

Interconnect, Passives & Electromechanical Component Insights – August 2023

Important Disclosures in the Appendix

2H23 and 2024 Outlook Muted, Inventory Digestion/Bookings Recovery Timeline Continues to Stretch

Note: This is not the full Insights report, if you are interested in receiving the full report, please reach out to schedule a call to discuss the requirements

Key Takeaways:

1. 3Q shipments seen tracking in-line, flat Q/Q with POP weakness in distribution offset by more stable demand direct.
2. The timeline for inventory digestions seen as stretching into 1H24, in turn pushing out expectations for bookings rebound.
3. 2H outlook relatively unchanged and at best projecting flattish sales. Early 2024 sales projections also muted on inventory overhang.

Top 4 Channel Comments:

- *The challenge is when the slowdown started, the industry thought it was all due to inventory – now most demand tailwinds have flipped to headwinds and inventory actually looks worse.*
- *Recovery timeline keeps moving out every time we talk with suppliers. Currently orders are not expected to rebound before 1Q, which means shipments not really rebounding before 2Q24.*
- *It is hard for us as a supplier to even think that next year will be great. Yes, we will see some growth, but we expect to be much more muted in the single digit range. There is just too much inventory out in the supply chain.*
- *There is simply too much inventory in the market. At the peak a few months ago, we estimated there was close to 100% more inventory than needed in the marketplace. That makes it a minimum of 6-8 quarters of burn.*

Other Key Takeaways:

4. Inventory in distribution seen as having peaked in 2Q; distributors noted as increasingly focused on rebalancing going forward. End customer inventory is viewed as still progressing slower than expected. Overall digestion is projected to last into 1Q24 as inventory headwinds are seen as compounded by soft end demand.
5. China/APAC still seen as relatively weakest; supply chain less optimistic China sees meaningful rebound in 2023.
6. EMEA demand is seen as seasonally soft QTD; supply chain concerned of weakness in semis spilling over to connectors in the region.
7. Americas seen as more stable at flat Q/Q with weakness in distribution POP but still stable demand direct and strength in Mil/Aero.
8. Auto feedback still mixed (unchanged M/M) with soft China/Asia, mixed EMEA and still healthy N.A. demand.
9. Suppliers noted as preparing for an impact from UAW strike, which is seen as increasingly likely. UAW demands seen as adding considerable cost to OEM supply chains, likely to put incremental pressure on 2024 connector/component pricing negotiations.
10. Industrial (ex-Energy/Medical) demand is still seen as weak, projected down in 2H on increasing inventory digestion in distribution.
11. IT datacom demand seen as stable Q/Q with softness in traditional infrastructure offset by upside in AI. Digestion in traditional infrastructure is seen as lasting longer into 1Q24. AI ramp up is seen as driving some sales improvement Q/Q in 4Q.
12. CE/Mobile noted as seeing improving inventory levels, but shipments outlook remains muted on continued end demand weakness.
13. PC experiencing minor improvement, well below seasonal orders in 3Q; true order unit rebound not expected until mid/late 2024.

Conclusion:

IP&E fundamentals remain challenged and the timeline for recovery continues to extend, with the supply chain now broadly calling for 1H24 vs. 4Q23 30-60 days ago. A lack of recovery in China remains a drag on fundamentals along with concerns of a muted recovery exiting the seasonally slower months of July and August in EMEA, while the Americas remains stable but down. We have seen limited changes from an end market standpoint; however, the supply chain is growing increasingly concerned about the impacts from the potential UAW strike in September, which we continue to monitor closely. We remain cautious about industry fundamentals through the balance of the year and into early 2024 and continue to believe the recovery from the inventory digestion is likely to take longer and be more muted throughout 2024.

Kevin Rottinghaus

Sr. Research Analyst – Partner
Kevin@EdgewaterRC.com
216.426.6272

Sean Muir

Sr. Research Analyst – Partner
Sean@EdgewaterRC.com
216.426.6277

Dennis Reed

Sr. Research Analyst
Dennis@EdgewaterRC.com
216.426.6279

Nik Todorov

Sr. Research Analyst
Todorov@EdgewaterRC.com
216.206.6103

APPENDIX

We, Kevin Rottinghaus, Sean Muir, Dennis Reed, and Nik Todorov hereby certify that the views expressed in this research report accurately reflect our personal views about any or all of the subject securities referred to in this research report. We certify that no part of our compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this research report. The analyst(s) responsible for the preparation of this report have no ownership stake in this company. Edgewater Research Company provides no investment banking services on this or any company.

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Kevin Rottinghaus

Sr. Research Analyst – Partner

Kevin@EdgewaterRC.com

216.426.6272

Sean Muir

Sr. Research Analyst – Partner

Sean@EdgewaterRC.com

216.426.6277

Dennis Reed

Sr. Research Analyst

Dennis@EdgewaterRC.com

216.426.6279

Nik Todorov

Sr. Research Analyst

Todorov@EdgewaterRC.com

216.206.6103

