Patrick Industries, Inc. (PATK)
Beats Previously Lowered Expectations as Pandemic Hits End Markets

Raising estimate on lower costs. Patrick beat our previously lowered estimates and set a course to manage through the pandemic. With good liquidity, a highly variable cost structure, and fixed cost reductions, Patrick is well positioned to emerge from the crisis as a strong consolidator serving several attractive end markets. We maintain a cautious RV and marine outlook as demand falls and dealers limit orders but raised our estimates on better results and incremental cost cuts.

- **Results and estimates.** Patrick reported upside to adjusted EPS expectations ($0.91 vs $0.71) fueled by modest revenue upside ($589 million vs. $584 million) and expense control. In response to the outbreak, management identified $35 million in fixed cost reductions and suspended share repurchases and acquisition activities (although two deals closed late Q1). After lowering our estimates in March to account for the pandemic, we raised our estimates slightly based on Q1 upside and incremental cost savings.

- **Recent trends.** Prior to the outbreak, trends in key Patrick end markets were strong. RV retail was tracking up LSD-MSD% through February and boat demand appeared healthy (up HSD%). But as the outbreak forced buyers to stay home, retail fell sharply in March and April. “We estimate RV and Marine retail units down approximately 50% to 60% in the month of April,” Mr. Nemeth said. The manufactured housing segment held up better, but the pace slowed.

- **RV and marine outlook.** Management expects RV shipments to decline 20-25%, implying 305,000-325,000 units. Our RV industry model is based on 325,000 shipments, which assumes retail drops 23% to 350,000 units while dealers reduce inventory by approximately 25,000 units. In the marine market, we assume 150,000-160,000 boats, down from over 200,000 last year.

- **Liquidity.** Patrick has ample liquidity and a variable cost structure built to withstand a downturn. Exiting the quarter, the company had over $500 million in available liquidity with net leverage well below the 4.0x maximum dictated by covenants (2.3x). Once the crisis fades, the company could look to deploy capital accretively, but for now the focus in on managing through the downturn.

- **Outlook.** We anticipate further volatility as the market reacts to coronavirus headlines. Beyond this summer, we are concerned with the direction of the American economy. From the outset of the pandemic, our options were limited until we flattened the curve. But along the way, we have all become central planners, collectively deciding when to reopen the economy, which businesses deserve subsidies, and whose job is essential. To the extent our prosperity is the result of free markets, this shift could damage the wealth upon which discretionary spending relies. With good liquidity and a variable cost structure, Patrick is positioned to withstand a prolonged downturn – and capture upside to the extent post-recession demand surges.
**April 30, 2020 | Patrick Industries, Inc.**

### Estimates

**Estimates.** We raised our 2020 EPS estimate to $1.85 (from $1.50) and raised our 2021 EPS to $2.70 from $2.50.

<table>
<thead>
<tr>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>RV Revenue</td>
<td>$878,600</td>
<td>$1,126,200</td>
<td>$1,434,300</td>
<td>$1,287,200</td>
<td>$1,025,100</td>
<td>$1,120,500</td>
</tr>
<tr>
<td>Growth</td>
<td>27.1%</td>
<td>28.2%</td>
<td>27.4%</td>
<td>-10.3%</td>
<td>-20.4%</td>
<td>9.3%</td>
</tr>
<tr>
<td>RV Industry Shipments</td>
<td>426,500</td>
<td>504,600</td>
<td>483,700</td>
<td>406,000</td>
<td>325,000</td>
<td>350,000</td>
</tr>
<tr>
<td>Growth</td>
<td>14%</td>
<td>18%</td>
<td>-4%</td>
<td>-16%</td>
<td>-20%</td>
<td>8%</td>
</tr>
<tr>
<td>Content per RV (LTM)</td>
<td>$2,039</td>
<td>$2,234</td>
<td>$2,965</td>
<td>$3,171</td>
<td>$3,154</td>
<td>$3,201</td>
</tr>
<tr>
<td>Growth</td>
<td>11%</td>
<td>10%</td>
<td>33%</td>
<td>7%</td>
<td>-1%</td>
<td>1%</td>
</tr>
<tr>
<td>MH Revenue</td>
<td>$162,100</td>
<td>$209,700</td>
<td>$274,700</td>
<td>$436,800</td>
<td>$360,900</td>
<td>$395,900</td>
</tr>
<tr>
<td>Growth</td>
<td>26%</td>
<td>29%</td>
<td>31%</td>
<td>59%</td>
<td>-17%</td>
<td>10%</td>
</tr>
<tr>
<td>MH Industry Shipments</td>
<td>81,200</td>
<td>92,800</td>
<td>96,600</td>
<td>94,600</td>
<td>75,907</td>
<td>80,447</td>
</tr>
<tr>
<td>Growth</td>
<td>15%</td>
<td>14%</td>
<td>4%</td>
<td>-2%</td>
<td>-20%</td>
<td>6%</td>
</tr>
<tr>
<td>Content per MH (LTM)</td>
<td>$1,966</td>
<td>$2,289</td>
<td>$2,849</td>
<td>$4,616</td>
<td>$4,754</td>
<td>$4,921</td>
</tr>
<tr>
<td>Growth</td>
<td>8%</td>
<td>16%</td>
<td>24%</td>
<td>62%</td>
<td>3%</td>
<td>3%</td>
</tr>
<tr>
<td>Other Revenue</td>
<td>$146,000</td>
<td>$188,300</td>
<td>$280,000</td>
<td>$284,600</td>
<td>$276,200</td>
<td>$294,700</td>
</tr>
<tr>
<td>Growth</td>
<td>46%</td>
<td>29%</td>
<td>49%</td>
<td>2%</td>
<td>-3%</td>
<td>7%</td>
</tr>
</tbody>
</table>

**Total Revenue** | $1,221,887 | $1,635,653 | $2,263,061 | $2,337,082 | $1,928,055 | $2,097,909 |
| Growth         | 32.8%     | 33.9%     | 38.4%     | 3.3%      | -17.5%    | 8.8%      |
| Est. Organic Growth | 9%       | 20%       | 10%       | -10%      | -19%      | 9%        |
| Total Gross Profit | $202,469 | $278,915  | $415,866  | $422,871  | $338,478  | $375,571  |
| Gross Margin    | 16.6%     | 17.1%     | 18.4%     | 18.1%     | 17.6%     | 17.9%     |
| YOY change      | 2 bp      | 48 bp     | 132 bp    | -28 bp    | -54 bp    | 35 bp     |
| Operating Income| $90,837   | $121,900  | $178,415  | $154,442  | $99,271   | $123,849  |
| Operating Margin| 7.4%      | 7.5%      | 7.9%      | 6.6%      | 5.1%      | 5.9%      |
| YOY change      | -16 bp    | 2 bp      | 43 bp     | -128 bp   | -146 bp   | 75 bp     |
| Net Income      | $55,577   | $78,438   | $119,832  | $89,566   | $42,863   | $63,037   |
| Earnings Per Share | $2.43    | $3.19     | $4.93     | $3.85     | $1.85     | $2.70     |
| Growth         | 33.7%     | 31.3%     | 54.6%     | -21.9%    | -51.9%    | 46.0%     |
| EBITDA Margin   | 9.4%      | 9.5%      | 10.3%     | 9.3%      | 8.4%      | 8.9%      |
| YOY change      | 1 bp      | 7 bp      | 81 bp     | -102 bp   | -94 bp    | 56 bp     |

Interest Expense | $7,185    | $8,790    | $26,436   | $36,616   | $41,192   | $39,800   |
Tax Rate         | 33.6%     | 25.9%     | 21.2%     | 24.0%     | 26.2%     | 25.0%     |
Diluted Share Count | 22,893   | 24,613    | 24,320    | 23,280    | 23,183    | 23,358    |

Source: Company data, Baird research
Management Outlook

**Outlook.** Management does not provide formal revenue, EBITDA, or EPS guidance. However, management has offered commentary on other select metrics, including outlooks for its end markets. Outlook details are provided below:

- RV and Marine retail units down 50-60% for month of April
- Anticipating RV and Marine wholesale shipments down 40-50% in Q2
- 2020 RV wholesale shipments down 20-25%
- 2020 Marine wholesale shipments down 25-30%
- Anticipating manufactured housing wholesale shipments down 20-30% in Q2
- Anticipating new housing starts down 20-30% in Q2
- 2020 manufactured housing wholesale shipments down 15-20%
- 2020 new housing starts down 15-20%
- Expect effective tax rate of 26-27%

**End market trends.** Management also included the following graphic in its investor presentation, summarizing current trends for each of its end markets.

<table>
<thead>
<tr>
<th>Wholesale Shipment</th>
<th>RV</th>
<th>Marine*</th>
<th>MH*</th>
<th>Industrial (housing starts)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jan-Feb: +13%</td>
<td>Jan-Feb: (18-20%)</td>
<td>Jan-Feb: +15%</td>
<td>Jan-Feb: +34%</td>
<td></td>
</tr>
<tr>
<td>Q1: Flat</td>
<td>Q1: (18-20%)</td>
<td>Q1: +8%</td>
<td>Q1: +22%</td>
<td></td>
</tr>
<tr>
<td>Retail Shipments**</td>
<td>Jan-Feb: +43-5%</td>
<td>Jan-Feb: +9%</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Q1: +1-3%</td>
<td>Q1: (5%)</td>
<td>-</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Industry Trends</td>
<td>-</td>
<td>Inventory levels expected to be calibrated for 2021 model year</td>
<td>-</td>
<td>Tight inventories, low interest rates and growing population of 35-44 year olds</td>
</tr>
<tr>
<td>COVID-19 Future Impact</td>
<td>-</td>
<td>Strong traffic at recent RV retail shows</td>
<td>-</td>
<td>Increased demand at big box retail as homeowners look to remodel</td>
</tr>
<tr>
<td>Short-term disruption to consumers</td>
<td>Short-term disruption to consumers</td>
<td>Short-term disruption to consumers</td>
<td>Short-term disruption to consumers</td>
<td></td>
</tr>
<tr>
<td>Long-term beneficiary of lifestyle and adaptation changes</td>
<td>Long-term beneficiary of lifestyle and adaptation changes</td>
<td>Long-term beneficiary of demographics, low inventories and police points</td>
<td>Long-term beneficiary of demographics, low inventories and low interest rates</td>
<td></td>
</tr>
</tbody>
</table>

* Company estimates

Source: Company presentation

Earnings Surprise History

![Patrick Industries Earnings Surprise History](source: FactSet)
# Quarterly Results Variance

## Metric Variance

<table>
<thead>
<tr>
<th>Sales Metrics</th>
<th>Actual (thousands, except per unit data)</th>
<th>Estimate (thousands, except per unit data)</th>
<th>Actual vs. Est. (thousands)</th>
<th>Last Year (thousands)</th>
<th>YOY Chg</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>RV Market</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenue</td>
<td>$320,200</td>
<td>$344,242</td>
<td>-$24,042</td>
<td>$342,436</td>
<td>-6%</td>
</tr>
<tr>
<td>Total RV Industry Shipments</td>
<td>100,404</td>
<td>103,661</td>
<td>-3,257</td>
<td>99,976</td>
<td>0.4%</td>
</tr>
<tr>
<td>RV Content Per Unit (TTM)</td>
<td>$3,112</td>
<td>$3,147</td>
<td>-$35</td>
<td>$3,131</td>
<td>-0.6%</td>
</tr>
<tr>
<td><strong>Manufactured Housing Market</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenue</td>
<td>$112,400</td>
<td>$103,675</td>
<td>$8,725</td>
<td>$106,019</td>
<td>6%</td>
</tr>
<tr>
<td>Industry Shipments</td>
<td>23,968</td>
<td>23,968</td>
<td>0</td>
<td>22,400</td>
<td>7.0%</td>
</tr>
<tr>
<td>Content Per Unit (TTM)</td>
<td>$4,596</td>
<td>$4,518</td>
<td>$78</td>
<td>$3,415</td>
<td>34.6%</td>
</tr>
<tr>
<td><strong>Industrial</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenue</td>
<td>$78,600</td>
<td>$76,082</td>
<td>$2,518</td>
<td>$68,977</td>
<td>14%</td>
</tr>
<tr>
<td><strong>Marine</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenue</td>
<td>$78,000</td>
<td>$83,977</td>
<td>-$5,977</td>
<td>$90,786</td>
<td>-14%</td>
</tr>
</tbody>
</table>

Source: Company data, Baird research

## Estimate Variance

<table>
<thead>
<tr>
<th>Income Statement</th>
<th>Actual (thousands, except per share data)</th>
<th>Estimate (thousands, except per share data)</th>
<th>Actual vs. Est. (thousands)</th>
<th>Last Year (thousands)</th>
<th>YOY Chg</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Net Revenue</strong></td>
<td>$589,232</td>
<td>$607,976</td>
<td>($18,744)</td>
<td>$608,218</td>
<td>-3.1%</td>
</tr>
<tr>
<td>Cost of Goods Sold</td>
<td>479,751</td>
<td>499,039</td>
<td>(19,288)</td>
<td>501,670</td>
<td>-4.4%</td>
</tr>
<tr>
<td>Gross Profit</td>
<td>109,481</td>
<td>108,938</td>
<td>543</td>
<td>106,548</td>
<td>2.8%</td>
</tr>
<tr>
<td>Warehouse and Delivery</td>
<td>24,732</td>
<td>25,855</td>
<td>(1,123)</td>
<td>24,041</td>
<td>2.9%</td>
</tr>
<tr>
<td>Selling, General &amp; Administrative Expenses</td>
<td>35,869</td>
<td>37,097</td>
<td>(1,228)</td>
<td>37,692</td>
<td>-4.8%</td>
</tr>
<tr>
<td>Amortization of Intangible Assets</td>
<td>9,601</td>
<td>10,000</td>
<td>(399)</td>
<td>8,989</td>
<td>6.8%</td>
</tr>
<tr>
<td>Loss/(Gain) on Sale of Fixed Assets</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>#DIV/0!</td>
<td></td>
</tr>
<tr>
<td>Total Operating Expenses</td>
<td>70,202</td>
<td>72,953</td>
<td>(2,751)</td>
<td>70,722</td>
<td>-0.7%</td>
</tr>
<tr>
<td>Operating Income</td>
<td>39,279</td>
<td>35,985</td>
<td>3,294</td>
<td>35,826</td>
<td>9.6%</td>
</tr>
<tr>
<td>Interest Expense</td>
<td>10,492</td>
<td>10,300</td>
<td>192</td>
<td>8,983</td>
<td>16.8%</td>
</tr>
<tr>
<td>Other Expense (Income)</td>
<td>-</td>
<td>-</td>
<td>0</td>
<td>-</td>
<td>NM</td>
</tr>
<tr>
<td>Income Before Income Taxes</td>
<td>28,787</td>
<td>25,685</td>
<td>3,102</td>
<td>26,843</td>
<td>7.2%</td>
</tr>
<tr>
<td>Taxes</td>
<td>7,600</td>
<td>6,421</td>
<td>1,179</td>
<td>5,994</td>
<td>26.8%</td>
</tr>
<tr>
<td>Net Income</td>
<td>$21,187</td>
<td>$19,264</td>
<td>$1,923</td>
<td>$20,849</td>
<td>1.6%</td>
</tr>
<tr>
<td>Adjusted Net Income</td>
<td>$21,187</td>
<td>$19,264</td>
<td>$1,923</td>
<td>$20,849</td>
<td>1.6%</td>
</tr>
<tr>
<td>Adjusted EPS - Diluted</td>
<td>$0.91</td>
<td>$0.83</td>
<td>$0.08</td>
<td>$0.90</td>
<td>1.5%</td>
</tr>
<tr>
<td>Basic Shares</td>
<td>23,016</td>
<td>22,960</td>
<td>56</td>
<td>23,039</td>
<td>-0.1%</td>
</tr>
<tr>
<td>Diluted Shares</td>
<td>23,267</td>
<td>23,225</td>
<td>42</td>
<td>23,248</td>
<td>0.1%</td>
</tr>
</tbody>
</table>

GROWTH (year/year)

| Revenue                                         | -3.1%                                    | 0.0%                                      |                            |                       |         |
| Adjusted EPS - Diluted                          | 1.5%                                     | -7.5%                                     |                            |                       |         |

MARGIN

| Gross Margin                                    | 18.6%                                    | 17.9%                                     | 70 bp                      | 17.5%                 | 110 bp  |
| Warehouse and Delivery % of Revenue             | 4.2%                                     | 4.3%                                     | -10 bp                     | 4.0%                  | 20 bp   |
| SGLA % of Revenue                               | 6.1%                                     | 6.1%                                     | 0 bp                       | 6.2%                  | -10 bp  |
| Amortization % of Revenue                       | 1.6%                                     | 1.6%                                     | 0 bp                       | 1.5%                  | 20 bp   |
| EBIT Margin                                     | 6.7%                                     | 5.9%                                     | 70 bp                      | 5.9%                  | 80 bp   |
| Tax Rate                                        | 26.4%                                    | 25.0%                                    | 140 bp                     | 22.3%                 | 410 bp  |
| Net Income Margin                               | 3.6%                                     | 3.2%                                     | 40 bp                      | 3.4%                  | 20 bp   |

Source: Company data, Baird research
Quarterly Results

**Revenue.** Revenue decreased 3% to $589 million, topping consensus ($584 million) but below our estimate ($608 million). Revenue results by end market include RV revenue -6% to $320 million (vs. our $344 million estimate), manufactured housing revenue +6% to $112 million (vs. our $104 million estimate), Industrial revenue +14% to $79 million (vs. our $76 million estimate), and Marine revenue -14% to $78 million (vs. our $84 million estimate).

**Gross margin.** Gross margin increased 110bp YOY to 18.6%, topping our estimate (17.9%).

**Operating margin.** Operating margin increased 80bp YOY to 6.7%, ahead of our 5.9% estimate.
EPS. EPS topped the consensus expectation ($0.91 vs. $0.71) and our estimate ($0.83).

Balance sheet. Patrick reported total debt of $671 million and a cash balance of $131 million at the end of Q1.
Segment Results

**Marine.** Marine revenue decreased 14% to $78 million in Q1, below our $84 million estimate. Management estimates “like RV OEMs, we saw the marine OEMs suspend operations for a period of time in late March that carried into the month of April. But they have been quick to resume operations as the second quarter represents almost 45% of full year retail shipments. And there is a backlog of retail boats sold from the recent first quarter boat shows, indicating that boaters are anxiously awaiting in anticipation of getting back on the water to escape the stay at home orders and spend time with their families outdoors.”

**RV.** RV revenue decreased 6% to $320 million (vs. our $344 million estimate), on flat industry wholesale shipments and a 1% decline in LTM content per unit. CEO Andy Nemeth commented, “our RV revenues were down $22 million or 6% in the quarter and represented 55% of our consolidated sales in the quarter. The decrease was primarily due to lost production days in the latter part of March due to RV OEMs curtailing production in alignment with plant closures, while still shipping retail finished goods units to dealers. RV wholesale unit shipments were down 20% in March and flat for the first quarter compared to 2019, while retail unit shipments are estimated to increase slightly after adjustments for the same period. Heading into the first quarter of 2020, RV OEMs and dealers had already, aggressively reduced and recalibrated inventories, pulling over 50,000 units out of inventory in 2019 and approximately 100,000 units since the second quarter of 2018, bringing dealer inventories to their lowest level we have had on record dating back to 2014. Temporary OEM production curtailments further decreased dealer inventories in April, as RVs were still retailing throughout the month at certain dealerships.”
The decline in RV revenue was driven by flat RV industry shipments, and a 1% decline in LTM content per unit ($3,112).
Industrial. Industrial revenue increased 14% YOY to $79 million (vs. our $76 million estimate) in Q1. Management noted housing starts increased 22% YOY in Q1. Sales for the industrial segment are primarily tied to residential housing, commercial construction, high-rise, hospitality, and institutional furniture markets. CEO Andy Nemeth commented, “new housing starts were also impacted by COVID-19 in mid-March and we saw a drop in new housing starts, but still positive for the month of March with growth of 2% compared to the prior year. For the quarter, new housing starts were up 22%. Our products are generally the last to go into new unit and trail new housing starts by four to six months. Single family housing starts were up 12% in the quarter while multifamily housing starts rose 47% with the South up 53%, the West up 27%, the Midwest up 41% and the Northeast region up 68%. The non-residential side of our industrial business, which is primarily focused on the hospitality, high rise, commercial construction and institutional furniture markets, was also strong in the first quarter.”

Manufactured Housing. MH revenue increased 6% to $112 million, ahead of our $104 million estimate. CEO Andy Nemeth noted, “MH production experienced some disruption in certain states in late March due to COVID-19, while finished goods units were shipped from OEM inventories. However, the industry, as a whole, maintained a steady albeit reduced pace of production throughout the month of April. Most of our manufactured housing related facilities and branch also continued to operate during April in alignment with our customer base and as part of the supply chain to those essential businesses.”
Revenue growth was driven by acquisitions driving growth in LTM content per MH ($4,596), and an 8% increase in industry shipments.
Company Profile

Revenue. Patrick Industries generated $2.34 billion in revenue in 2019. During 2019, RV revenue declined 10% to $1.29 billion and accounted for 55% of total revenue. Manufactured Housing revenue grew 59% to $437 million (19% of total revenue). Industrial revenue grew 2% to $286 million (12% of total revenue). Marine revenue increased 20% to $328 million (14% of total revenue).

Incremental Margin. Patrick reported incremental gross margin of -15% in Q1.

Economic returns. Patrick has been able to generate an ROIC above its cost of capital, even as invested capital grows to expand the business. However, given the cyclicality of the RV business, ROIC would be at risk during an economic downturn.

ROIC vs. WACC
RV Industry Overview

**RV industry.** Last cycle, the North American RV industry peaked at 343K retail units in 2007. In 2018, the North American retail market reached 493K units, representing 144% of prior peak volume, before declining 7% to 460K units in 2019. Still, trends vary between the towable and motorhome markets – a function of both cyclical and secular forces. In 2019, the North American towable retail market declined 6% to 408K units while the motorhome market declined 11% to 52K units. We believe there has been a secular shift in favor of towables driven by: 1) lower-priced units, 2) young families entering the RV lifestyle, and 3) increased towing capacity.

**Retail market share.** Based on 2018 disclosure, Patrick derives a combined 49% of its revenue from Thor and Forest River (specific OEM mix not known). For perspective, Thor is the No. 1 player in the North American RV market with ~44% share, Forest River is the No. 2 player with ~35% share, and Winnebago is the No. 3 player with ~10% share (including Grand Design). Broadly, we believe retail market share trends are important, as we want to see Patrick partnering with prospering OEMs that are increasing their share of the RV retail market.

<table>
<thead>
<tr>
<th>North American RV Retail Market Share</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>2019 Market Share</strong></td>
</tr>
<tr>
<td>Thor Industries</td>
</tr>
<tr>
<td>Forest River</td>
</tr>
<tr>
<td>Winnebago</td>
</tr>
<tr>
<td>Grand Design</td>
</tr>
</tbody>
</table>

*Source: SSI, Baird research*

**RV consumer demographics.** An RV consumer demographics study conducted in 2011 suggests that a number of demographic factors favor continued growth in the RV industry – specifically in towables. Encouragingly, the household penetration rate of RV ownership has increased, and we think there is room for this metric to creep higher over time. While strong RV retail sales from the 2012-2016 time frame have reduced the average age of RVs moderately, we still think high average age is a positive that supports higher levels of RV demand as consumer replacement cycles unfold. Finally, the modestly lower average age of the RV consumer, all else equal, bode well for future towable demand as consumers enter the RV lifestyle earlier, and thus need more affordable RV options (favoring towables over motorhomes).

<table>
<thead>
<tr>
<th>RV Consumer Demographics</th>
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</thead>
<tbody>
<tr>
<td><strong>2005</strong></td>
</tr>
<tr>
<td>Household RV ownership rates</td>
</tr>
<tr>
<td>Average age of all RVs</td>
</tr>
<tr>
<td>Average time consumers have owned their current RV</td>
</tr>
<tr>
<td>Age of typical RV owner</td>
</tr>
<tr>
<td>Average income of RV owner</td>
</tr>
</tbody>
</table>

*Source: RV Consumer Demographic Profile - 2011 & 2016, Company data, Baird research*
Converting tent campers. We believe a number of secular trends support towable demand beyond prior peak volumes, including the opportunity to convert tent campers into trailer owners. In the United States, the total number of camping households in the U.S. is now estimated at more than 77 million households, having grown by more than 6 million since 2014, according to the 2018 North American Camping Report. Just 24% camp in an RV, while 61% do so in a tent – representing a sizeable potential addressable market if more can be converted.

Aging boomers support higher conversion to RV camping. Not surprisingly, campers are less inclined to use a tent as they age. The RV industry has been somewhat successful attracting younger consumers to the RV lifestyle. According to the 2016 North American Camping Report, Millennials were the generation most interested in trying out a towable RV (travel trailer, fifth wheel, camping trailer, truck camper). However, the Baby Boomer demographic remains the generation most interested in entering the motorhome RV lifestyle (35% of Baby Boomers were interested in trying out a motorhome). Net, the RV industry is well-positioned to capitalize on demand from retiring Baby Boomers, while the industry continues to attract new entrants – primarily through the towable market.
Housing Industry Overview

Manufactured housing industry. Demand for manufactured housing is driven by credit availability, the impact of financial regulations on access to credit, the differential between interest rates charged for traditional mortgages and loans for manufactured housing, job growth, and other factors. U.S. manufactured housing industry shipments peaked in 1998 at 373K units. Prior to 1998, manufactured housing shipments averaged nearly 20% of single-family housing starts. However, demand fell 87% from the 1998 peak to the 2009 trough – and manufactured housing shipments finished near 95K units in 2019. Net, 2019 demand represents a 90% increase from the 2009 trough but is just 25% of prior peak demand and just 7% of U.S. housing starts. Manufactured housing industry participants are optimistic that the industry could see a potential boost from demographics as baby boomers retire (in the past retirees represented a material portion of the manufactured housing demand curve). Net, while we believe structural changes to the credit environment fundamentally limit the demand for manufactured housing, we acknowledge there is still room for recovery, given the industry is operating at such depressed levels.

U.S. housing market. Demand for Patrick’s Industrial products is sensitive to the U.S. residential housing market (~50% of Industrial revenue) as well as trends in the retail fixture, office, and commercial furnishings markets. According to management, Patrick’s Industrial sales generally lag residential housing starts by six to nine months. U.S. residential housing starts increased 3% to 1.29 million in 2019 but remain 38% below the 2005 peak, suggesting continued room for a cyclical recovery to unfold.
Valuation. Our $45 price target for Patrick Industries is based on 15-16x our forward EPS estimate one year from now, above the five-year average (14x) as investors look through pressures associated with the COVID-19 pandemic. Patrick currently trades at 24x our NTM estimate (which includes a period of severely depressed earnings from the impact of social distancing measures). Among a peer group, we see LCI Industries (LCII) as the best comparison, trading at 20x NTM EPS vs. its 15-16x ten-year average.

Key RV and MH supplier. Patrick is a key partner to OEMs involved in producing RVs and MHs, emphasizing design and décor. The company manufactures decorative interior products and other components and distributes building products and other materials. OEMs value Patrick as a source of ideas to differentiate their products in competitive markets. Patrick’s newly introduced design and innovation center, termed “The Studio,” serves as a key differentiator. The Studio offers one space in which buyers and product managers can view Patrick’s suite of products, making the purchasing and design process easier for its customers.

Leading consolidator. Patrick is a leading consolidator in the RV, MH, and industrial markets – and more recently has entered adjacent markets such as marine. Since 2010, Patrick has over 30 companies with acquired revenue of approximately $900 million. Management generally pays 5.0-6.5x EBITDA for well-run businesses with established product niches – seeking to expand market share and reduce costs. In 2016, Patrick acquired seven businesses – Parkland Plastics; The Progressive Group; Cana Cabinetry; Mishawaka Sheet Metal; L.S. Manufacturing, Inc.; BH Electronics, Inc.; and Sigma Wire & KRA Intl. – adding $167 million to annualized sales.

Healthy end markets. Patrick manufactures and distributes products with demand tied to three primary end markets – RVs, MH, and residential housing. While we believe the RV market is later-cycle, given the consolidated industry has surpassed prior peak volume, we think there is good retail momentum early in the season. Additionally, we believe secular factors such as lower-priced units, attracting younger buyers to the RV lifestyle, and increased towing capacity support demand beyond prior peak. Meanwhile, our analysis of dealer inventory suggests inventory levels are balanced, supportive of the shipment growth forecasted by RVIA in 2017. In MH, the industry finished near 81K units in 2016 – just 22% of the 1998 peak (373K units) and 50% of the average from 2000-2006 (163K units). Given the low base and potential for an improvement in financing conditions, we believe this market can grow modestly. Finally, roughly half the demand for Patrick’s Industrial products is tied to residential housing. U.S. single-family housing starts reached 1.17 million in 2016, 43% below the 2005 peak. Pent-up demand and favorable fundamentals (e.g., income, credit) support continued growth in residential housing starts over the next several years.

Increasing content per unit. Patrick generally commands a strong market share position in its existing product lines, with share typically ranging anywhere from 20-70%, achieved through a combination of organic market share growth and acquired product lines. Broadly, content per unit growth is driven by new products, product extensions, acquisitions, market share gains, and changes in industry mix. The company estimates the addressable market for Patrick in RVs is approximately $4 billion ($6,300 per unit), while the addressable market in MH is roughly $900 million ($6,900 per unit). Existing content per unit and management’s estimate of the total addressable market imply that Patrick currently has 50% share of its addressable market in RVs and 50% of its addressable market in MH. Net, management sees ample opportunity to increase content per unit in both the RV and MH industries.

Entering adjacent markets. As a continuation of Patrick’s strategy to grow through acquisition, the company is also targeting growth in adjacent industries. The acquisition of BH Electronics, Inc. is one example of recent growth through adjacencies and was Patrick’s first solely marine-focused acquisition (the company had done two deals previously that provided marine exposure in addition to RV and Industrial end-market exposure). Management has articulated a longer-term strategy of
becoming a supplier to broader leisure industries – and sees particular opportunity in the marine industry, given fragmented supplier and distribution models, as well as significant pent-up demand. Still, revenue from acquisitions in adjacent markets does not contribute materially to consolidated revenue today.

Risks & Caveats

- **Economic cycles.** Demand for RVs, MH, and residential housing is sensitive to economic conditions, especially wealth, credit, employment, consumer confidence, demographic trends, and tax policy. The current RV cycle has exceeded prior peak volume. An industry slowdown could cause channel partners to destock inventory.

- **Competitive market.** The RV and MH housing industries are highly competitive with low barriers to entry. Part of Patrick’s growth strategy relies on increasing its content per unit, whether organically by gaining market share in existing product lines or through acquisition. However, given the competitive nature of the industry, there is no guarantee Patrick will continue to increase its market share position.

- **Acquisitions.** Patrick has articulated a strategy to supplement organic growth in the business with growth through acquisition. As a result, success against its growth plans hinges, in part, on the company’s ability to continue acquiring businesses at reasonable multiples and integrating them effectively. We note that Patrick is not the only supplier working to roll up the RV and MH supplier industries – and the company faces competition sourcing deals from other large consolidators such as LCI Industries. Additionally, there is execution risk associated with acquiring and integrating larger and more complex businesses, completing more deals in a given year, and entering adjacent markets in which the company has less experience.

- **Access to credit.** Consumer demand for RVs, MH, and residential housing is sensitive to availability of consumer credit.

- **Customer concentration.** Patrick’s two largest customers (Thor and Forest River) represented a combined 49% of consolidated net sales in 2018.

- **Labor costs.** Patrick is experiencing labor shortages in its manufacturing facilities in Elkhart County as the RV industry continues to grow. The Elkhart County unemployment rate was just 2.7% in December 2019. Low unemployment in the Elkhart area may result in higher labor costs.

- **Cyber incidents or data breaches.** Like all companies, Patrick is at risk from cyber security threats or data breaches, coming from items such as phishing scams. Recently, the company was a victim of a targeted email phishing message that resulted in the inadvertent disclosure of the W-2s for current and former employees. While Patrick maintains insurance to cover the company in the event of a data breach like this, data breaches like this could happen again in the future and the company’s costs to insure against these incidents may also increase. And in a competitive labor market, the breach could be used against Patrick.

- **Lack of long-term supply contracts.** Patrick does not have long-term supply contracts with customers. In addition to the risk of unanticipated customer attrition, Patrick bears the risk of accurately forecasting customer demand and maintaining appropriate inventory on hand to fulfill customer orders. The ability to accurately forecast inventory can be particularly troublesome if there is a sharp downturn in demand.

- **Raw materials.** Patrick sources large quantities of raw materials, such as gypsum, lauan, particleboard, MDF, and aluminum as key inputs for its products. Prices for these inputs can be volatile and the company may not be able to pass along higher raw material costs to its customers. Additionally, Patrick sources a significant portion of its raw materials and other inputs from suppliers located in Indonesia, China, and Malaysia, which would be subject to a proposed (though increasingly less likely) border adjustment tax.
- **Financial leverage.** As of December 2019, Patrick had net leverage of 3x debt/LTM adjusted EBITDA. Investors may consider this level of leverage high for a business in a cyclical industry.

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**Company Description**

Patrick is a key partner to OEMs involved in making recreation vehicles and manufactured homes. The company manufactures decorative interior products and other components and distributes building products and other materials. OEMs value Patrick as a source of ideas to differentiate products in competitive markets – creativity that comes to life in The Studio, a design and innovation center opened in the heart of Elkhart, which is known as the RV capital of the world. Patrick is a leading consolidation platform in the recreation vehicle and manufactured housing industries, and has also acquired businesses in other industrial markets, such as marine. Since 2010, the company has acquired over 40 companies representing over $1.5 billion in annualized revenue.
## Baird/ Patrick Industries - Summary Model

<table>
<thead>
<tr>
<th></th>
<th>2017</th>
<th>2018</th>
<th>1Q19</th>
<th>2Q19</th>
<th>3Q19</th>
<th>4Q19</th>
<th>2019</th>
<th>1Q20</th>
<th>2Q20E</th>
<th>3Q20E</th>
<th>4Q20E</th>
<th>2020E</th>
<th>2021E</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Net Revenue</strong></td>
<td>$1,635,653</td>
<td>$2,263,061</td>
<td>$608,218</td>
<td>$613,218</td>
<td>$566,186</td>
<td>$549,460</td>
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<td>$589,232</td>
<td>$376,752</td>
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<td>$517,506</td>
<td>$1,928,055</td>
<td>$2,097,909</td>
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<tr>
<td><strong>Adjusted EPS</strong></td>
<td>$3.19</td>
<td>$4.93</td>
<td>$0.90</td>
<td>$1.18</td>
<td>$0.92</td>
<td>$0.86</td>
<td>$3.85</td>
<td>$0.91</td>
<td>($0.06)</td>
<td>$0.32</td>
<td>$0.67</td>
<td>$1.85</td>
<td>$2.70</td>
</tr>
<tr>
<td><strong>Adj. EPS ex-excess tax benefit</strong></td>
<td>$2.94</td>
<td>$4.65</td>
<td>$0.86</td>
<td>$1.17</td>
<td>$0.92</td>
<td>$0.86</td>
<td>$3.81</td>
<td>$0.91</td>
<td>($0.06)</td>
<td>$0.32</td>
<td>$0.67</td>
<td>$1.85</td>
<td>$2.70</td>
</tr>
<tr>
<td><strong>GAAP EPS</strong></td>
<td>$3.48</td>
<td>$4.93</td>
<td>$0.90</td>
<td>$1.18</td>
<td>$0.92</td>
<td>$0.86</td>
<td>$3.85</td>
<td>$0.91</td>
<td>($0.06)</td>
<td>$0.32</td>
<td>$0.67</td>
<td>$1.85</td>
<td>$2.70</td>
</tr>
</tbody>
</table>

Source: Company reports and Baird estimates

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Request Baird’s working Excel PATK Model
Appendix - Important Disclosures and Analyst Certification

Approved on 30 April 2020 19:38EDT/ Published on 30 April 2020 19:43EDT.

Covered Companies Mentioned
All stock prices below are the 4/29/2020 closing price.

LCI Industries (LCII - $86.72 - Outperform)
Thor Industries (THO - $66.20 - Outperform)
(See recent research reports for more information)
3 Robert W. Baird & Co. Incorporated and/or its affiliates have received investment banking compensation from Patrick Industries, Inc. in the past 12 months.

1 Robert W. Baird & Co. Incorporated makes a market in the securities of PATK, LCII and THO.

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