2014 Mid-Year Economic Update

An MDM Webcast transcript,
featuring Bridget Strand, Economist, and
Ranga Bodla, Director of Industry Marketing, NetSuite

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This is the full transcript of the MDM Webcast "The 2014 Mid-Year Economic Update" from June 2014.

The Webcast presentation slides are included at the end of this transcript.

The wholesale distribution industry continues to grow faster than the rest of the economy, and there are signs that this positive trend will continue, according to Economist Bridget Strand. Strand joined Tom Gale, president of Industrial Market Information, and Ranga Bodla, director of industry marketing for NetSuite, for the 2014 Mid-Year Economic Update.

Tom Gale: Welcome, and thank you for joining us for today's webcast, the 2014 Mid-Year Economic Update. My name's Tom Gale. I'm publisher of the Modern Distribution Management newsletter and the website MDM.com. I have the pleasure of moderating today's program. Our 60-minute program today is sponsored by NetSuite. This is the seventh year that Modern Distribution Management has produced an economic forecast as part of our webcast programming schedule.

The wholesale distribution industry saw some solid gains in 2013, outpacing both the industry's growth in 2012 and the rest of the economy as a whole. There have been a few key milestones that we'll discuss today, as well as overall optimism for a solid growth cycle in the next few years, but the U.S. economy is still experiencing turbulence as it has slowly crawled back from recession.

Overall, our data is certainly more positive than a year ago, particularly in construction markets, but we'll also discuss some of the downward pressures continuing in 2014 that deserve consideration across all wholesale distribution sectors.

Our program today brings together a number of economic resources to provide as complete a picture as possible midway through 2014 of macroeconomic trends in the U.S. We're going to start with a look at research we're completing right now with the latest government data in our 2014 Wholesale Distribution Economic Trends Report. We'll be combining that with more macro-level data that Bridget Strand, our economist, will be presenting today as well, but I'd like to just take a few moments here to talk about the benchmarking tool that we've been producing at MDM for I believe nine years now.

The data that we use is a compilation from the U.S. Census Bureau, Bureau of Labor Statistics and Bu-

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reau of Economic Analysis. We bring in the latest forecasts and data from prior quarters and for 2013. One of the issues this year is that a lot of government release dates were pushed back due to sequestration and other factors last year, so anybody who's doing economic analysis is on the waiting list, so to speak, to get the most updated data. We're working on the latest release right now. We hope to release our report that we are previewing today within the next week or two.

Finally, we're assisted on this annually by the business research division of the Leeds School of Business at the University of Colorado, and they've been great partners in data analysis and validation for us, as well.

I'd like to introduce our speakers now. Bridget Strand is the economist for Industrial Market Information, a market analytics research firm that's a sister company to Modern Distribution Management and has been around since 1987. Bridget has a background in applied economic theory and international trade and development. Prior to joining IMI, she worked as an economist for the city and county of Denver, CO. She has also held roles in the finance sector and was a consultant with the OECD in Paris, France, and the World Bank as well. Her research has been published in a number of journals.

Ranga Bodla, director of industry marketing with a focus on wholesale distribution, brings to NetSuite more than 15 years of combined product management and marketing experience with expertise in the software technology industry. In his current role, Ranga's charged with driving the marketing strategy in programs targeting wholesale distribution companies. Prior to joining NetSuite, Ranga led a global team focused on the successful go-to-market of SAP's governance, risk and compliance solutions, and prior to that he led product management and marketing at Pilot Software, which was later acquired by SAP.

And with that I'd like to move in and give a little bit more depth and understanding of the benchmarking research that we do annually. We'll be sharing a few of the highlights here that really provide a good contrast and supplement to the overall macroeconomic data that Bridget's going to go over here in a little bit.

The Wholesale Distribution Economic Trends Report provides an analysis of 18 different wholesale distribution sectors. They're listed here on the slide, and they are available as a combined fact book, and they're also available for individual sale. The actual analysis is really a number of benchmarks across revenues, inventories, a lot of sector-specific data and subsectors even across all of the major categories in distribution. It includes employment size change, average gross margin changes year-to-year and revenue growth trends going back 10 years, which show growth trend patterns for actual revenue, real revenue that is adjusted for inflation, employment growth and also inventory-to-sales ratio. We'll be providing a little bit more information at the end of our program today on ordering this report, and we will be following up as soon as the compilation is complete here, as I mentioned, in the next week or two. And with that I'd like to bring on Bridget and hand it over to you. Welcome, Bridget.

Bridget Strand: Thank you, Tom. So we're going to start with some of the key data from the 2014 Wholesale Distribution Economic Trends Report. Overall, total revenues of wholesale distributors grew by 4.2 percent to $5.1 trillion in 2013, demonstrating slightly higher growth than in 2012. Revenues increased by 3.9 percent after adjusting for the effects of inflation, most evident usually in energy, agricultural or steel and copper sectors. A small gap in revenue growth is reflected in the overall low inflation rate in the economy.

The wholesale distribution industry grew faster than the overall U.S. economy in 2013. Aggregate revenues of wholesaler-distributors increased 0.8 percentage points over the nominal U.S. gross domestic product as overall economic growth slowed in the fourth quarter of 2013 after an impressive third quarter. If we look at the 10-year quarterly percentage change of revenue growth, as shown in this chart, you can see that wholesale distribution started slowly in 2013 but had a very strong fourth-quarter finish with the highest quarterly growth rate in the last 10 years.

Similar to what we saw last year, most wholesale distribution sectors experienced moderate growth. Seventeen of the 19 registered positive nominal revenue growth in 2013. Most growth rates are moderate, continuing a trend seen from 2010 to the present as the recovery slowed and prices stabilized. This is also leading to smaller gaps between actual revenues and real inflation-adjusted revenues for even the most historically inflation-impacted sectors.

There were two industries with double-digit growth, and this was driven somewhat by a backlog

of orders in certain end-use industries as well as new capital investment strategies focusing on process improvements through technology. Technology prices have come down as competition has increased and global supply chains allow for economies of scale. This can be seen in some of the large revenue changes we see for computer equipment and software wholesale distributors.

However, that sector did have a one percent negative growth in 2012, which can lead to the higher percentage changes. If we focus on core industrial and construction distribution sectors, the 2013 revenue numbers show how market recovery in an industrial sector is clearly outpacing construction markets. It's worth noting that while reported revenues by industrial distributors in 2013 increased by 11.8 percent adjusted for inflation, there were a lot of mixed messages.

Many industrial distributors reported flat revenue years as certain end-market segments rebounded more slowly than others. Our research also indicated a higher than normal shift in market share in many markets as well.

Oil and gas makes up the largest percentage of industry revenues in 2013. This chart shows all the sectors ranked largest to smallest by their 2013 revenues, as well as provides the percentage of the overall industry and the average gross margins. In the oil and gas sector it was a slightly higher – however, this group also had the lowest gross margins, which is slightly higher than last year's of 3 percent. This may be related to high transportation costs serving a very diverse industry.

Competition in all sectors has tightened margins as the importance of existing friendships or long-term relationships are going away in favor of efficiency, quality and customer service. Eleven of the 19 sectors do have margins greater than 20 percent, and the overall wholesale distribution industry has an average gross margin of 17.5 percent, which is down just slightly from 18 percent in 2012.

Now we're going to move into more macroeconomic discussion, the key takeaways. In general, things look much better than they have in the last few years. Economic growth moderated and stabilized, steady employment growth, increased consumer confidence and increased demand in the construction and manufacturing sectors.

I see five real reasons for optimism right now. The housing sector: It's one of our largest drivers of economic growth, and it's coming back. Private sector record growth and stability: Corporations have more cash than ever, and profits are expected to grow. Fiscal policy risks have lessened, so the debt ceiling, sequestration and tax issues from 2011 and 2012 are hopefully over, and at least they are right now. Also, global monetary and fiscal risks have decreased substantially. While Europe has not recovered completely, the situation is much better than it was the last few years. And finally, consumer spending and sentiment is high. We'll see some more of this later, but it drives demand and overall economic growth.

Of course you can't always be optimistic, especially as an economist, so a current reason for pessimism: the stock market correction that many are predicting. We don't know when or if, but of course it would have an impact. There are always other things out of your control. I saw this morning that North Korea wanted to wage war over a Hollywood movie. As economists, we can't take these things into account.

Challenges: Some of the challenges facing the wholesale distribution sector include changing demographics in the labor force and technology adoption. So this requires managing increased channel diversity and the need for workers with specialized skill sets. There's also going to be an aging-out of a lot of baby boomer workers in the next few years.

Transportation and energy cost management: There's always uncertainty around energy prices. However, they have stabilized at this moment. Aging transportation infrastructure, which is likely going to require significant federal and state funding, and alternate channel fulfillment models. Opportunities can be created from these challenges, as there is a gap in specialty trade contractor jobs. There's much more demand than there is supply for manufacturing and construction, so this is a service opportunity for distributors to find and fill those skill gaps.

The GDP outlook. This chart shows the percentage change in inflation-adjusted GDP. The Congressional Business Office puts out a forecast each year, and this year the forecast for inflation-adjusted GDP growth predicts an increase in economic growth through 2016 before it slows and flattens.

The forecast looked at both domestic and global impacts on the economy, and with the pressure on federal programs from baby boomer retirement and health care, along with continued competition from abroad, growth will be restrained but stable. The main story here is the next few years look to be good growth years, notwithstanding continued challenges and headwinds we've already pointed out in terms

of shifting competitive factors.

But long-term, a pattern of stable but flat growth, which is what we've been in the past few years, has a few repercussions for distributors. It reduces the business cycle risk facing distributors in terms of wild swings, but it also means that businesses need to be more selective in targeting growth areas. Particularly as alternate competitors reach into new sectors, there are more companies competing for a fairly stable pool of customer dollars.

Looking at our federal spending, the overall federal deficit situation has stabilized from the bailout, unemployment and stimulus spending during the recession, but a federal surplus is still not anywhere on the horizon. This is driven by continued social program commitments, a significant trade deficit and interest payments on Treasury bills and bonds, which increased significantly in the quantitative easing periods.

Federal spending and the uncertainty about the ability of the government to pass budgets and raise debt ceilings can impact demand and create difficulties for distributors serving government contractors, as well as difficulties predicting the demand for the future. The good news is that as the government dysfunction lessens, this removes a significant part of the downward pressure on the growth of the manufacturing sector.

Looking at our corporate profits over a 10-year trend, corporate profits are often an indicator of industry growth or stability as well as the overall health of the private sector. Profits have been continuously increasing over the last two years, and the outlook is positive, even though the first quarter of 2014 results were somewhat disappointing. This was largely related to the fact that inventories increased dramatically in Q3 and Q4 of 2013, and this led to the negative GDP growth.

Just yesterday, that growth was revised down to a negative 2.9 percent. However, backward-looking data does not always determine future trends, and this is likely a blip. Second-quarter results are expected to be higher, as pent-up demand is met in the manufacturing and construction sectors.

It's important to note the area of mergers and acquisitions and initial public offerings is also very strong. Clearly, a 10 percent stock market correction would have an impact, but until that occurs, if it does, the outlook is quite positive.

Inflation trends: Uncertainty in prices adds risk to both distributors and their downstream customer sectors, and in another positive indication of stability, both consumer and producer price indices are showing incremental and smooth growth. This lends additional confidence to the opportunities available in companies investing for growth or expansion. They are important indicators that track inflationary or other external pressures on prices.

As the CPI and PPI show the differences in the volatility that's faced by consumers and producers, you can see in the shaded recessionary period on this chart the PPI had extreme fluctuations and then increased steadily for a couple of years before leveling off. At the same time, any volatility for consumers was driven by food and energy cost changes, and those have been relatively moderate. Producer prices are an important indicator for industry, as they directly impact manufacturers' bottom line, and volatility in prices creates supply-chain decision challenges. While we do expect to see inflation over the next few years, the outlook is stable for all the industries served by the wholesale distribution sector other than certain inputs such as steel, copper and energy prices, which are more sensitive to short-term fluctuations.

Back to that consumer sentiment we talked about, one of our key reasons of optimism is related to consumer spending and sentiment. Consumers can be a fickle bunch and can easily be spooked by the media and financial markets. The most recent sentiment index result that came out this week had a really important and very key point: more people are now answering the survey saying that they think the economy is good, a result not seen since prior to the recession.

While the actual impact on the economy of this is yet to be seen, it is an important milestone. It's especially important, as consumers and the private sector were completely responsible for the recovery as federal government cut spending and jobs. It's a leading indicator for personal consumption expenditures. The stock market, banking sector and private sector all follow it closely when creating forecasts. Increases in the index often result in increased retail sales, vehicle sales and even housing starts. At the moment these all look to be heading in an upward direction.

Employment trends: Total employment has recovered to pre-recession levels in the overall non-farm sector, as well as in the private industrial sector. The industrial sector is actually recovering faster in that they exceeded pre-recession employment levels in 2014. As demand rebounds, employment is an impor-

tant indicator for distributors in that it signals a much more stable demand for inputs. While supply gaps in skilled workers could potentially impact the growth potential in the manufacturing and construction sectors, it has also led to technology adoption and increased productivity that create new opportunities for distributors.

Another macro-indicator: unemployment rate. This is another leading positive indicator toward stability and economic growth. Considering the weights given to the unemployment rate, the recovery period saw rather consistent improvements when looked at on an annual basis. There was also some seasonally consistent variation. As we approach the point at which the Fed is comfortable raising interest rates and further scaling back the expansionary monetary policy, we may see the unemployment rate stabilize at its current level, because more people will re-enter the labor force due to new opportunities and an increased demand in certain sectors.

Employment, focusing on manufacturing and construction. Again, the shaded areas are the recession. As we've been saying, employment recovery is an important variable in the U.S.' economic stability and growth and is even more important in the powerhouse sectors of manufacturing and construction, which are key for the wholesale distribution industry. Observing the 10-year employment trend illuminates a downward trend for manufacturing for years prior to the recession. This can be explained by a number of factors, including offshore outsourcing, as well as the impact of technology on productivity.

At the same time, revenues per employee were increasing, so while we may not see the same level of historical employment, the sector output and revenue is predicted to continue to grow. Construction employment is recovering more slowly and cautiously, but the outlook here is quite positive as federal and state governments need to address infrastructure deficiencies and the growth of public-private partnerships are utilized to address various large development projects. In addition to the positive outlook in the housing sector, this creates a longer-term growth opportunity for the wholesale distribution industry.

Looking at monthly changes in employment, over the last decade for the total non-farm employment as it compared to the construction industry, it's clear that the huge losses in the construction sector drove the unemployment situation for the whole country much lower. We reached peak employment from pre-recession levels this year, which is a milestone yet not a complete picture. The importance of the construction sector in the overall economy, as well as its downstream and upstream impacts for manufacturing, transportation and retail sales underscores the importance of the recovery of that sector.

We were just discussing housing starts, and here's housing starts. As documented in our 2014 Wholesale Distribution Economic Trends Report, the uptick in housing starts has resulted in increased revenues for sectors, including the furniture wholesale distributors. In addition, homebuilding particularly helps wood products, non-metallic mineral products, HVAC, household appliances, electrical and construction machinery distribution sectors.

Slightly different from previous housing recoveries, this one's characterized by a marked difference in the growth of multi-unit versus single-unit residential projects. Multi-unit structures are growing at a much higher rate due to a number of reasons, including urban development focusing on mixed-use and multi-unit projects that provide residents easier access to services and necessities without the need for personal transport.

Wholesale distributors in upstream products is an important trend to take into account in strategies for identifying new opportunities, as well as those surrounding existing sales and marketing channels. Again turning to manufacturing and consumption, but looking from a spending perspective, it's seen that construction spending actually peaked in 2006 before the downturn in the economy and before manufacturing sales peaked in 2008. It also shows the construction sector recession lasted much longer and did not hit its trough until 2011. Over the last two years, total construction spending has rebounded more quickly than manufacturing sales.

However, manufacturing sales in the first quarter of 2014 did get back to their 2008 peaks. Growth drivers here are energy infrastructure, the housing supply chain, including housing starts, transportation equipment, medical care expansion from ACA, increased confidence and productivity, along with a more stable domestic policy.

Changing to the private sector growth. The importance of private sector growth, again one of another reasons for our optimism, cannot be underestimated. It's been illustrated in 2014 with cash-flush balance sheets and strong profits expected in the second quarter. The financial markets are another indicator that, to this economist, often gets too much weight given to it in terms of the actual real economic contribu-

tion, notwithstanding banking bankruptcies and bailouts. The S&P has hit all-time highs multiple days in a row, continuing the run that began in 2009. This has resulted in what I'm calling an acid bubble as investors chase any yield they can under the current monetary policy. Many economists are calling for a 10 percent or more correction this year. If that occurs, everyone on this call would be affected, some more than others.

Related to that, some on this call – and this economist in particular – understand the reality of the economic impact on the industrial sector and that hype is often driven by the fear and greed paradox in investors and consumers and has media just throwing logs on the fire. That isn't to say it couldn't become a global contagion with fragility in vast economies and inflation in developing ones. Bottom line, it isn't my opinion that any plans or strategies should take too much into account the financial markets at this point, as there's too many unknowns and it's on its way up.

Energy prices: A sign of stability in U.S. economic strength is shown in the stability of oil prices over 2013. Oil production has grown more in the United States over the last five years than anywhere else in the world, even as domestic oil consumption has declined. With these changes has come a growing diversity in the types of oil the U.S. fields produce and that U.S. refiners need. This diversity is demonstrated in the products that U.S. consumers want and the types of infrastructure required to be in place to transport the oil.

An interesting development we are starting to see is beginnings of different energy consumption patterns from renewable, reusable or traditional energy sources. The push for more sustainability, as well as efficiency, will create opportunities in every sector that distributors sell into today, and these opportunities will only continue to grow for the next decade and longer.

Transportation: With the growth of Amazon and other online sectors into traditional distribution markets, it's important at least to consider some long-term shifts we are starting to see since the recession. Many distributors are reevaluating and refining their inventory models to make them more efficient and cost-effective. We've seen the increase of drop ship, use of master distributors and other strategies.

The transportation infrastructure in the U.S. is undergoing strains, as illustrated by the recent logjam in railcar shipments as well as in the highway system, shown in the slide. Long-term it certainly should provide opportunity for certain distribution sectors as the infrastructure is upgraded, but it is also worth noting the impacts as delivery times potentially become less reliable with increased gridlock, a long way perhaps, but certainly worth consideration by an industry whose foundation is built on efficient product delivery.

So what does this all mean? Looking forward, let's sum up with a few key points.

GDP growth is expected to increase in the second half of 2014 and realize a rate for the year of 2 to 2.5 percent. However, the first-quarter revised results from yesterday may result in some new estimates after we see the Q2 preliminary results. In 2015, we expect continued near-zero interest rates, a slight uptick in inflation and for GDP growth to increase into 2016. Monetary policy will likely change more significantly in 2016 as the Fed addresses a situation of owning 20 percent or more of U.S. treasuries.

Employment will also continue to grow to 2016 as new workers enter the workforce and others choose not to retire at the age of 65. Fiscal policy has moderated through 2013 after the debt ceiling, government shutdown, sequestration and taxes of 2012 are hopefully resolved. There is little change anticipated in 2014, especially as it's a mid-term elections year.

The government continues to crack down on illegal banking practices, and banks continue to keep credit very tight. However, this will eventually loosen and will be a new source of economic growth in 2015 and '16 as companies and households take advantage of low interest rates and loosened lending practices.

Regulatory policy changes that may impact industry are those related to the environment in terms of carbon taxes, permits and miles-per-gallon requirements. There's also those related to energy, pipeline and export issues.

As we end this discussion, I'll look outward to the global implications for the wholesale distribution industry. While the Eurozone issues have calmed down, there are still austerity measures dampening growth and demand. And as the U.S. recovers, I expect U.S. exports to increase to this region.

Canada and Mexico continue to be important trading partners, and also many manufacturers are bringing operations back to North America from Southeast Asia as labor and transportation costs for those offshore operations continue to increase. The IMF World Economic Outlook released in April 2014

projects GDP growth for 2014 and 2015 to be 2.3 and 2.4 percent respectively in Canada, slightly slower than the U.S., 1.2 and 1.6 percent in the euro area, which has finally turned positive, and 3 and 3.5 percent in Mexico, which is stable.

What does this mean? Overall, we are in a better place than we were last year and definitely the years prior. There are many opportunities for distributors who are willing to invest in growth and identifying the customers and channels that are poised for growth in both the short and the long term.

I thank you all very much for your time today, and at this point I'm going to hand this back to Tom.

Gale: Thank you, Bridget. There are a couple of takeaways that I wanted to share. As we put together the macro-trends that you just outlined and we take a look at the benchmarking year-to-year that our Wholesale Distribution Economic Trends Report provides, and then some of the other more qualitative research surrounding industry trends that we've been putting together here this year for MDM as well, there are a couple of key things that came together for me.

One of those is that the recovery has been so much slower and longer than anything previously, and while the headwinds are largely gone in prior years here, there are still some squalls out there. I mean, people are still experiencing that, and again, so much of distribution is fragmented by end-market and by geography that there are certainly a lot of mixed signals that we continue to get.

Another thing is the strength of the private sector and corporate profits, and this year another difference from prior cycles has been the M&A cycle in terms of investment in distribution. And in prior recoveries and business cycles we've seen that either the strategic investors and buyers of companies within industry sectors has had an advantage over the financial buyers and private equity money that has flowed into the industry in great amounts over the past 10 years.

What's really interesting right now in all the reports we're getting is that it's never been so competitive between both financial and strategic buyers. It's a good atmosphere developing for distribution company owners that have really been able to foundationally build strong companies in that, and there's a gap there in terms of the valuations that are taking place between companies that have been investing and able to strengthen their balance sheets over the last few years versus those who have been a little bit behind on the power curve. And that's a really very different atmosphere than we've seen prior as well.

And then the final – and I think this bears out in both what you talked about and also in our benchmarking studies through the Distribution Trend Reports – is some of the technology impacts that are starting to enter into wholesale distribution. And you mentioned AmazonSupply, but certainly the emergence and the increase of e-commerce and alternate channels as well. I think we're starting to see some of that impact take place in 2014 more so than we've seen prior as well. So before we go to a Q&A I'd like to shift gears a little bit, and also, speaking of technology impacts, I'd like to provide an opportunity for Ranga Bodla of NetSuite to provide us a little bit of an overview and perspective from NetSuite on what we've been talking about today as well. Ranga?

Ranga Bodla: Perfect. Thank you, Tom. I appreciate the opportunity and the partnership with Modern Distribution Management on the economic trends. And, as you said, there is definitely an opportunity for technology.

We're seeing a lot of shifts in the market, and I wanted to just spend a few minutes to talk about what we're seeing happen and what we see as the value of technology and how it can fit into this. Just to kind of build on what Bridget has already brought up, I think one of the biggest things we're seeing is a huge evolution in terms of business models. You brought up one of the examples, AmazonSupply, as one piece of it, Tom, but I think it's not just AmazonSupply. It's this move to e-commerce as more of a part of the market. You're seeing shifts in how people are buying as you're seeing this shifting workforce. People are demanding a different experience.

So you're seeing a big change in the business model itself; distributors becoming manufacturers and manufacturers becoming distributors, other people that aren't even in the market coming into the market. There's a real competitive shift that's happening.

The second is that we're seeing a need for agility. I think that the pace of change has become such a rapid element, and I think that's another really important aspect of this that we need to be paying attention to, and it's important for distributors to look at, because of the innovation that you're seeing and the pace of that innovation. AmazonSupply, two years ago and where they are now, is not where

we would've expected. I think they've been able to be very successful and penetrate in a way that we wouldn't have expected where we were three years ago.

The third is the global aspect of this, so a global view of the business is becoming increasingly important, where you have to think about more than just North America or even the U.S., for example, but this larger market that's out there. And the expectations of consumers and what they have from the businesses they work with is hugely important, so new technology is impacting the expectations of buyers, and if they're getting a certain consumer-grade experience they expect that same thing from a B2B perspective.

And last but not least, but probably very important, is the employee engagement. Especially as you're seeing a shifting of the workforce, you're having a lot more millennials in the workforce and representing a much larger portion of the workforce, the engagement that they require and demand is very different, and that requires a different approach and a different focus.

So one of the biggest things that we see out there is that it's impossible to adapt to that world with yesterday's fragmented business systems. If you have different systems for manufacturing, for e-commerce, for warehousing, for in-store, for sales, etc., this fragmentation that exists, it becomes very difficult to make those changes and to adapt those changes.

There are brittle connections between these different systems, which directly prevents the agility that's required in order to be successful. And so one of the big things that we really like to think about is the concept of bringing all this holistically together. You have to think about not just the order management and the warehousing process. You have to be thinking about "How are we driving the marketing and customer acquisition? How are we selling and building our awareness? How are we driving opportunities, and do we have visibility into this, into the overall picture, but then also how does this tie back into our after-sales service and support, and how are we thinking about going to market and putting this out online and driving a commerce experience that people are expecting and demanding of distributors?"

And I think these are all important elements that we, NetSuite, believe in very strongly. We've been in the business now since 1998, but we've been working very closely with a number of distributors because we believe that that's a market that can realize value from what we offer, and we've found a lot of success in that market.

So with that I want to, just to conclude, turn it back over to Tom. If you have further questions for me, feel free to ask those, but I encourage you to look a little further into what we can do with your company and with your business. Tom?

Gale: Ranga, thank you so much, and we do have some time for questions here. And I do have a question to start here. Bridget, you mentioned the first-quarter GDP numbers being revised significantly downward. Do you anticipate that's going to have an impact on Fed policy as it applies to their buyback program and approach to inflation?

Strand: No, I don't, because I think the Fed is going to keep with their slow tapering unless we see some other economic issues, if the housing sector slows down or if energy prices get unreasonable. So at this point I think that the Fed's just going to continue to taper through the rest of this year and 2015, and I don't see any dramatic changes in interest rates until probably 2016.

At the same time, they are going to be watching out for inflation or deflation, which is more of a risk right now. The first-quarter results were corporate profits were down, and this was one area where the media actually said the weather was causing a lot of it, and it did, and it impacted a lot of different sectors, but I expect second quarter to be much better, and third quarter as well, so a good question.

Gale: You just talked a little bit about construction, and I'm just bringing up a reference slide here. I'm going back to slide 22, so this is housing starts and privately owned one-unit structures, but the question is around residential versus commercial construction or multi-unit. Is there a little bit further detail you can provide in terms of growth and strength among just the single-unit versus multi-unit?

Strand: I think what's partly held down some of the one-unit structures is the tight lending from banks, so there are a lot of people who are renting instead of getting a house or moving into a multi-unit. And a lot of this mixed-use development too is mixed-use coding, so there's both business and residential located in the same area. I think that once we see the banks loosen on their lending, and I kind of touched

on that, that there's going to be a new growth opportunity there as both corporations and households get back into borrowing. And so I think that for now we're seeing a lot more of this multi-unit growth, and it's got a number of drivers, but a lot of it is being driven by the bank lending and the fact that getting credit or – there's another indicator I saw.

The number of cash-only sales or all-cash sales is higher than it's ever been in history. People are getting into the market and providing all-cash both because then they can beat out the other people who want the house, but they're the ones that can afford the otherwise 30 percent downs that we're seeing in the market. So I think all of those things are in play there.

Gale: Is there one particular or specific geographies around the country where those more heated markets are taking place than others that you've seen right now?

Strand: There are a lot of growth in areas like Austin, San Antonio, certain Midwestern, like Kansas City and Grand Rapids, are picking up. There's definitely still difficulties in Florida and in the Las Vegas area – those were probably some of the hardest hit. There's constant demand in the Silicon Valley and San Francisco Bay Area. And Phoenix, which saw a quick downturn, is actually rebounding very quickly, and the demand is very high for building. I think part of that, off the cuff, might be because we just came off the worst winter, and East Coasters are tired of it. But definitely a lot of the cities that are growing are the smaller, younger cities, and they're really tuned-in to a lot of this mixed-use development and transit development, but that's where we're seeing a lot of that.

Gale: Is a lot of that either technology- or manufacturing-driven, which has certainly been a lot of the key drivers the last few years?

Strand: Yep, it definitely is. We see a lot of that being technology-driven and advanced manufacturing-driven and even traditional manufacturing-driven as well, traditional also leverages a lot of technology. So there are certain areas where it's difficult to build out and there's still inventory that's too high, so that's where these newer areas that are creating more jobs. Where the jobs are going is where the houses are going, and I think that we'll continue to see that for the next year or so.

Gale: And a little bit along those lines in terms of just regional impacts and that, one of the interesting statistics that you shared at the end here about the International Monetary Fund or the World Economic Outlook, it was interesting where Canada was showing a 2+ percent GDP growth projection for 2014 and 2015. The euro area was somewhere between 1 and 1.5 percent, but Mexico is actually 3 to 3.5 percent and so certainly in terms of investment and a lot of manufacturing activity is starting to be directed there and relates back to the onshoring that you talked about as well.

Strand: And also in Mexico, the recent decision to de-privatize the state oil company I think has a lot of people watching to see what kind of opportunities are going to come into there, because that was a pretty significant de-privatization of a sector that is hugely important. So I think that certainly certain areas of Mexico are still an at-risk investment, but manufacturing companies are doing very well there, and they have been for years. It's not new, but bringing back operations from abroad – and a lot of that also is it's a lot easier to run an arm's length company when you have to take a four-hour flight than a 24-hour flight. A lot of it depends on the political stability, but I see good things and higher growth for Mexico actually. They do have a little bit more inflationary pressures, which some of the GDP forecasts are up and higher than that due to price kind of instability or not even price instability but uncertainty. So they're definitely markets to watch.

Gale: Have another question here, and I've just pulled up the slide on the unemployment rate. There's a lot of volatility here, it looks either seasonally or year-to-year. Overall, during the recovery years since 2009, are there some core structural changes taking place here that distributors need to think about?

Strand: In terms of employment, there is, and you have to think of the unemployment rate as just being part of the picture, because it is people in the labor force, so once people retire out they're no longer in the

labor force, so they're not used in the calculation of the rate. Also young people that are not on unemployment and perhaps have decided to go back to school are not going to be in the labor force. So I think that we've come down quite a bit in the last few years, and the forecasts I've seen are about maybe 1 percentage point down to about 5 percent by 2015, and as I stated before, there's going to be more people entering the workforce.

And in terms of how it impacts distribution, I think we know that manufacturers and construction and industry in general, with the technology points that Ranga hit on is going through a little bit of a structural change itself; younger workers, more technology, higher skills needed in a lot of these sectors. And I think that that's probably the most structural change, outside of health care, because with the ACA and all of that need, services industries are pretty well at employment, and I hope to see more going into the industrial sectors. So I don't see any risks from it, but I do think that, just as we've touched on a lot of things, rethinking how to approach companies that might be going through this technology change and how to address new types of sales and marketing systems that are leveraging real-time inventory is something that distributors are going to have to address.

Gale: Does this decreasing unemployment rate have an impact on talent in terms of finding talent? A lot of what MDM's been researching this past year and hearing a lot from the industry is some of the shifting skill sets that are required. And certainly if you look in the mass media you see a lot about the increase in higher analytic capabilities and bringing that onboard and more specialized skills related around technology. Are we able to connect some dots between some of the struggles that we're seeing distributors find talent and this trend line downwards?

Strand: Well, I think we're seeing a lot of people who became unemployed and couldn't get new jobs because of those reasons, but the talent issue has been a long time coming, and there are lots of reasons for it. And talking about the media, the push on STEM and the maker community is great to see, and I've seen a lot of it in-person in Denver, as well as in other more technology-driven cities. I think finding talent should become easier as people are realizing they don't need to go to college for a four-year degree. They need to attain some skills and then get some job training and apprentice or start coding – kids are starting to code in fourth grade.

So I think that the view for talent is on the upward trend. However, there's also the problem of the workforce not staying in a job for 20 years anymore, of moving, of wanting to move and challenge themselves differently. We see that in pretty much the 18-to-34-year-old range. It's not a lifetime commitment, and they don't see themselves in one place, and that's been how manufacturing has operated for a very long time.

The talent question should start to ease, but it's going to take a few years before we close that gap. And some companies are doing it very successfully, but it's another thing on their list, you know. "Got to get an ERP system, a CRM system. I got to find skilled people. I need to be effectively delivering my products and get an e-commerce site up." So it's kind of like "Which fire do we put out first?"

Gale: So just from your latest experience in terms of looking at the major metro area of Denver and surrounding areas, has there been an uptick in terms of vocational school and more specialized two-year training versus four-year degrees?

Strand: Absolutely, and there are also a lot of sponsorships from manufacturing companies sponsoring CAD machines and things like that to get the students some real hands-on training and then offering internships that turn into externships, and I saw a lot of that. And there's also a lot of technology in the Denver, Boulder, Fort Collins area, so there's already the kind of mentality that these are good skills to have. And I think that the focus on student debt in the media – and I could attest that getting a Ph.D. is very expensive – makes people second-guess.

And marketing analysts are still making some of the top salaries in the country right now. Marketing analyst wasn't really a job 10 years ago. You had a marketing strategy. So I think that in this area, and I as-

sume it's probably happening in other areas as well, we'll start to fill some of those gaps. You might have to go somewhere to find that talent, and it might not be where the company's located, but I think that those gaps are going to start to be filled.

Gale: Great. Well, let's end with that question now. And, Bridget and Ranga both, thank you so much again for your insight today. And I'd like to also thank NetSuite for its sponsorship of this program today and its ongoing support of industry education.

You can learn more about NetSuite at NetSuite.com. And with that I'd like to thank you for joining us today, and this concludes our program.

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2014 MID-YEAR ECONOMIC UPDATE

Bridget Strand, Tom Gale and Ranga Bodla

June 26, 2014

Produced by:

Modern Distribution Management®
Wholesale Distribution News, Expert Analysis & Market Research

Event Sponsor:

NETSUITE

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Ranga Bodla
Director of Industry Marketing
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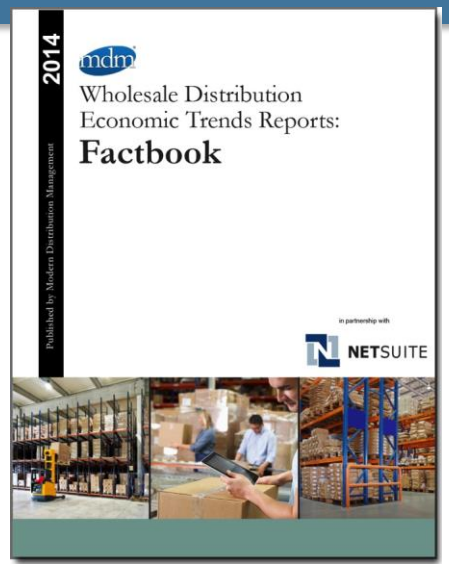
Agenda



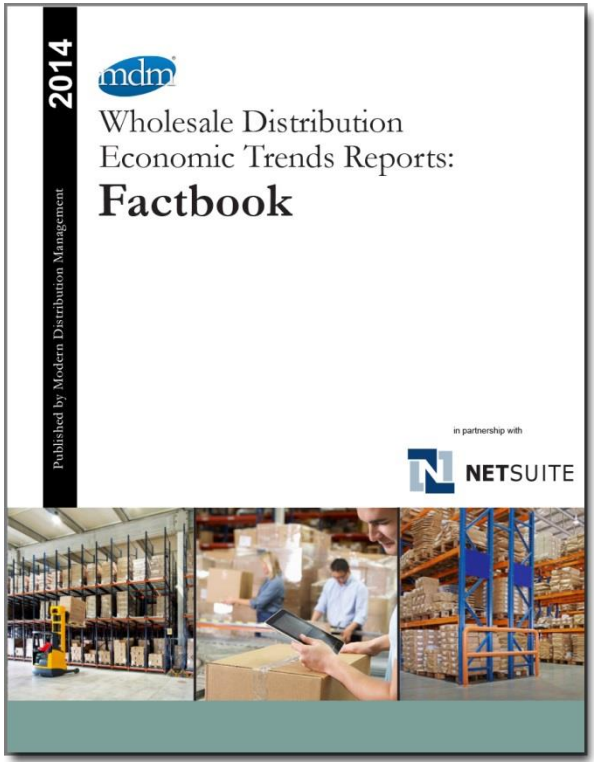
Today's Discussion

- 2013 WD industry performance & trends
- Economic outlook
- Sales and inventory trends
- Specific industries
- Highlights from the 2014 Wholesale Distribution Economic Trends Report

About the Wholesale Distribution Economic Trends Report data

- Foundational data from U.S. Census Bureau, Bureau of Labor Statistics and Bureau of Economic Analysis
- Based on latest Wholesale Trade Survey and Economic Census
- Include revenue growth forecasts
- Analysis by Business Research Division, Leeds School of Business, University of Colorado

The 2014 Wholesale Distribution Economic Trends Report



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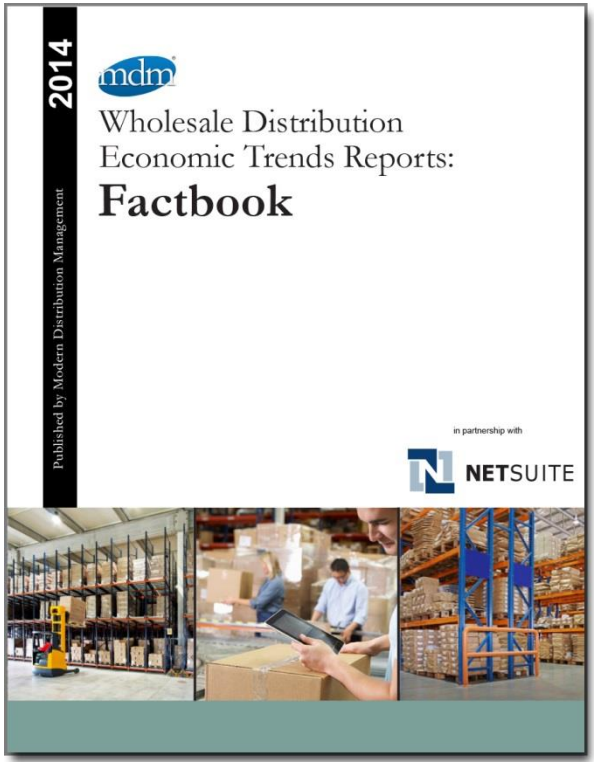
(Offer valid through July 31, 2014)

Analysis of 18 sectors (available for individual sale)

- Apparel & Piece Goods
- Agricultural Products
- Beer, Wine & Liquor
- Building Materials & Construction
- Chemicals & Plastics
- Commercial Equipment & Supplies
- Computer Equipment & Software
- Electrical & Electronics
- Furniture & Home Furnishings
- Grocery & Foodservice
- Hardware, Plumbing & Heating Equipment/Supplies
- Industrial
- Metal Service Centers
- Miscellaneous Durable Goods
- Motor Vehicle & Motor Vehicle Parts
- Office Products
- Oil & Gas
- Other Consumer Products

The 2014 Wholesale Distribution Economic Trends Report



Discount Code: 2014WDETR

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Analysis of 18 sectors (available for individual sale)

- **Trend Data**
  Revenues, Inventories, Inventory-to-Sales Ratio, Total Employment, Average Annual Revenues per Employee and Average Weekly Earnings
- **Sector Summary**
  2013 Revenues, Percent of Industry Revenues, No. of Companies and Average Gross Margin
- **Summary Trend Data**
  2013 Actual Revenues, 2013 Real Revenues, Revenue Gap and 2012 Q4 Employment,
- **Sector Growth vs. U.S. GDP Growth** - 2000: Q1 to 2012:Q4
- **Employment Size Distribution of Wholesale Distribution Companies**
- **Actual Revenue Growth** – Quarterly 2006 to Present
- **Real Revenue Growth** – Quarterly 2006 to Present
- **Employment Growth** – Quarterly 2006 to Present
- **Inventory-to-Sales Ratio** – 3-Month Moving Average with Trendline

2013 WD industry performance

Measure	Value	% chng
Industry revenues ($B), 2013:Q4	$1,332	5.8%
Industry revenues ($B), 2013	$5,135	4.2%
Total Employment, 2013:Q4	4,891,100	1.3%
Avg. annual revenues per emp.	$1,057,100	2.9%

% change vs. previous year

Source: 2014 Wholesale Distribution Economic Trends Report

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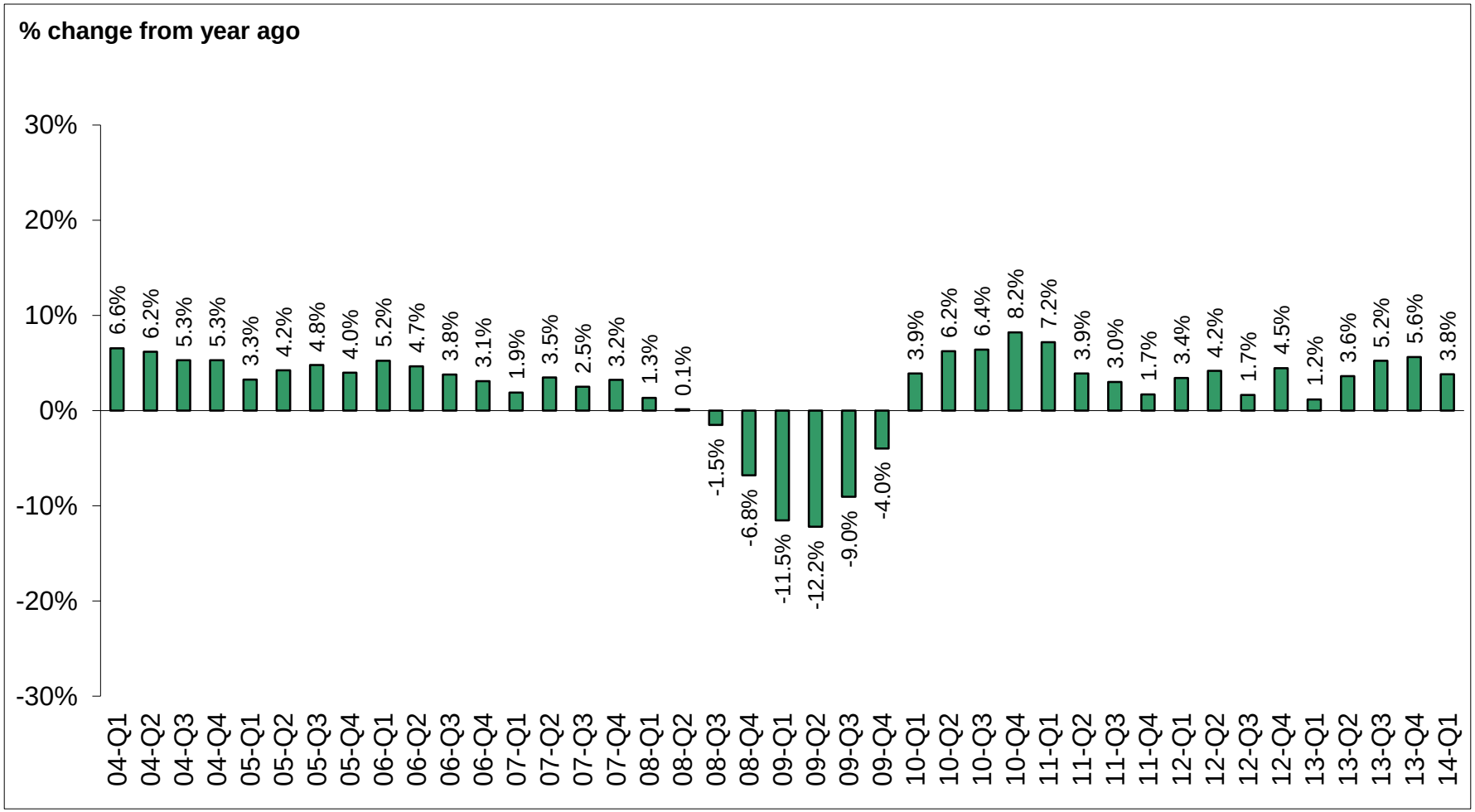
10-Year Revenue – Quarterly Percentage Change

Wholesale Distribution – 18 sectors



Source: 2014 Wholesale Distribution Economic Trends Report

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Economic Outlook – 2014

Major Sector (Largest to Smallest Sector Revenues)	Actual Revenues (2013)	% change vs. previous year Real Revenues* (2013)	Revenue Gap (Actual - Real)	Employment (2013: Q4)
Oil and Gas Products Wholesale Distributors	4.5%	5.6%	-1.1%	1.7%
Grocery and Foodservice Wholesale Distributors	5.5%	2.8%	2.7%	0.2%
Pharmaceutical Wholesalers	5.9%	1.6%	4.3%	-0.7%
Industrial Distributors	11.8%	10.3%	1.5%	2.2%
Electrical and Electronics Wholesalers	5.9%	5.9%	0.0%	2.5%
Motor Vehicles and Motor Vehicle Parts Wholesale Distributors	2.9%	3.0%	-0.1%	2.8%
Computer Equipment and Software Wholesale Distributors	0.9%	4.5%	-3.6%	1.9%
Other Consumer Products Wholesale Distributors	3.5%	3.5%	0.1%	1.3%
Agricultural Products Wholesale Distributors	2.3%	10.4%	-8.2%	-0.3%
Miscellaneous Durable Goods Wholesale Distributors	-3.7%	-2.0%	-1.7%	-0.2%
Commercial Equipment and Supplies Wholesale Distributors	2.3%	3.8%	-1.6%	0.4%
Metal Service Centers	-3.9%	1.8%	-5.6%	-1.5%
Apparel and Piece Goods Wholesale Distributors	0.3%	-0.2%	0.5%	1.5%
Beer, Wine and Liquor Wholesalers	2.2%	-0.1%	2.2%	3.8%
Chemicals and Plastics Wholesale Distributors	4.1%	3.8%	0.3%	1.7%
Building Material and Construction Wholesale Distributors	12.8%	5.0%	7.8%	1.1%
Hardware, Plumbing, and Heating Equipment/Supplies Wholesalers	6.4%	5.1%	1.2%	2.8%
Office Product Wholesalers and Paper Merchants	4.4%	1.9%	2.5%	-1.0%
Furniture and Home Furnishing Wholesale Distributors	6.6%	5.7%	0.9%	3.9%
Total	4.2%	3.9%	0.3%	1.3%

*Real revenues equal actual revenues adjusted for product inflation using sector-specific price deflators.

Source: 2014 Wholesale Distribution Economic Trends Report

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2013 Industrial/Construction sectors

% change vs. previous year, inflation adjusted

Major Sector	Real Revenues
Industrial Distributors	10.3%
Electrical/Electronics Distributors	5.9%
Metal Service Centers	1.8%
Bldg Material/Construction Distributors	5.0%
Hardware, Plumbing, HVAC Distributors	5.1%

Source: 2014 Wholesale Distribution Economic Trends Report

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Economic Outlook – 2014

Major Sector (Largest to Smallest Sector Revenues)	2013 Revenues ($B)	% of Industry Revenues	No. of Companies	Avg. Gross Margin (2012)
Oil and Gas Products Wholesale Distributors	$752.3	14.7%	4,769	4%
Grocery and Foodservice Wholesale Distributors	$589.2	11.5%	23,283	13%
Pharmaceutical Wholesalers	$437.3	8.5%	5,378	8%
Industrial Distributors	$425.3	8.3%	41,021	28%
Electrical and Electronics Wholesalers	$419.1	8.2%	17,334	24%
Motor Vehicles and Motor Vehicle Parts Wholesale Distributors	$394.5	7.7%	16,049	19%
Computer Equipment and Software Wholesale Distributors	$257.9	5.0%	6,386	17%
Other Consumer Products Wholesale Distributors	$254.4	5.0%	19,409	17%
Agricultural Products Wholesale Distributors	$252.2	4.9%	3,112	10%
Miscellaneous Durable Goods Wholesale Distributors	$228.2	4.4%	26,865	20%
Commercial Equipment and Supplies Wholesale Distributors	$194.0	4.0%	15,119	33%
Metal Service Centers	$153.3	3.0%	7,434	14%
Apparel and Piece Goods Wholesale Distributors	$141.6	2.8%	12,517	31%
Beer, Wine and Liquor Wholesalers	$126.6	2.5%	3,207	27%
Chemicals and Plastics Wholesale Distributors	$124.3	2.4%	7,707	24%
Building Material and Construction Wholesale Distributors	$116.9	2.3%	10,068	23%
Hardware, Plumbing, and Heating Equipment/Supplies Wholesalers	$116.2	2.3%	9,663	28%
Office Product Wholesalers and Paper Merchants	$90.4	1.8%	7,121	21%
Furniture and Home Furnishing Wholesale Distributors	$61.5	1.2%	9,581	30%
Total	$5,135.3	100.0%	246,023	17%

Source: 2014 Wholesale Distribution Economic Trends Report

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Economic Outlook – 2014

Key Takeaways

- Economic growth has moderated and stabilized with steady employment growth, increased consumer confidence and increased demand in the construction and manufacturing sectors.

- Five reasons for Optimism
  - Housing sector
  - Private Sector Record Growth and Stability
  - Fiscal Policy risks have lessened
  - Global monetary and fiscal risks have decreased substantially
  - Consumer Spending and Sentiment High

- Current reason for pessimism: Stock market correction

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Economic Outlook – 2014

Challenges

- Changing demographics in the labor force, technology adoption
  - Managing increased channel diversity
  - Need for workers with specialized skill sets

- Transportation and energy cost management
  - uncertainty around energy prices
  - aging transportation infrastructure
  - alternate channel fulfillment models

Opportunities

- Gap in specialty trade contractor jobs – manufacturing/construction
  - Service opportunities for distributors to fill skill gaps

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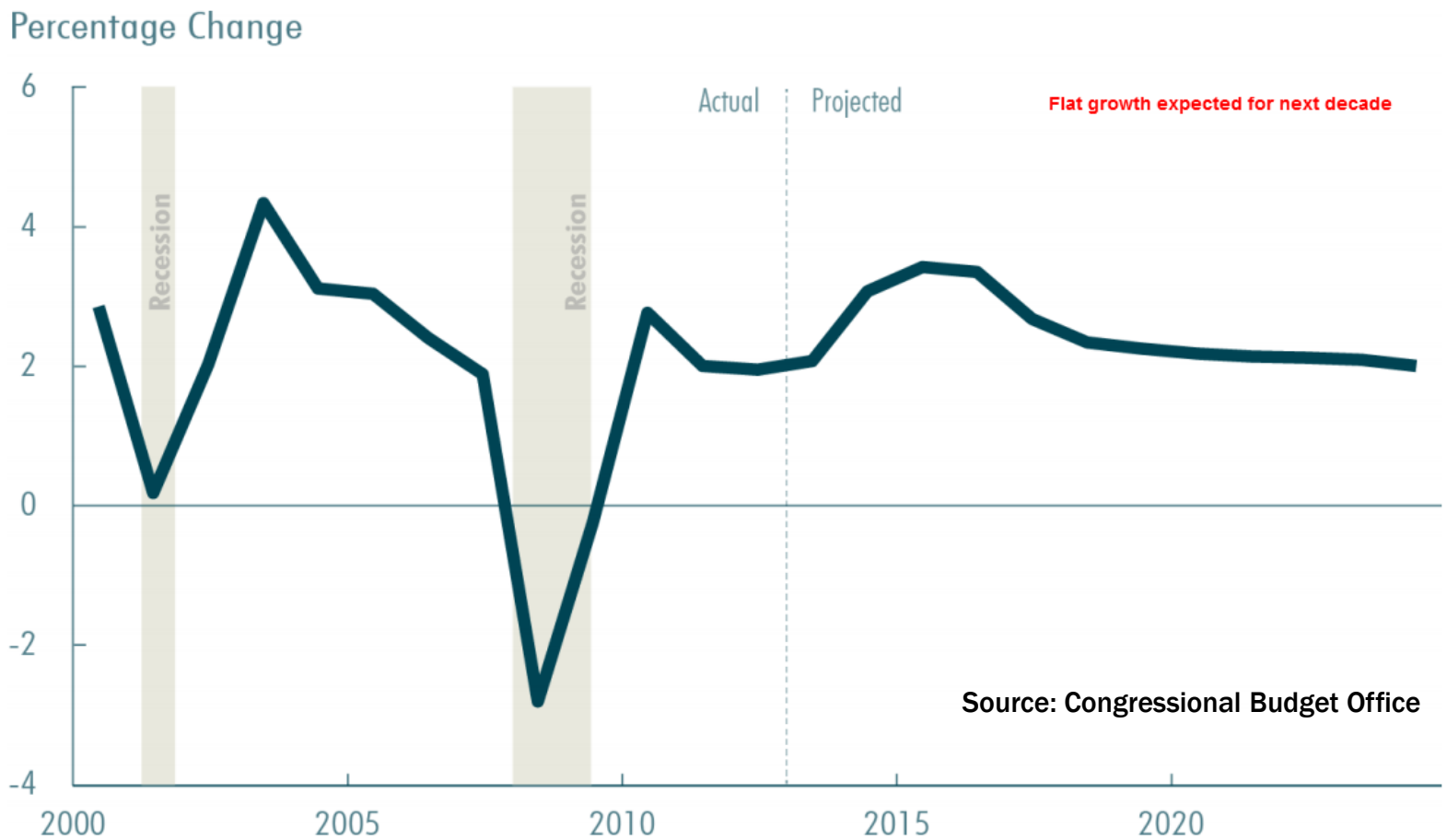
GDP outlook

Change in Inflation-Adjusted GDP



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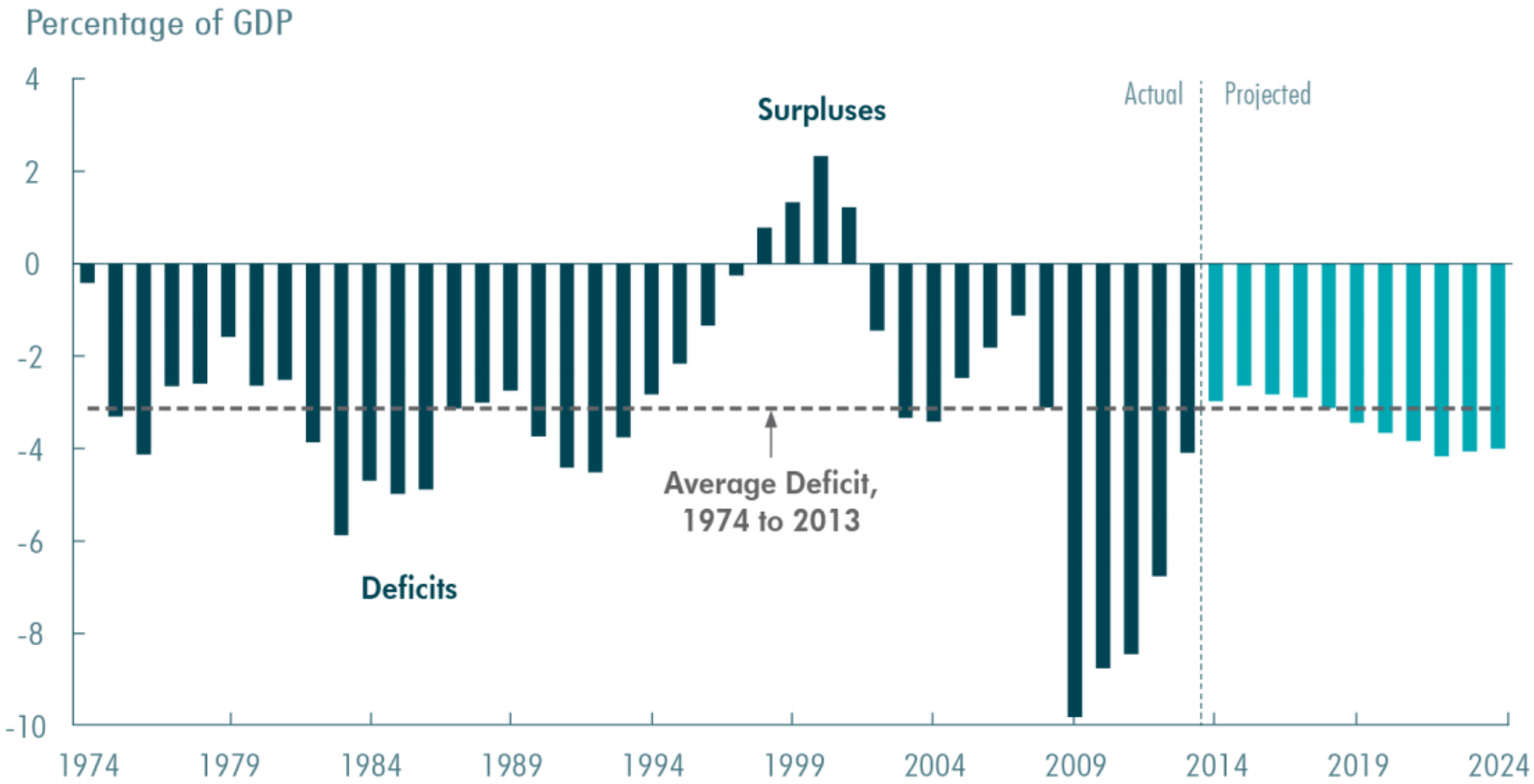
Federal spending

Total Federal Deficits or Surpluses



Source: Congressional Budget Office

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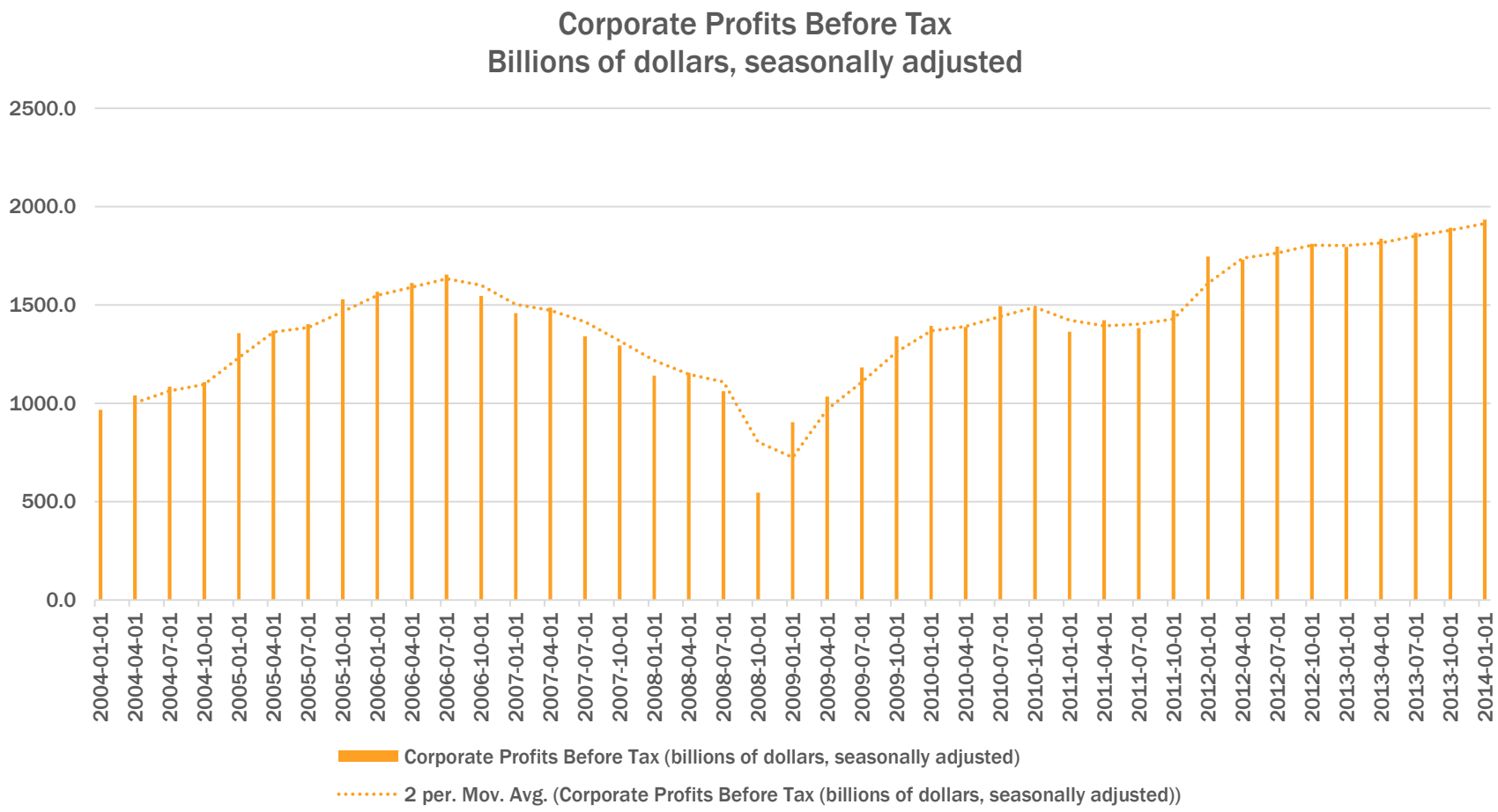
Corporate profits – 10-year trend



Source: FRED Database; Bureau of Economic Analysis

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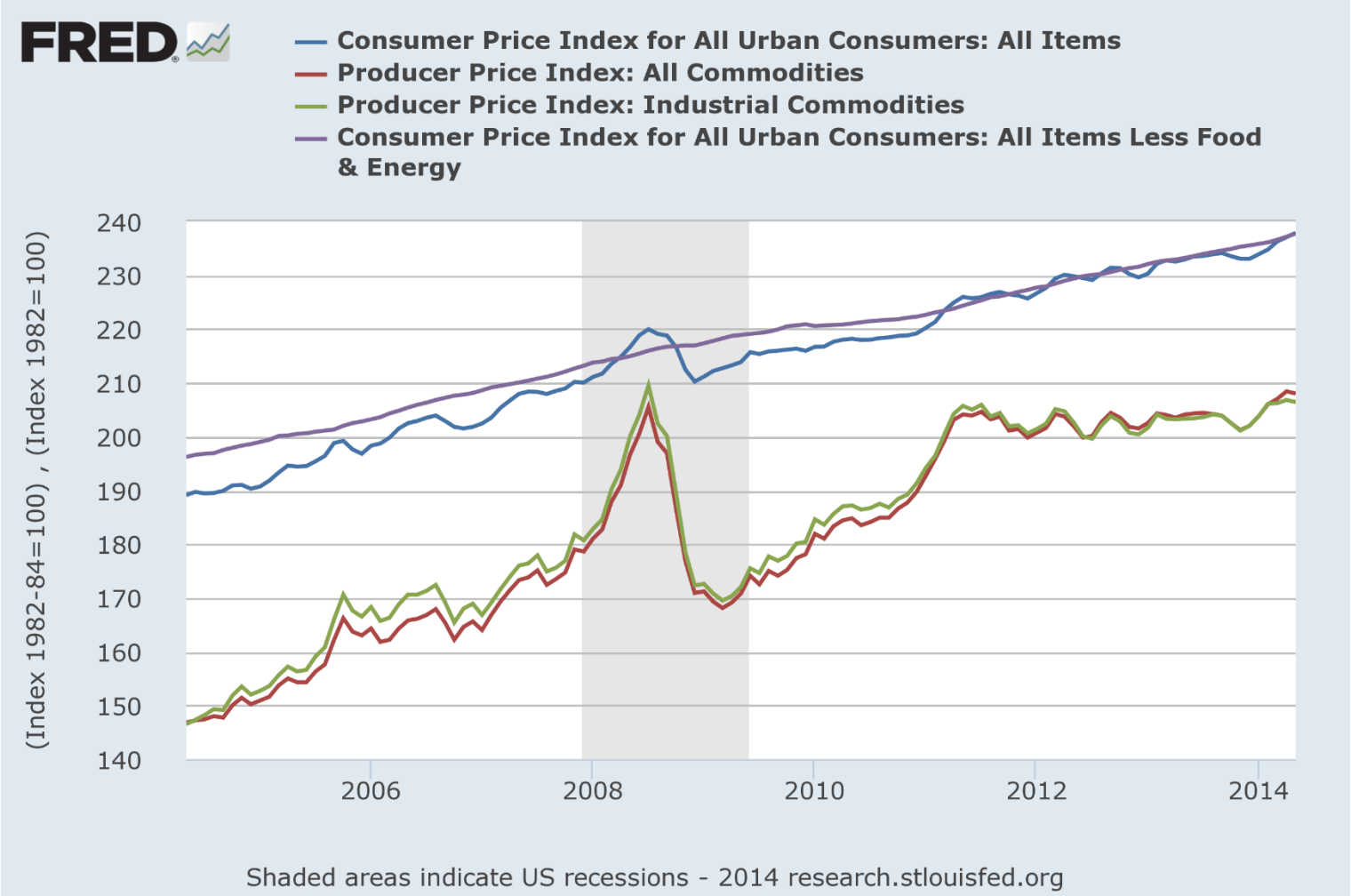
Inflation trends



Source: Bureau of Labor Statistics

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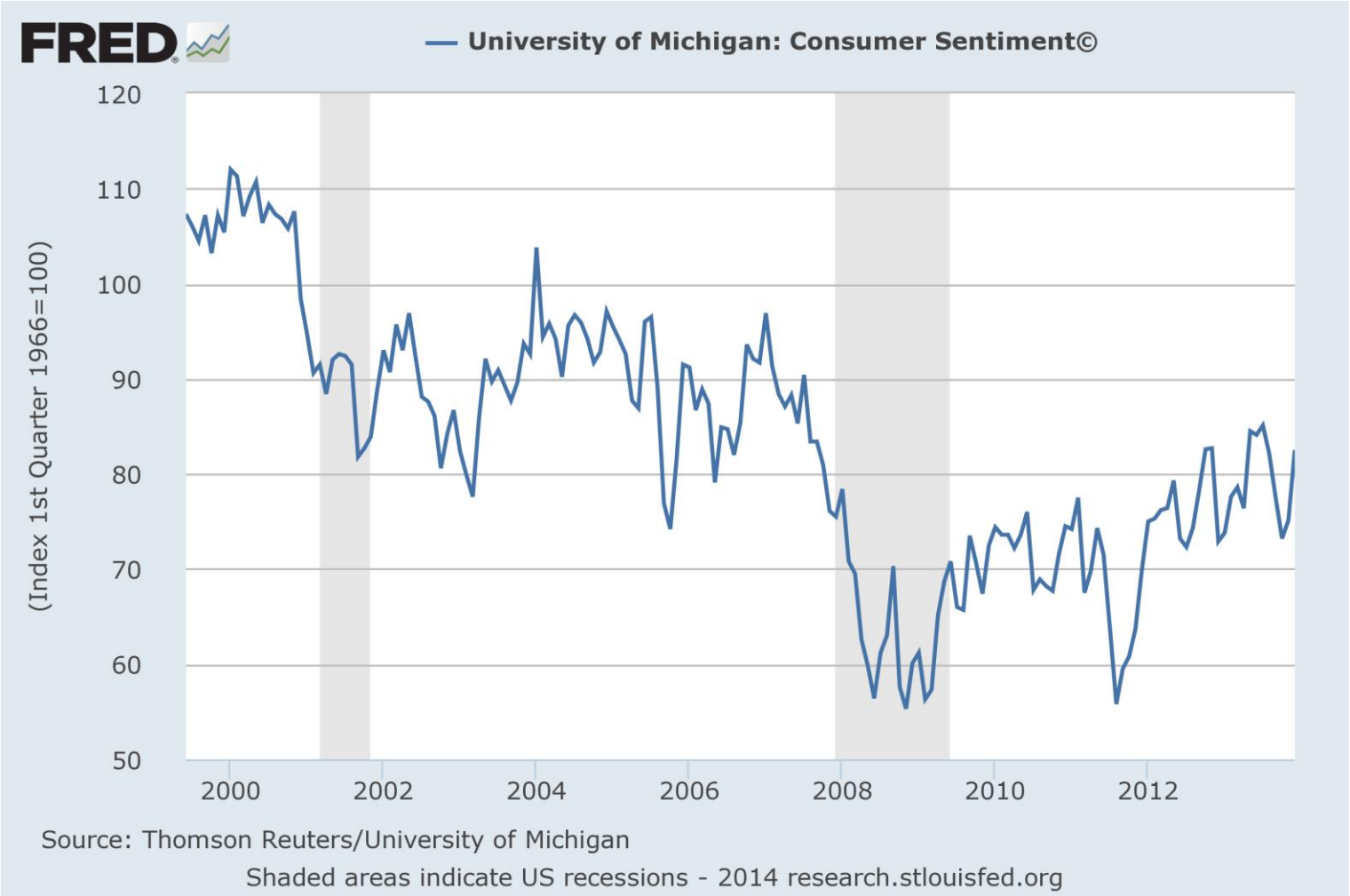
Consumer sentiment



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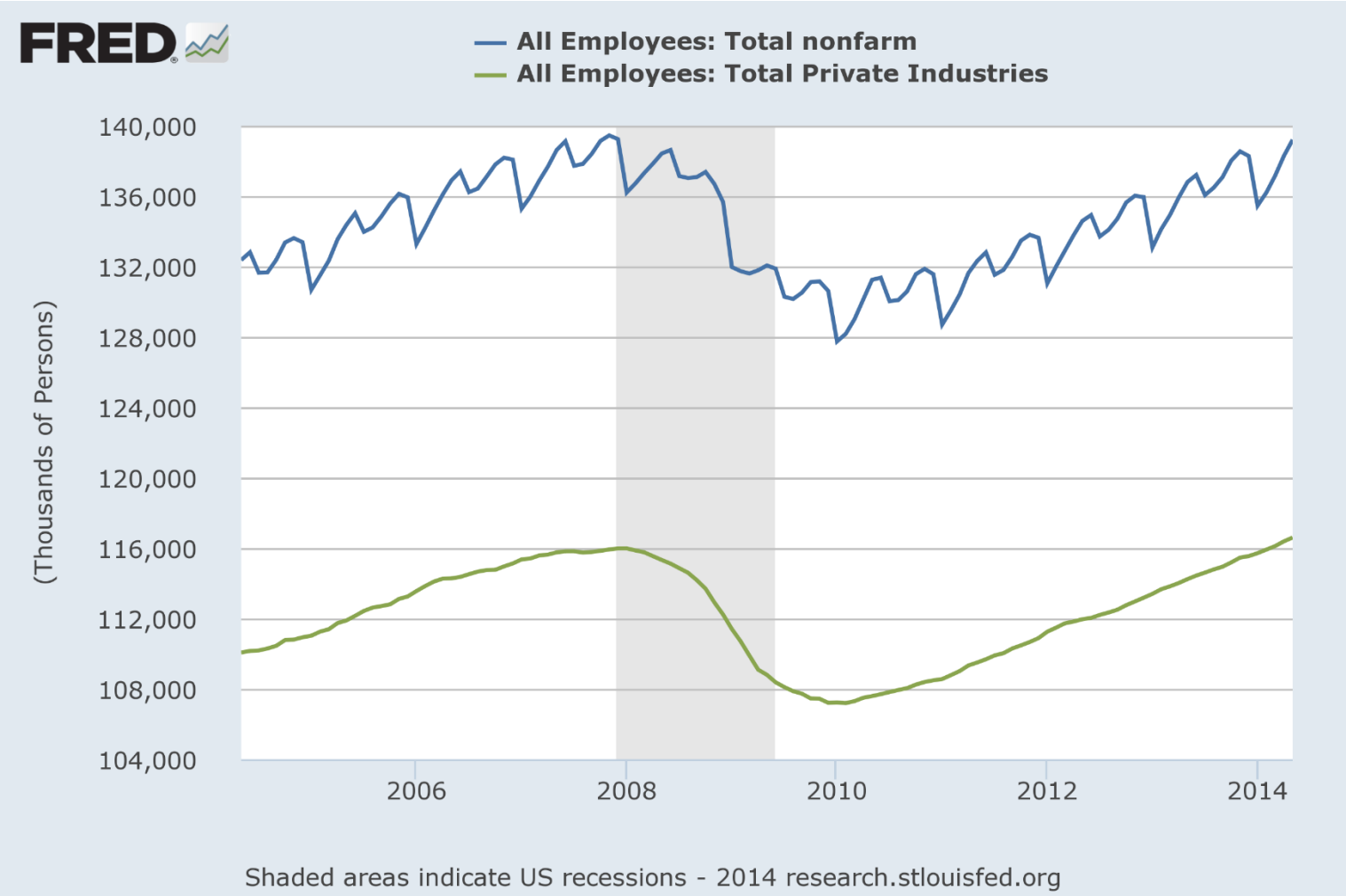
Employment trends



Source: Bureau of Labor Statistics

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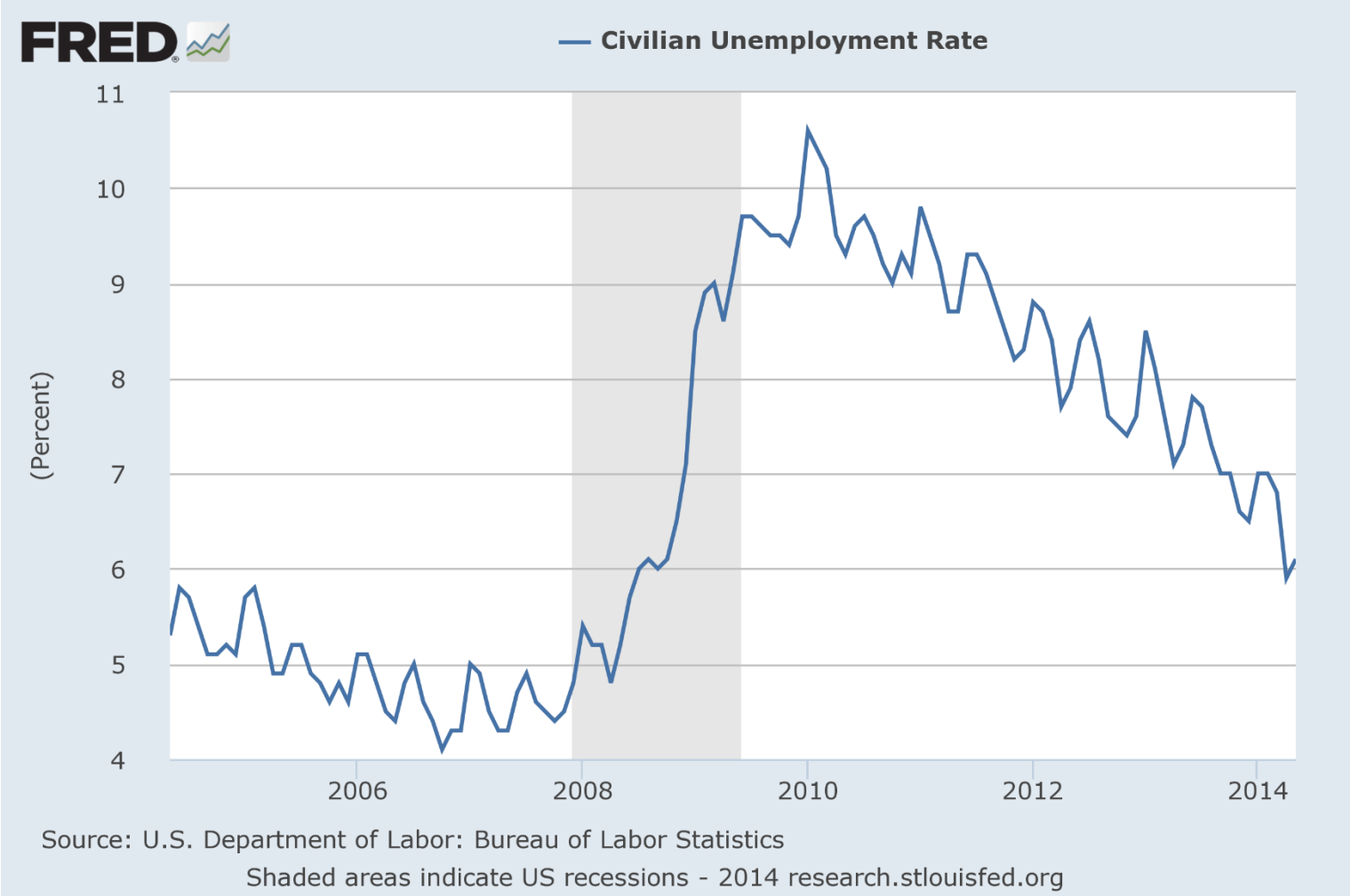
Unemployment trends



Source: Bureau of Labor Statistics

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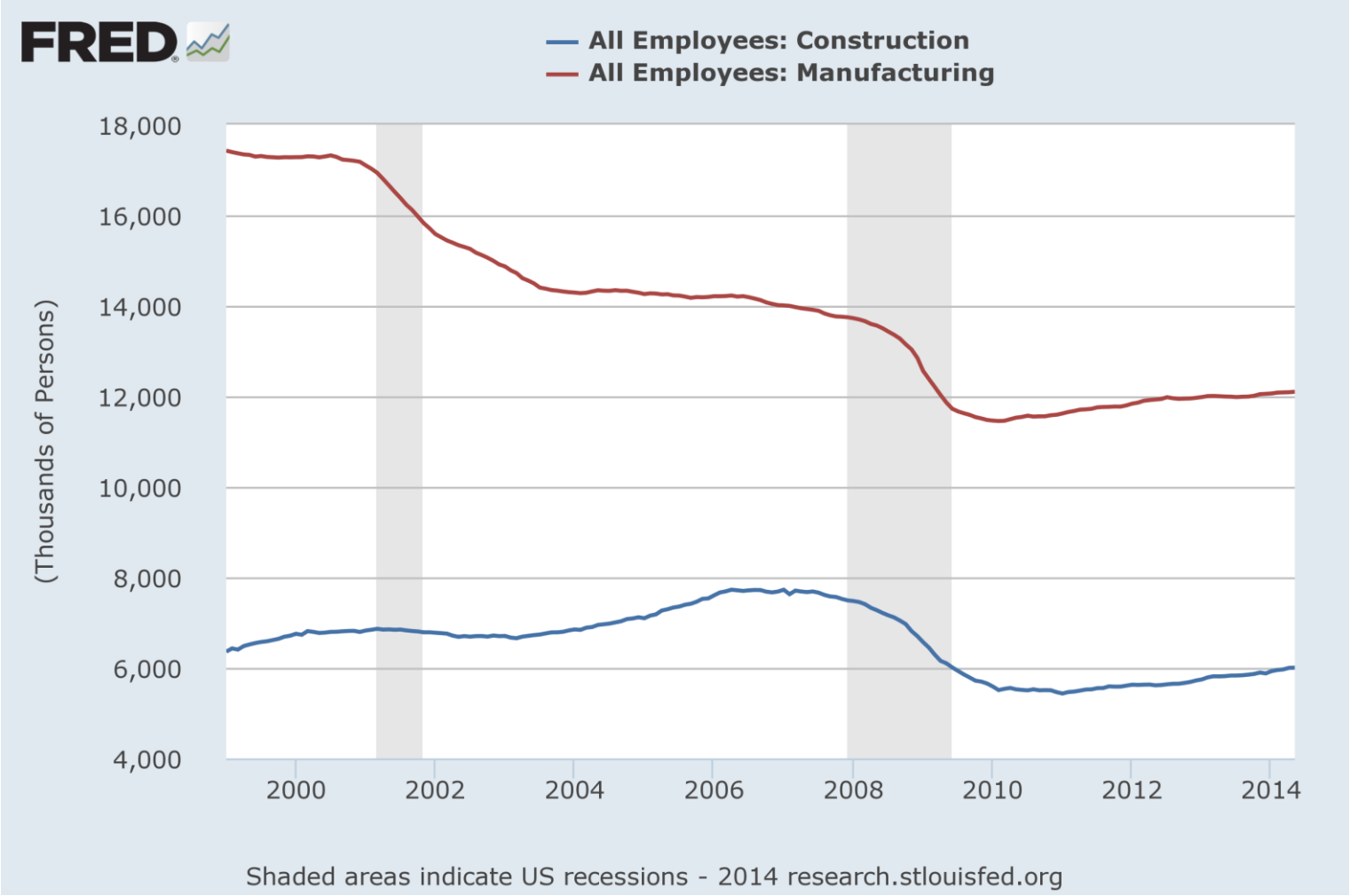
Employment: Manufacturing & construction



Source: Bureau of Labor Statistics

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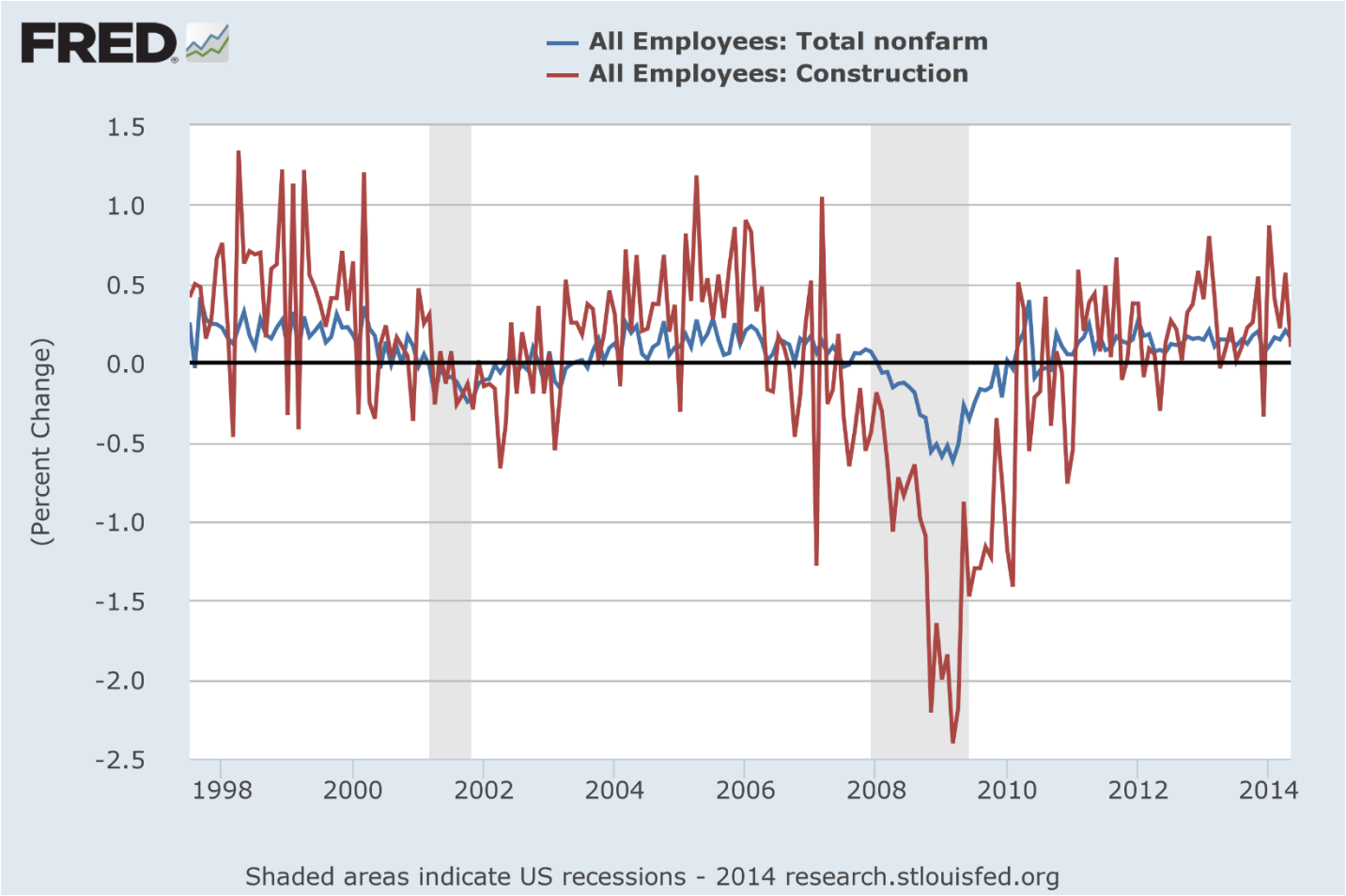
Economic Outlook – 2014



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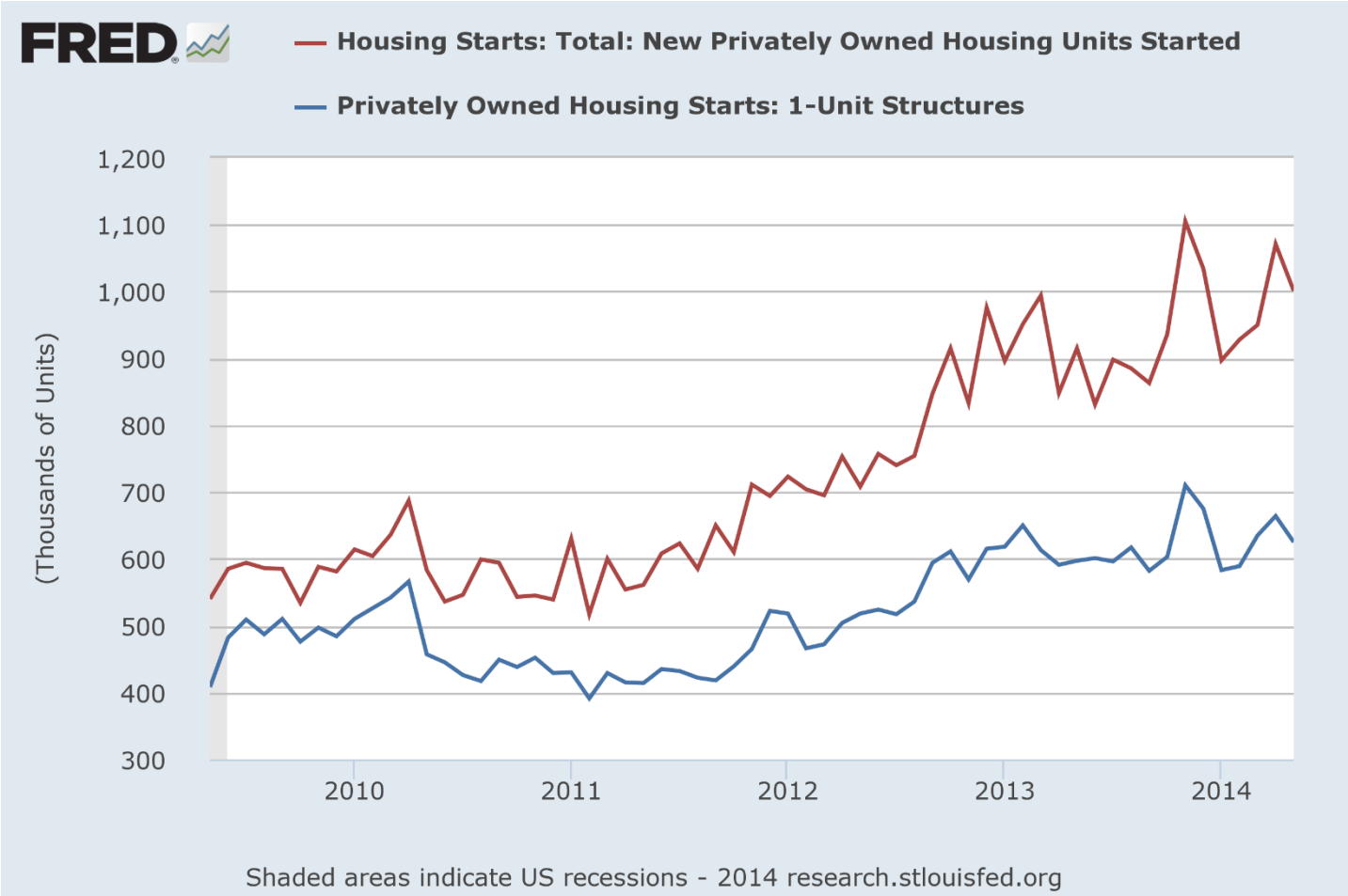
Economic Outlook – 2014



Source: The U.S. Census Bureau and the Department of Housing and Urban Development

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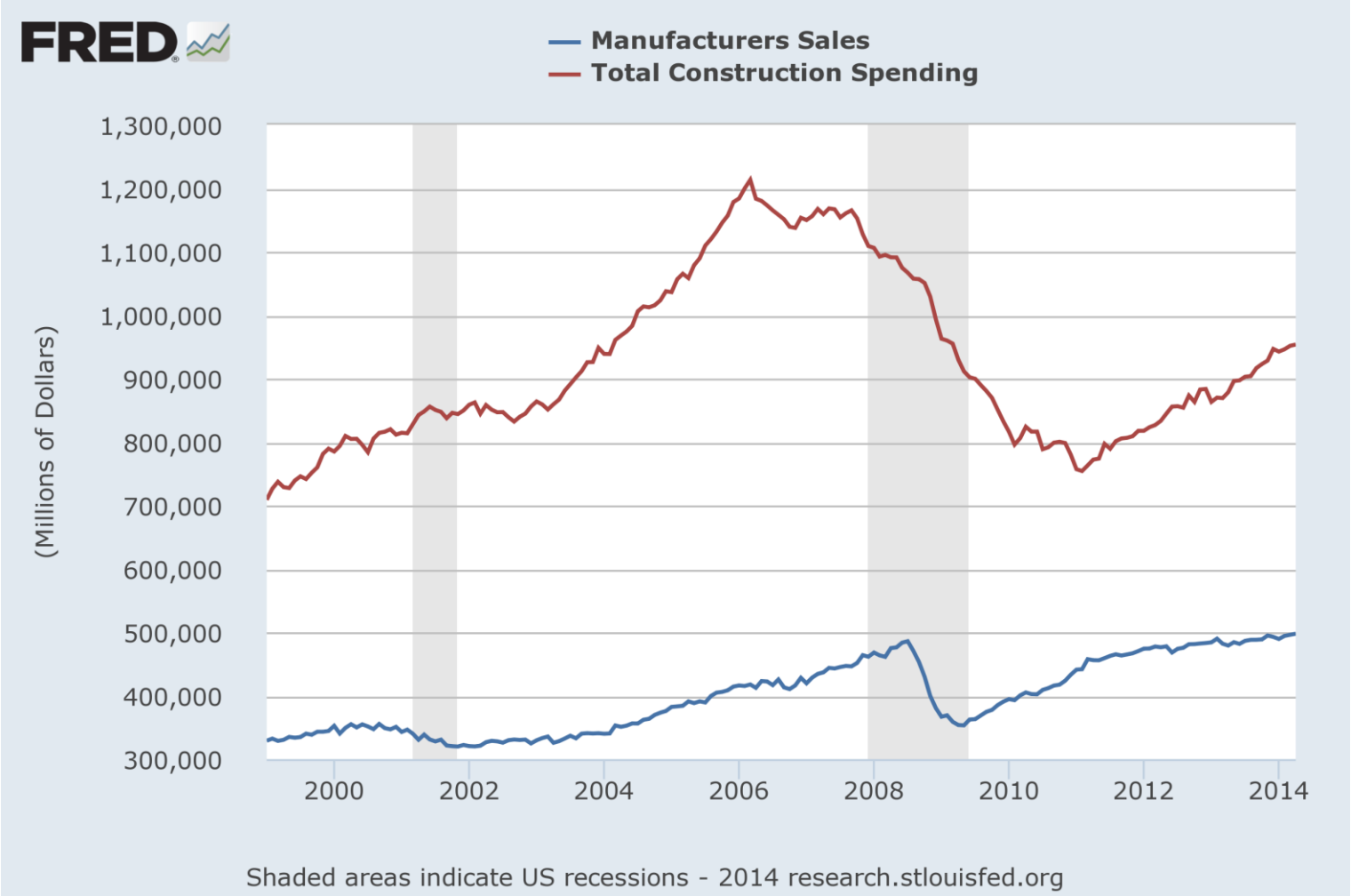
Economic Outlook – 2014



Source: Bureau of Economic Analysis; The US Census Bureau

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Private sector growth

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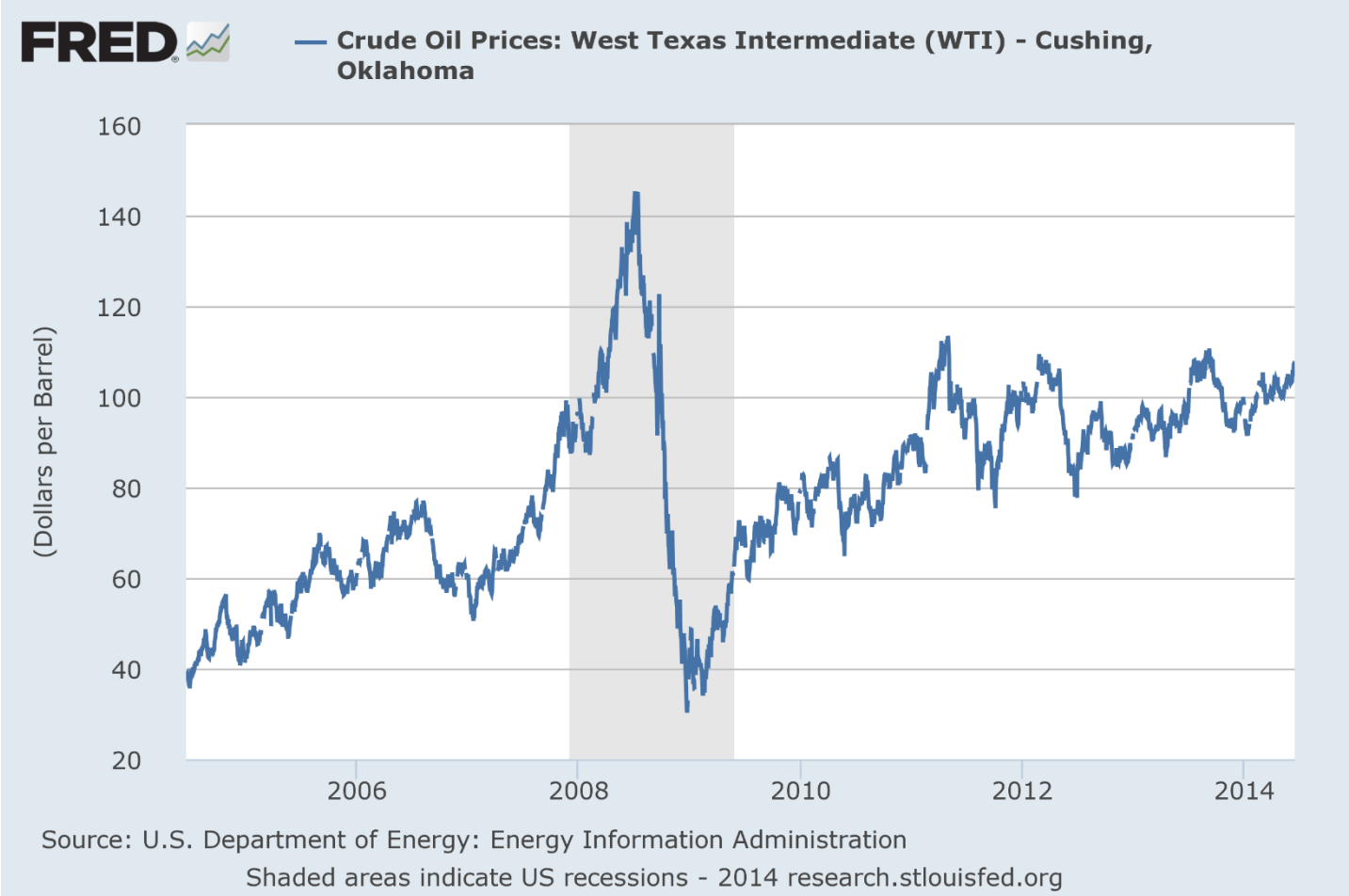
Energy prices



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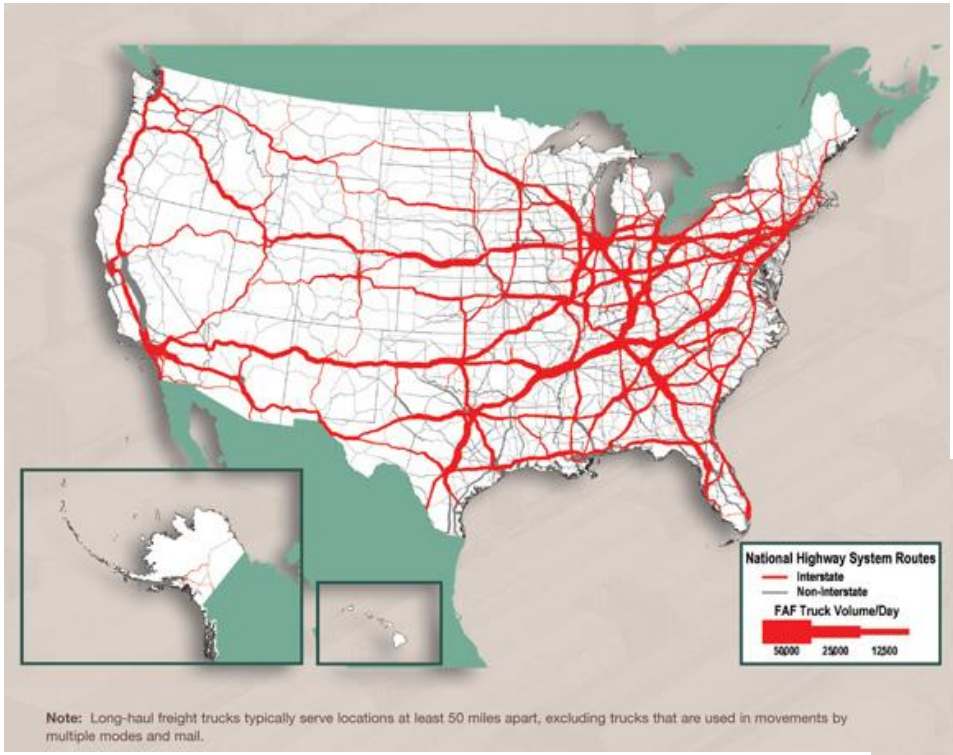
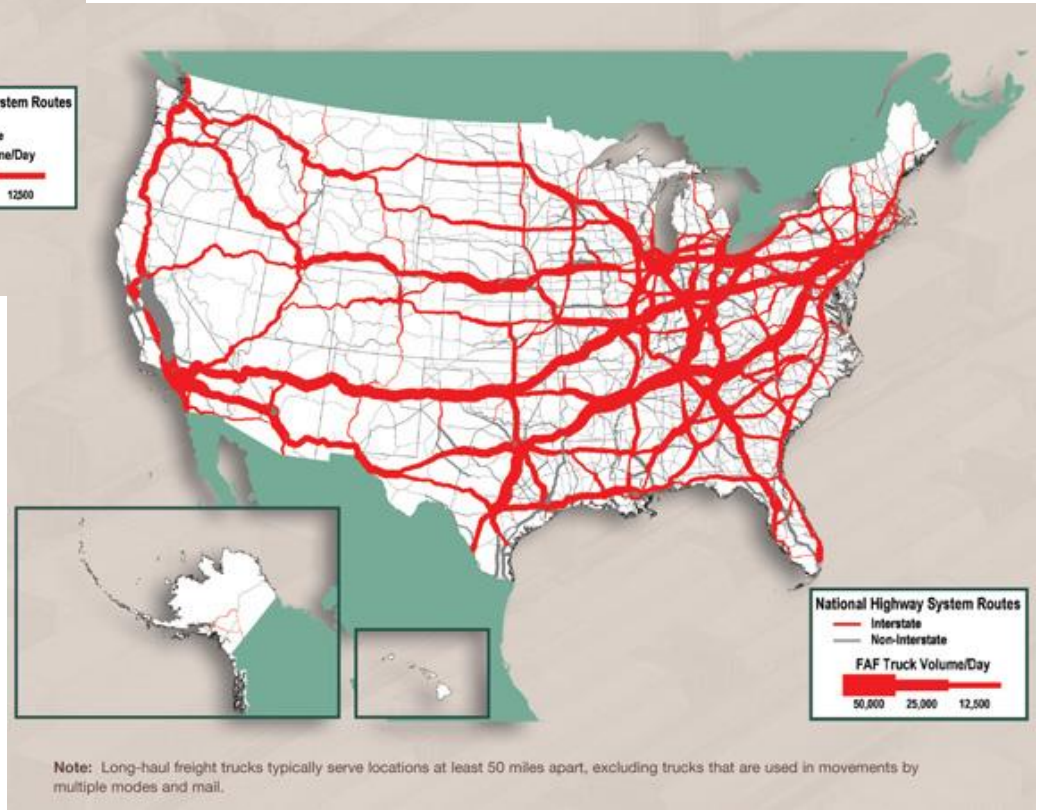
Transportation Volume: 2007 and 2040



Estimated Transportation Volume in 2007 (shown to the left and in 2040 (shown below)

By 2040, long-haul freight truck traffic in the United States is expected to increase dramatically on Interstate highways and other arterials throughout the nation. Forecast data indicate that truck travel may reach 662 million miles per day

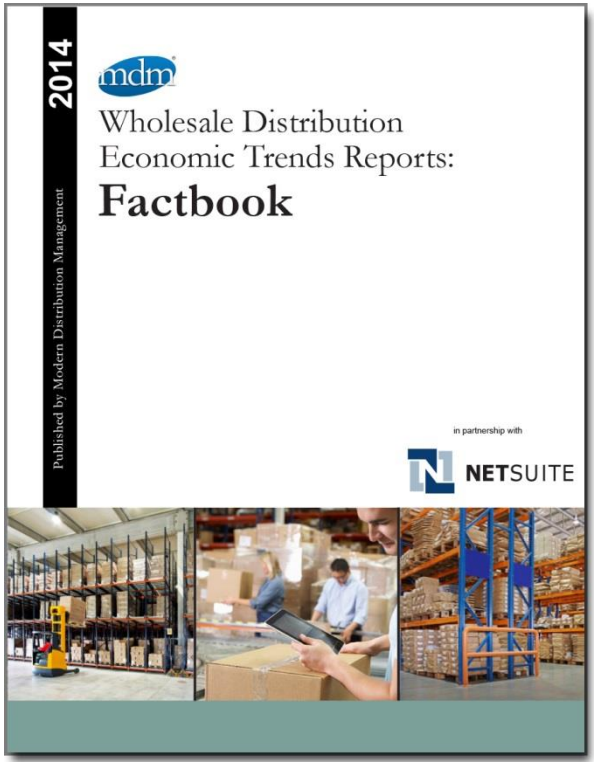
- Opportunities will grow as transportation equipment and maintenance grows
- Gridlock likely?



Looking forward

- GDP growth 2014-2016
- Employment
- The Fed
- Fiscal and other Government Policy
- Global risks and rewards

The 2014 Wholesale Distribution Economic Trends Report



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- Metal Service Centers
- Miscellaneous Durable Goods
- Motor Vehicle & Motor Vehicle Parts
- Office Products
- Oil & Gas
- Other Consumer Products

Where Business is Going

NetSuite for Wholesale Distribution

Ranga Bodla

Sr. Director, Industry Marketing, NetSuite

NETSUITE

Today's Constant State of Change

Business Models are Constantly Evolving

Agility is a Must

A Global View is Required

New Technology Impacts Expectations

Employee Engagement is Essential

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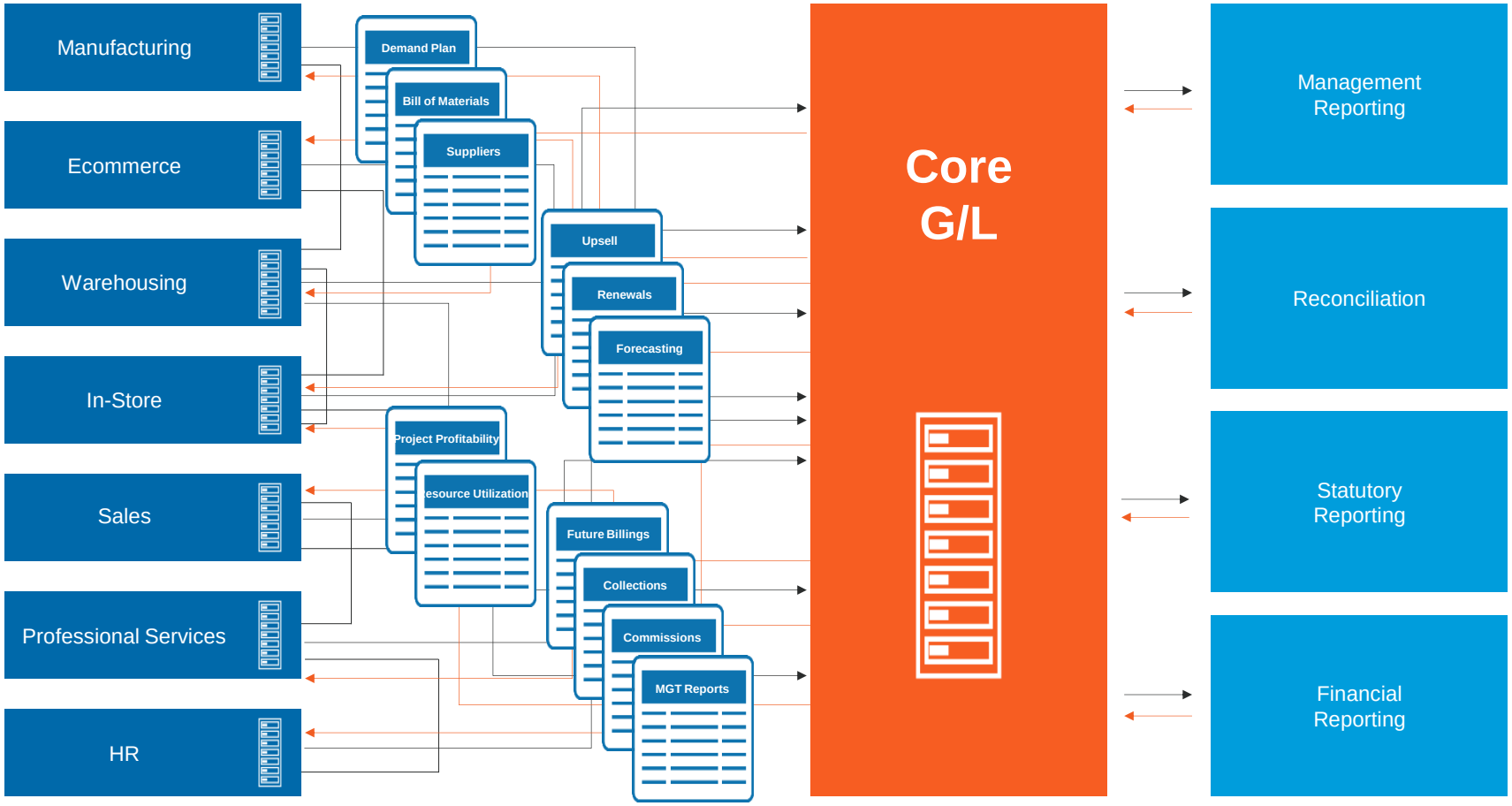
Cannot Adapt to Today's World with Yesterday's Fragmented Business Systems



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BUSINESS FUNCTION	BUSINESS PROCESS		NETSUITE PREDEFINED WORKFLOWS	BUSINESS IMPACT
Marketing	Segmentation Campaign Management Awareness	Market Definition, Markets Served Campaigns, Effectiveness, Leads Management	Marketing Strategy and Definition Marketing Program To ROI	Customer Acquisition Cost; ROI/Promotional Value; Marketing Effectiveness
Selling	Opportunity Management Pricing	Team, Channel/Reseller, Forecasting, Pipeline Management, Commission Management Configuring, Contracts, Promotions, Strategy	Lead to Quote	Forecasted Revenue; Projected Inventory Demand; Sales Effectiveness/ Close Ratios; Rep Productivity; Pipeline Management
Order	Input Type	EDI, Ecommerce, Direct Sales, Channel, Point of Sale, Mobile, Intercompany	Order to Cash	Customer Profitability; Cost to Serve; Profitability by Segment
Sourcing	Suppliers Procurement Sales & Operational Planning	Management, Performance, Stratification MRO, Direct, Purchase Requisition, Supplier Collaboration, Drop Ship Demand Forecasting	Procure to Pay	Inventory Cost Management; Lead Time; Cash Flow Management; Purchasing Compliance
Warehouse	Inventory Material Handling	Material Handling, 3PL, Receipts & Putaway Categorization, Fulfillment, Intelligence	Assemble to Order	Asset/Capital Management; Fulfillment Costs; Inventory Controls
Fulfillment	Shipping	Pick, Pack, Ship, Trade Compliance, Industry Compliance	Order to Fulfillment	Receivables; Shipping Cost; Cycle Time; On Time Delivery
Service and Support	CRM/Case Management Field Service Customer Self Service	Product Support, Warranty/Repair, RMA - Return Material Authorization, Rentals and Service My Account, Customer Portal, Knowledge Base	Call to Resolution	DSOs; Product Issues; Product Support Costs; Cost to Close

COMMERCE READY – SUITECLOUD – FINANCIALS

REPORTING & ANALYTICS | SUITEFLOW | GRC – GOVERNANCE RISK & COMPLIANCE | SDN – SUITECLOUD DEVELOPER NETWORK | HUMAN CAPITAL MANAGEMENT (HCM)

Why Today's Businesses Choose NetSuite

#1 Cloud ERP

Flexibility Built In

Business Intelligence That's Free For All

Commerce-Ready ERP

Designed for Modern Business

It Just Works

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Wholesale / Distribution Success

vega
Nuheat
Advantage Sign Supply, Inc. — Sign Making Equipment & Supplies
lightspeed
DC DENTAL — Supplies • Equipment • Service • Design
igea GROUP
ATLONA — Connecting technology to your world
Tacoma Screw Products, Inc. — Since 1946 — Fasteners • Tools • Maintenance & Shop Supplies
NBTY INC.
designs for health — Science first.
AUTOMATION-X
There's an engineer behind everything we sell. INSTRUMART
Allied Valve Inc.
sunlighten — empowering wellness™
INDIAN HARVEST
MFS SUPPLY
Fresh Produce Group
CTT — Building critical traffic connections
MerchSource — The Item Company
NYS COLLECTION EYEWEAR
SURFTECH
Arnolds
GOLDEN
MONTEREY LIGHTING SOLUTIONS
DVA Inc.
RIDOUT PLASTICS
ThermoWorks
GOOD HEALTH natural products
Spectronics — Inclusive Learning Technologies
RST — DESIGN | LIVING | OUTDOOR | SPORTS
ALPINE HEALTH
PPP — Professional Pavement Products, Inc.
best KITEBOARDING.COM
RUFFWEAR — For Dogs On The Go
cream — Wine Company
MICHE
SLINGSHOT
FullSource — Live Safely. Work Efficiently.
OUTDOOR TECH.
TECHNICA, U.S.A.
US MARKERBOARD — Quality Products - Knowledgeable Customer Service - Great Prices
LIGHTWEDGE
KASK helmets
ENDOCHOICE
MOUNTAIN KHAKIS
jelinekcorkgroup
BÉBÉ au LAIT
skinauthority — Live the skin healthy lifestyle™
IPICO — RFID REALISED
iAutomation — Take Control
HESTRA 1936
WOLFGANG PUCK COFFEE
TRIAD MAGNETICS
ECO BAGS

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2014 MID-YEAR ECONOMIC UPDATE

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