

SLOW TO GROW

The electrical industry is lagging behind the overall economy as a recovery begins to take hold. That's normal, but don't expect to see significant growth until 2013.

What a difference six months make, especially when the recovery has seemingly stalled.

At mid-year 2011 the electrical industry overall was facing better times ahead than at any time during the past four years. Nationally, we closed out 2010 up 2.9%. Historically, that is not very robust coming out of a downturn. For instance, following the 2002 recession the industry in 2003 racked up a nearly 7% growth rate. The strength of that recovery was demonstrated by all four of the major market segments responding with mid-to higher single-digit increases.

However, not unnoticed was that only the distributor-served industrial market showed positive growth last year coming out of the 2009 recession. That growth was a relatively strong 9.5%. One could hope that the industrial market's growth would be contagious and spread to other segments of the industry. But such was not the case. What we had was one segment in positive territory and three segments in negative growth territory.

This year started off strong, led by a surge in the industrial market, which grew around 20% in the first quarter. With continued strength in the distributor-served industrial market, we expect to see reasonably good growth overall through the remainder of this year, but that's where it ends. By this time next year, through the first three quarters of



2012, we will be skimming along at total industry growth just below the zero line. The fourth quarter of next year should raise total industry growth for the year to fractionally above zero.

It's not important to dissect the overall economy to get at what ails this industry. In truth, this industry seems very healthy if only the economy would lend a hand.

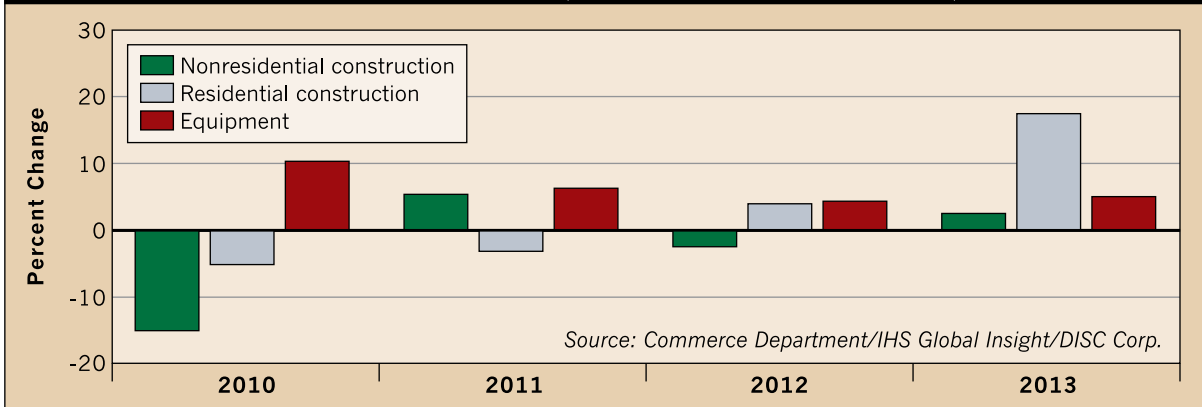
But the overall economy is captive to events that are out of our control. There are two factors that control our destiny in terms of economic health.

First, is the government's handling of monetary and fiscal matters. Not pointing fingers, but the buck always stops with any administration's handling of the economy. Second, there is the question of what the rest of the world is doing, especially Europe, which is in dire straits.

If Europe falls into a recession it will reduce demand for American goods and services and act as a negative influence on overall economic growth. That's not good for electrical industry growth prospects. With domestic growth already weak, the European connection could tip us into a recession.

By Herm Isenstein, President, DISC Corp.

CHART 1: KEY ECONOMIC INDICATORS, 2010-2013 (PERCENT CHANGE, DEFLATED \$)



We'll wait and see what develops as we progress through the end of this year before making any further comments.

KEY ECONOMIC INDICATORS

In the meantime, let's see what our key economic indicators look like so we can talk about our industry prospects for next year. The indicators most important to the electrical industry are broad and the heart and soul of overall business investment. As these indicators go, so goes the electrical industry.

The critical indicator in this mix is nonresidential construction spending which in turn is comprised of a mix of different segments. Nonresidential construction decreased nearly 16% last year but is expected to improve to about 5.5% this year. This is in deflated dollars.

At the same time residential construction expenditures were off about 4.5% last year and are expected to decline another 2% this year.

Rounding out our key indicators is business investment in equipment. This has been the force behind industry performance last year and again this year. Moreover, we expect it to increase faster next year than either of the construction indicators. The take on that is construction is still in the tank while the industrial sector is buoying the industry.

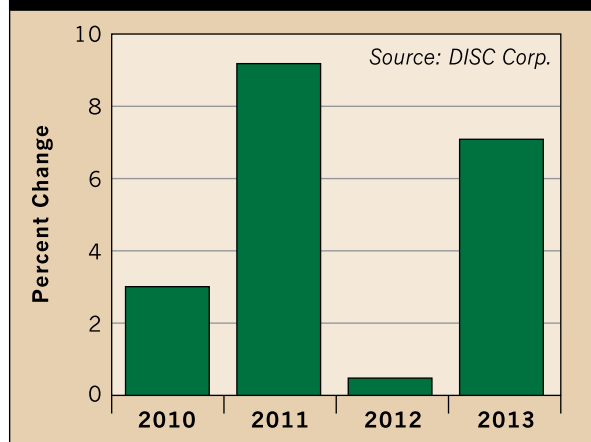
INDUSTRY SALES

If the indicators perform perfectly as shown above, I am very confident that our forecast of industry sales will be very close to the mark.

For 2011, we expect total electrical industry sales to increase about 9% from the year-ago level. But this is not all physical growth, because we had about a 7% price factor to deal with. Absent that, the industry can expect to be up about 2% in real physical volume, so resources could have been added to keep up with real industry growth.

The critical year will be 2012, and that is fraught with uncertainty. Growth is forecasted to be very close to zero. Even given a small windage allowance for a forecast error (plus or minus) we are dangerously close to negative ground.

CHART 2: ELECTRICAL INDUSTRY SALES, 2010-2013 (PERCENT CHANGE YEAR AGO)



The bottom line for the industry next year is that it is unlikely to see any meaningful growth. It will be another year of belt-tightening, especially for businesses serving the contractor market. We are looking to be off by about 1%-2%. At the same time, the distributor-served industrial market comes to the rescue, but it's not much of a rescue, growing only 2%.

For good news we will need to wait until 2013. If there are no more curve balls we could see solid high-single-digit growth in 2013, even as high as 7%. The really great news should come in 2014 and 2015, when our sales forecast is for 15% and 12% respectively. No kidding, that really is our long-term outlook, but that is so far away in terms of where we are now and where we have been that I wouldn't bet the ranch on a long-range forecast at this point.

Stay tuned. We'll keep you posted. ■

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