders have fallen steadily since early 2008, and for the year overall new orders fell 6.8%.
- This year the decline has accelerated averaging a steep 32% decrease through May.

Non Defense Capital Goods New Orders

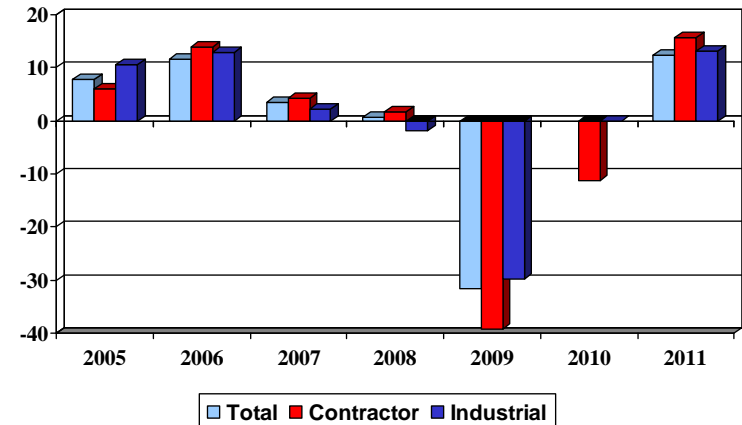
% Change 2009 vs Year Ago



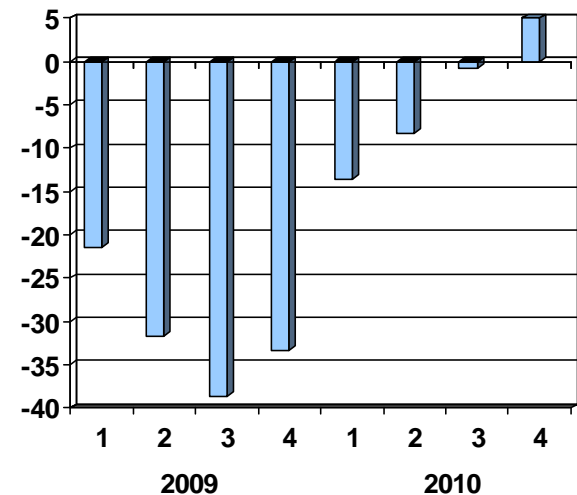
Our View of the industry Cycle

- Where is the overall economy in its business cycle? The larger question is where is the electrical industry in its business cycle?
- The trough for the electrical industry was in 2003 ending the last cycle. A new peak was reached in 2006.
- On our analysis the trough of the current cycle will be the 3rd quarter of 2010 with a modest upturn in the 4th quarter of 2010.
- We expect the distributor served industrial market to bottom out in the 2nd quarter of next year and begin increasing in the 3rd quarter.
- The contractor market will follow a quarter later. The lag is entirely due to weak non-residential construction.

Distributor Sales
% change



Total Distributor Sales Quarterly
% change year ago



The Recovery

- The turnaround in the electrical industry will be in the 4th quarter of next year, depressed by the contractor market. Both residential and non-residential construction are in the doldrums this year.
- If you serve the residential market it is reasonable to expect a turnaround before the overall contractor market turns, optimistically as early as the 2010 second quarter. Non-residential construction weighs too heavily to drive either total contractor sales or total industry sales into the plus column before the end of next year.
- The distributor served industrial market is expected to bottom out in the second quarter of 2010, a full quarter ahead of the overall industry.
- The crucial issue remains: resources still have to be carefully managed. It's a lot easier in the upturn than in the downturn, and we are still in the downturn phase.
- While we focus on growth rates, and double digit negative growth is not easy to ignore, remember that it is the level of sales that is crucially important. It's dollars that pay bills not growth rates.
- We have gone from an industry generating \$74 billion last year to an industry producing just \$50 billion this year. How many people and how much inventory do you need if your revenue is proportionate to industry revenue? Of course, inventories are in a class of their own fraught with lots of difficult issues .
- The implication is that you have to take your resources down significantly in a short period of time and will need to keep them slim because we aren't looking for industry sales to exceed the \$50 billion range before 2012. We won't get back to the \$70 billion level before 2014. That's a long time to keep your head down.