

Industrial Sector

Inflationary Pressures & Tariffs: Need for More Proactive IR in 2H'18



**INDUSTRIAL
INVESTORS ASKING
FOR GREATER
TRANSPARENCY**

**INVESTORS HAVE
VARIED OPINIONS
ON WHERE WE ARE
IN THE CYCLE**

**PORTFOLIOS HAVE
ALREADY STARTED
SHIFTING**

Industrial Sector IR Perspectives

Wall Street's Perspectives on Inflationary Pressures & Tariffs

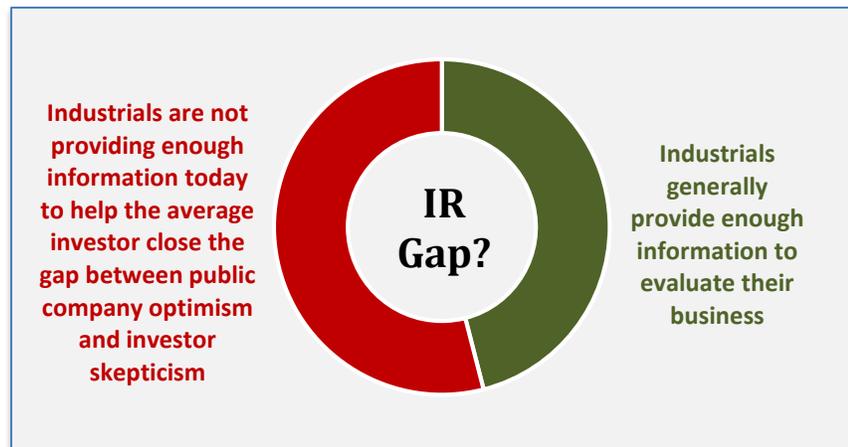
Alpha IR Group is the leading IR consultancy for industrial companies and is currently conducting a sophisticated survey of several hundred buy-side and sell-side participants that invest across the Industrials spectrum. The complete results of this survey will be released in late August, but we have received some important feedback that could impact the upcoming earnings cycle, so we've developed a pre-read for our clients and friends across the Industrial complex.

The initial results we've received imply that near-term communications could have a significant impact on portfolio decisions for asset managers, making this earnings season a fairly critical one for the sector. Investors will be seeking an elevated discussion surrounding recent inflationary pressures, including raw materials, tariff impacts, and pricing and contract structures related to these issues. We have been encouraging our partnership clients to expand their communication surrounding these issues over the last two quarters, as it is clear the Street is concerned and needs more information from companies to be confident in their investments. Many investors believe they are at an inflection point where critical portfolio allocation decisions must be made, deciding where to pare back certain positions given perceived risks in this environment, especially if significant gains have been achieved.

While this survey included several additional core topics, we are providing initial insights into a handful that we believe are most critical to understand ahead of upcoming communications events. We've included some direct quotes from the Street to consider here as you finalize your scripts and Q&A documents this earnings season. We hope you find these perspectives beneficial and as always, our team is happy to offer counsel or discuss this feedback anytime.

“As a PM who’s invested across the Industrial complex, I expect much more transparent IR communications and a more active dialogue with our holdings on these issues throughout fiscal 2018.”

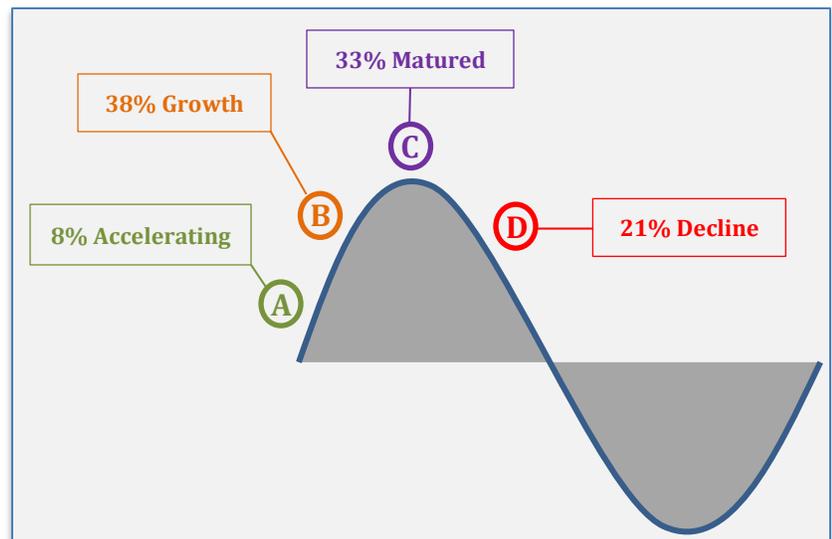
α 54% of the participants we surveyed felt that Industrial companies needed to be more open with their IR communication than they have been during the first half of the year.



“There is a clear reticence across the sector to openly discuss how the tariff and raw material situation might impact the go forward business. We've received a fair amount of information on price adjustments and how long those generally take to gain traction, but I'd like to see Industrials go further and talk us through various scenarios, how their businesses can flex and adjust, and what they're generally hearing across their client base that better supports their 2019 forecasts.”

- Research Director from \$25B Value Firm

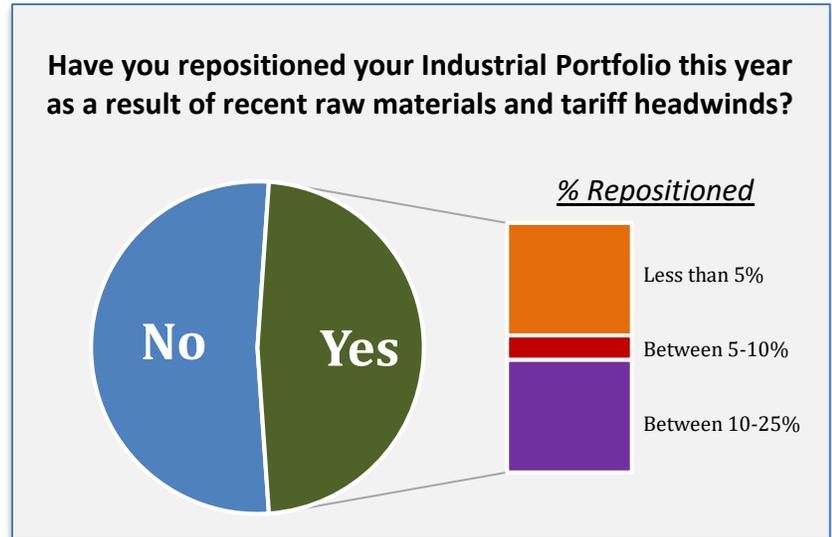
α Investors remain extremely divided in their current view of the industrial business cycle. While 46% see continued growth, 33% believe we've peaked and 21% believe we have already rolled over.



“Industrials still have at least two quarters of growth to go, but inflation is clearly impacting margins and as they raise prices, growth will slow.”

- PM from \$10B Growth Firm

α Almost half of the buy-side has already started to reposition their portfolios based on recent headwinds, and many expect to see significant shifts occur as fiscal 2018 unwinds.



Alpha Perspective: Now is the time to think much more strategically and proactively about your IR program, targeting new investors who can fill the coming void left by position reductions.

Direct Advice from the Street:

- α “In particular in this coming quarter, we need to know how much they paid in tariffs in the past versus their expectations for the coming years if current policy holds. You can’t leave investors without direction, or they will generally err on the side of caution.”
- α “Trade wars and tariffs could bring positive inflation for many companies, but we’re concerned about when there is too much inflation and/or how fast is too fast? I often ask Industrial management teams if there is a ceiling on the amount of cost inflation that you can push through at any given time.”
- α “If all the talked-about tariffs do indeed go into effect, does product sourcing become an issue and thus will your procurement strategy have to change? We’d like to hear a lot more discussion around product sourcing this period.”

- α “We’d like more clarity on how company contracts allow for switching and what the incremental switching costs would be. Additionally, how could this potentially change the behavior of your customers in terms of how customers choose to operate their business as well as the bigger picture impacts on end-market cycles and the demand for different products.”
- α “Our team wants to hear if companies have already felt the impact of these items yet, and if so where? If not, when do they expect the impact of these tariffs to take hold and what order of magnitude impact they're expecting.”
- α “We need a more consistent discussion around how the competitive landscape is changing in relation to all these cost pressures.”
- α “It seems clear that many companies that are directly impacted by these tariffs need to outline what percentage of their COGS will be potentially impacted. Additionally, we’d like to hear some cautious commentary around how their outlook could shift if and when tariffs are fully introduced.”
- α “My advice to Industrial IR departments today is, ‘set a strategy, tell investors how you will get there, and set tangible, measurable metrics that investors can hold you accountable to delivering.’ Additionally, align compensation to those metrics, including both quality earnings-per-share metrics and ROIC as those are what drive value for me as an investor.”
- α “One immediate piece of advice I have is please do not hedge raw materials. These companies should add surcharges as key commodities fluctuate and tell us how they’re going to continue to move margin risk to customers.”
- α “Beyond the impact of volatile raw materials and tariff-related headwinds, we want to know how companies plan to shift their priorities related to tax policy and capital deployment over the next few quarters.”

Conclusion:

Alpha IR generally advises our partnership clients to refrain from speaking or speculating around the outcomes of politically-charged issues in the marketplace. However, our initial research suggests that the investment community is not focused on the political aspects of the current issues in Washington. Rather, they are focused on the current and future economic ramifications on the industries they follow and the companies they own. Hence, we recommend that Industrials speak clearly and succinctly about how they are planning for and modeling potential impacts related to tariffs, inflation, supply chain disruptions, taxes, and other economic issues.

Over the past two decades, Alpha IR has advised hundreds of industrial companies on investor communications. We are happy to provide additional color on this study and would be willing to offer a free few hours consultation around this type of communication over the next few months. Please reach out directly to info@alpha-ir.com or call 312-445-2870 if you'd like to connect.



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Alpha IR Group

About Alpha IR Group:

Alpha IR Group is a full-service investor relations consulting firm that partners with companies to deliver best-in-class investor relations, from strategic insights to daily, tactical execution. Alpha IR offers a range of tailored programs, as well as sophisticated insights and significant experience with activist preparedness, investor day preparation and execution, earnings support, M&A/transaction support, perception studies, and more. The firm's leaders have over 100 years of combined sell-side, buy-side, investment banking, and IR consulting experience. Alpha's growing staff supports a client base that spans seven industry verticals and represents over \$100 billion of equity value trading on public exchanges in North America.



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