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MDM Special Report:

2015 M&A in Distribution

Table of Contents

MODERN DISTRIBUTION MANAGEMENT

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by J. Van Ness Philip

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ISSN 0544-6538

mdm.com

The Next Normal for M&A

Commentary by Thomas P. Gale

During the midsummer doldrums, two big acquisition deals announced in the past few weeks are worth analyzing:

- Grainger plans to acquire Cromwell Group, the largest independent MRO distributor in the UK, for a little more than Cromwell's annual revenue of US$442 million, or about 11x EBITDA margins.
- The Home Depot plans to buy Interline Brands for $1.6 billion, just under its 2014 annual revenue of $1.7 billion.

Both these deals break some current molds and at least start to paint a picture for how M&A might look different going forward. You could define normal the past few years as a continuation of portfolio building in the U.S. by European distributors, such as Sonepar, Wurth and others. For North American companies, it has been a feeding frenzy across a few strategic opportunity levels: grow market share by geographic acquisition within a core product portfolio or grow wallet share by expanding into other product categories.

Overall, it has been a seller's market, where the pool of highly attractive acquisition targets within many highly fragmented verticals is getting picked pretty hard. Financial market conditions continue to fuel record levels of demand.

Both the Grainger and Home Depot deals push this envelope more than a bit by exploring new markets and channels for growth opportunity through acquisition.

After years of M&A acquisition activity by European companies buying up industrial distribution capacity in North America, Grainger's big-time entry into the UK market turns the tide, with an e-commerce beachhead twist to it. Grainger sees adoption of online sales lagging in Europe (Cromwell's digital sales are relatively low). Grainger expects to boost its German online business as well as in the UK by using Zoro. It's a pure e-commerce site targeted at smaller customers, and modeled on its predecessor in Japan, MonataRO, which Grainger holds a stake in. Grainger has grown Zoro in the U.S. from startup to $300 million in four years.

At one level you could say this move by Grainger is merely an extension of its successful multichannel growth strategy, but it is a bit more creative than recent add-ons in the way it integrates the pieces.

As for Home Depot, its more definitive move back into B2B from B2C definitely gets it outside the retail box and beyond services to build a growth strategy into larger professional customers and markets with higher growth potential and stronger service components.

I expect we will continue to see more creative crossovers across these dimensions in the deals ahead that will change the shape of competitors.

M&A Competition Heating Up

Strategic buyers, private equity firms vying for same targets

Unlike previous cycles of strong merger and acquisition activity in distribution, today's market is unique in that strategic buyers and private equity firms are going after the same targets, setting the stage for an especially compelling consolidation story in the second half of 2015.

By Jenel Stelton-Holtmeier and Eric Smith

When the Great Recession ended, merger and acquisition activity began a generally upward trajectory in terms of volume. Deal activity peaked in the last quarter of 2012 in advance of tax changes being implemented, but excluding this spike volume has generally continued to grow.

Domestic M&A activity across all industries equaled that peak in third-quarter 2014, according to Houlihan Lokey, and while that number has dipped in the two subsequent quarters, all signs point to continued consolidation for distribution in 2015 and beyond.

"The M&A market today is as strong as it's ever been," says Reed Anderson, head of Houlihan Lokey's industrial distribution practice. "That's generally speaking, but it's particularly true in the distribution space."

While the industry has seen strong M&A cycles in the past, usually it has been driven by either the strategic buyers – big players looking to expand and get bigger – or by private equity firms looking to invest in the industry. What makes this cycle different, according to Anderson, is that strategics and private equity firms are competing for the same targets.

Strategic buyers still make up the lion's share of distribution M&A transactions. According to data from Supply Chain Equity Partners' proprietary distribution database, there were 331 distribution transactions completed in 2014. Of those, 213 were strategic buyer transactions, 47 were private equity-backed platforms and 71 were private equity-backed strategic buyers. (See **Figure 1**).

A "Unique Confluence"

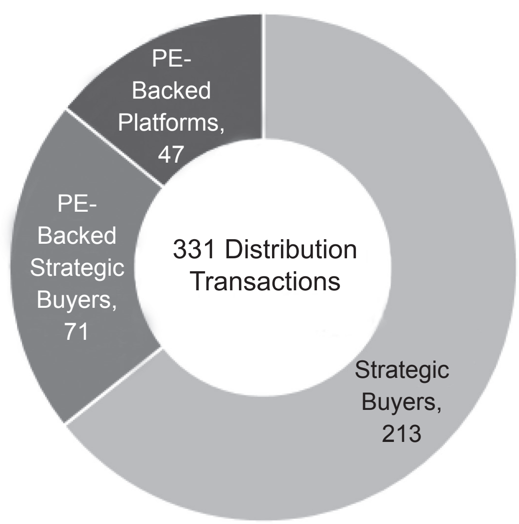
The M&A market in distribution is "incredibly strong right now" because of the industry's financial strength and stability, says Jason Kliewer, co-head of Baird's distribution group.

Theoretically, it makes sense that strategic buyers would be willing and able to pay more for a business because of their ability to capitalize on synergies, but recently private equity has been able to outbid strategic buyers on many deals. Private equity firms have an abundance of cash on hand from investors and financing is cheap – meaning more money is available for larger deals. And distributors have proven to be valuable targets.

"The private equity community – both mid-market funds that have traditionally invested in distribution, as well as the larger cap funds – has really looked at distribution models," Kliewer says. "They saw the performance through the downturn, the cash generation of distribution in 2009 – for many distributors that was a record cash year. From an ability to finance a transaction with leverage, that's very attractive in terms of risk."

On the strategic buyer side, slower-than-desired overall gross domestic product growth in the U.S. appears to be hampering organic growth for many of the key players. As a result, companies that haven't historically been known as acquisitive are looking for ways to augment their balance sheets, while at the same time, historically acquisitive strategics are picking up the pace of investment.

Figure 1: 2014 Distribution Transactions



Source: Supply Chain Equity Partners proprietary distribution database.

"It is a low-growth environment for a lot of larger strategic buyers, and one of the ways they can continue to grow is to make an acquisition and cross-sell a broader product range," Kliewer says. "In addition to those cost opportunities, the ability to take an acquisition and accelerate what would then be organic growth through cross-selling is very attractive."

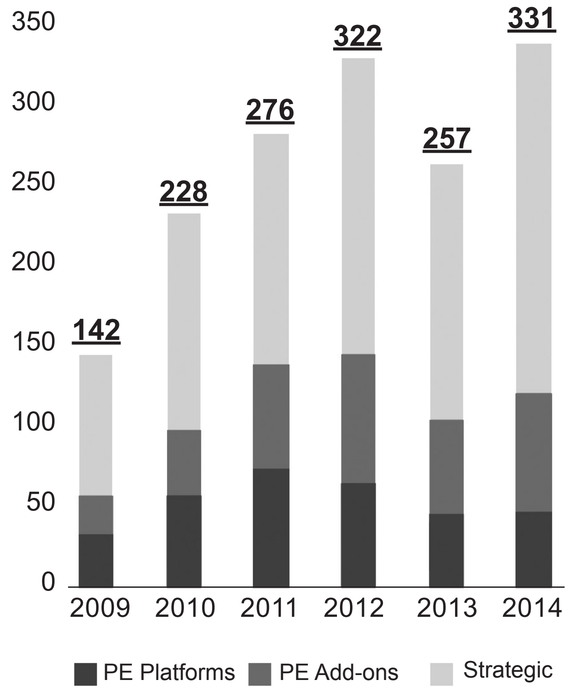
This "unique confluence" of factors – strong financing markets, high cash availability and strategic buyers looking for growth – are keeping the M&A market hot for distribution, Anderson says.

But it also means that it is a seller's market, says Jim Miller, a principal and founder at Supply Chain Equity Partners. Sellers have high expectations for valuations, because they're seeing those valuations in the market.

However, conditions may be shifting slightly in favor of buyers. "It's becoming a little bit more of a favorable buyer environment," says Charley Hale, president of FCX Performance, a distributor of process flow control products. "We definitely see the number of opportunities out there increasing."

Hale says FCX has a "very robust pipeline" as it looks to acquire companies in the range of $25 million to $50 million in annual revenue, and that potential sellers are receptive to the offers being made.

Figure 2: Number of Wholesale Distribution Transactions



Source: Supply Chain Equity Partners proprietary distribution database.

Sector Activity

While activity in distribution is broad-based, some sectors are stronger than others. Industrial distributors, particularly those dealing in maintenance, repair and operations-related products, continue to be strong targets. And aftermarket automotive has seen a lot of activity over the past year, Miller says.

"But the sector that seems to be getting strong and building momentum is building products," he says. "In terms of just deal volume, we've seen a lot of stuff in the building products space."

Certainly some of the largest M&A deals in distribution so far in 2015 have been in the building materials space. In April, Builders FirstSource, Dallas, TX, agreed to acquire Denver, CO- based ProBuild Holdings LLC for $1.6 billion.

And rumors have been floated that US LBM Holdings LLC, Green Bay, WI, is for sale with expectations that it could fetch $1 billion at auction, according to a report from Reuters. Meanwhile, the building materials distributor has been buying up a slew of other companies, completing 14 acquisitions in the last nine months.

Housing and construction has been among the slowest areas to recover from the Great Recession, though several analysts say that it's hit bottom. Building products is a cyclical market, Anderson says. "The market has moved and now it's in the upswing."

The economics of the U.S. residential construction sector, which has seen housing unit starts climb back to 1 million or more per month, bodes well for the building materials sector as it stages a slow but steady recovery.

"The market hasn't rebounded strongly, but there's a lot of excess capacity in some areas of distribution of building products," Kliewer says. "And at the same time there are more experts that think we're in for a longer, slower recovery, which in many ways is more conducive to a longer-term growth potential for the sector."

Oil and gas-related businesses are the exception to the strong activity. "That sector kind of shut down for a while because of the quick decline in prices for oil, so any activity you see there now is more borne out of the distress side," Anderson says.

Figure 3: Private Equity Buyer Activity – By Sector of Distribution

	2014		2013	
Sector of Distribution	Number of Distributors Acquired by PE in 2014	% in 2014	#	% in 2013
Industrial	48	*41%*	32	*31%*
Auto / Truck Parts Aftermarket	18	*15%*	10	*10%*
Building Products*	17	*14%*	17	*17%*
Consumer Products	9	*8%*	12	*12%*
Specialty Chemicals	6	*5%*	3	*3%*
Electrical / Electrconics	6	*5%*	7	*7%*
Foodservice & Beverage	5	*4%*	6	*6%*
Health Care	5	*4%*	9	*9%*
Other Sectors of Distribution	4	*3%*	6	*6%*
Total # of Distributors	118	*100%*	102	*100%*

*Building Products category includes HVACR/Plumbing distribution M&A, as well as other transactions involving distributors of product categories such as roofing, lumber, landscaping, kitchen cabinets and construction-related supplies.

Source: Supply Chain Equity Partners proprietary distribution database. PE transactions include PE platforms and add-ons.

Negative Influences

The significant deflation experienced in the price of oil since July 2014 also adds a lot of uncertainty for businesses that are impacted directly and indirectly by the economics around oil and gas.

"That deflation in oil has been causing deflation on a lot of byproducts that run through distribution," Miller says. And that may be responsible for some of the pullback in M&A activity in some areas.

There's also uncertainty around the financing market. While it's as good as it's ever been, "no one expects it to get better," Anderson says. So the question over everyone's heads is when is it going to go the other direction – and how quickly?

For now, expectations are for continued financing strength, but the concern is out there, he says.

Limited volume of exceptional targets may also be slowing activity, according to Miller. "The deal flow is still pretty strong, but there was tremendous pull-forward of deal activity in 2012 in advance of tax rates going up," he says. "I'm not sure how many companies that were pulled forward in their natural evolution would have been on the blocks around now."

"It's harder and harder today to buy solid platform businesses versus where it was a number of years ago," Anderson says. "People are willing to stretch more on valuations."

However, the positives in distribution M&A continue to outweigh the negatives, and activity is expected to be strong through 2015.

"I see over the next couple of years, unless there's a market correction or any of the unknowables that can come our way, a continued strong M&A market for distribution," Kliewer says.

M&A: Easing the Transition

Potential challenges abound for uniting companies with distinct cultures

In some ways, the financial and legal details of a merger or acquisition are the easy part. Once those pieces are in place, the challenge becomes uniting companies that have their own distinct histories, cultures and processes.

By Jenel Stelton-Holtmeier

The acquisition process doesn't end with ink drying on legal documents transferring ownership of one company to another. The process still requires bringing together two distinct companies to function as a cohesive unit.

There is no strict guidebook for successful integration. In fact, the process an acquiring company follows can vary depending on the acquisition target. But there are some key elements that can ease the transition for the acquirer and the acquired.

Culture is King

Successful acquisitions begin and end with a focus on cultural fit, says Bill Scheller, CEO of BlackHawk Industrial, Broken Arrow, OK. "We want them to feel like they're becoming part of the BlackHawk family," he says. "It's sort of like when you get married, you become a part of another family. And it's about being comfortable with your in-laws and happy with spending Christmases together."

If everyone is focused on making a better and stronger business, it's much easier to get everyone working together. If the cultures clash – "if they're more about 'my way' than collaboration," Scheller says – it can be a recipe for disaster.

"When you're performing acquisitions at a rate like we are, you have to be very intentional about driving the culture and making sure it doesn't get watered down or lost," says Wendy Whiteash, vice president of strategy and organizational development for US LBM Holdings, Green Bay, WI. "We're bringing on companies that have their own histories, their own perspectives and cultures, as well."

Acquirers have to respect that history and culture even as they work to bring the acquisition target into the corporate structure.

"There's always uncertainty no matter how good the commercial aspects of the transaction look," says Charley Hale, president of FCX Performance Inc., Columbus, OH. "There's uncertainty from the buyer and seller. Be upfront, try to communicate, meet with all the employees after a transaction, tell them the lay of the land going forward. You can tell they don't believe you, that there's skepticism, but as you go through that, you continue to execute against what you said you would do, then they start to buy in."

Easing the transition

One of the most common mistakes is not communicating enough, according to a report from Merrill Datasite. Focusing on improving communication among team members post-deal can be a huge advantage when trying to ensure the integration stays on track.

"You've really got to be very cognizant of communicating to your own employees and the target employees," Hale says. "In our business, it's built around vendor relationships, there are a number of exclusive and semi-exclusive vendor relationships, so the ability to bring those vender pieces together and make the vendors comfortable, the combination is going to produce growth above what they've seen in the past. And then trying to capture the customer synergies."

Timing of that communication is critical, as well. For example, BlackHawk Industrial won't announce acquisitions on Fridays. "I don't want employees sitting over the weekend and thinking about what might happen to them," Scheller says. "We do them on Mondays or Tuesdays, where I can actually spend time with the employees for three or four days and they can get to know BlackHawk and get to know Bill Scheller and the special culture that we're creating."

US LBM hosts associate meetings in the "first week or two," Whiteash says. "The executive team is on-site at the acquired business to meet with all associates to welcome them, tell the US LBM story and make a personal connection."

Meeting face-to-face with the acquired teams not only allows for the new company to explain its goals, but it provides assurance that communicating with everyone is a core value.

BlackHawk appoints a local "core values leader" to be a "cheerleader" at the local level. "With every acquisition, almost immediately, that person is appointed to be the local influential nonownership, nonmangement kind of person to bring everyone together," Scheller says.

Another stumbling block that sometimes occurs is trying to accomplish too much too fast, which can overwhelm the integration team. This can lead to more errors being made along the way or bad feelings developing – undermining the ever-important focus on culture.

"Our biggest challenge is balancing the desire for bringing all the things that we bring and the need to understand how abrupt change can be disruptive to our new associates," says Frank Roach, CEO of Ferguson, Newport News, VA.

Sometimes pressure for quick implementation comes from the acquired company, Whiteash says. The new partner wants to accelerate onto US LBM's logistics platform or launch its mobile app, but due diligence needs to be undertaken.

Branding and rebranding

A company's brand is often its core identity – the name that its associates stand behind and its customers recognize as representing certain values. But when an acquisition occurs, the question arises: What name will be the best one to continue under?

For many companies, the corporate brand represents consistency throughout the organization and underscores a uniform experience regardless of the geographic location. For others, such as global electrical distributor Sonepar, the power is in maintaining the local brand name. On Crawford Electric Supply's website, for example, the focus is on that local entity; Sonepar's logo appears only in the bottom corner of the page.

Other companies – US LBM holdings, for example – take a hybrid approach.

"Some customers might not know the name US LBM," Whiteash says. "But they know Hines in Chicago or they know Shelly's in Philadelphia. We have several companies in the portfolio that have been around for 100 years, or more, and they have quite the loyal customer base."

In contrast, US LBM Holdings was founded in 2009.

"Minimizing the emotional changes that typically come with acquisitions is also important as we begin to grow a trusting relationship with the newly acquired team," Whiteash says. "We're clear up front that there is no intention to change the operating company's name or leadership team."

Smaller acquisitions that expand the product portfolio and have synergies with the existing brand already in the market may be "tucked into" the local division, she says.

For BlackHawk Industrial, eventually getting the acquired companies under the BlackHawk banner is the ultimate goal – but the timeline to achieve that is variable, Scheller says. Some have been completed in 30 days, others have taken close to a year.

"There's a cadence to what we do, and that cadence is really dictated by the distributor that we acquire and the customers in that space," Scheller says. "We listen to the management, so we get the pulse of the customers."

Operational considerations

People are the most important part of any acquisition, Scheller says. After all, distribution is still a people business. So review of the compensation package has to be part of the integration process – and is best undertaken as part of the pre-agreement due diligence.

"We want to make sure that what we bring to the table is value-adding for the employees," Scheller says. To help ease the transition, employees of the acquired company maintain their pay grade and tenure as a BlackHawk Industrial employee. And usually, the benefits package is an improvement over what they were provided before.

"We want employees to feel they are going to be valued as part of BlackHawk Industrial," he says.

But it's not always that simple, which is why it's better to start early.

"You're always dealing with how sales people are compensated," Hale says. "If there are a thousand distribution businesses, there are a thousand and five commission plans out there. Being able to manage how those come together is critical, because that's the core of what you're buying."

Integration is about more than just integrating people, however. Companies are often at very different evolutionary points when it comes to technology, particularly around e-commerce and mobile applications.

"That's the future – EDI, electronic order entry, the Web – all of that is part of what we call 'big enough to serve,'" Scheller says. "Our model is to take those individual distributors that are small enough to care in their local marketplaces and have deep relationships with their end-users, and help them get to big enough to serve."

But getting everyone on the same platform can take time, and it doesn't do anyone any favors to try and hurry the process along without proper due diligence here, either. Setting a realistic and detailed timeline for implementation can provide checkpoints that help everyone recognize progress is being made even if the process takes longer than desired.

There is no single, correct road map to follow for post-merger acquisition. But if a company has undertaken the proper due diligence, including assessing culture and existing relationships, the process can be eased.

"Buying the wrong company is never the right thing to do," Scheller says.

And there are plenty of examples in the industry of mistakes that were made in buying companies or in consolidations, he says. "We learn from other's mistakes and try to make sure we don't repeat them."

Rebranding Road Map

Reinvention requires distributors to take a strategic approach

Increasing consolidation and channel blurring have sparked rebranding campaigns across distribution, shining light on the need for company leaders to be strategic in how they execute name changes and repositioning efforts.

By Eric Smith

As mergers, acquisitions and spinoffs escalate across distribution, more companies must decide which organizational names will survive, which will disappear and, if a new entity is forged, which will be created.

But consolidation isn't the only factor sparking a rise in rebranding throughout the industry. Channel blurring and product expansion have created the need for companies to refresh their image and create a new identity. When distributors add capabilities and adapt to an evolving industry, legacy names become obsolete, and it may be time for a reinvention.

No matter which scenario a distributor finds itself facing, the focus in a B2B rebranding should always begin with a company's most important stakeholder – the customer – according to Larry Mersereau, owner of PromoPower and author of *Stand Out*, a book about how small businesses can better differentiate, brand and position themselves.

"When people think about branding, they tend to think about themselves, meaning their company," he says. "They think, 'What is it about us that's special? What makes us wonderful?' But it doesn't matter what makes the company wonderful for you; what's important is what makes it wonderful for your customer base. Why do they love you, why do they buy from you? That is what your brand needs to talk about."

What's in a name?

The desire to attract more customers drives many companies' rebranding efforts, whether it's a new name, logo, tagline, website or some combination of these. That was the motive behind the recent name change at Falcon Fastening Solutions, Charlotte, NC, known from 1979-2014 as Falcon Metal Corp.

The company had evolved over the years, and in December 2013, Falcon's leaders agreed that a subtle name shift – specifically, shedding the word "Metal" – would more accurately describe its offerings, according to President Don Nowak.

"Our customers knew what we did, but when we went to the market and started working heavily in business development, there seemed to be confusion," Nowak says. "Some folks considered us a steel service center, others thought we were a sheet metal fabricator."

Nowak and his team worried that a big change would diminish the brand equity the company had built over 35 years, so keeping the word Falcon, as most customers called it, was paramount for any rebranding campaign. As the company weighed variations of a new name, it discovered that other companies used the words "falcon," "fastening" and "solutions," but none had all three, so Nowak and his team settled on that combination as the new moniker.

"Customers were familiar with us as Falcon," Nowak says. "... But with the prospects, it helped us to clarify who we are and what we do a lot more easily than it did before."

Clarification was at the heart of the name change that occurred last year at Edmonton, AB-based distributor Vallen, a Sonepar Canada company that rebranded from CenturyVallen.

According to President Guy Mersereau, the company didn't intend to sharpen its name until a third-party marketing firm, which CenturyVallen hired to help better convey the company's identity to customers, suppliers and even its own employees, devised a new tagline of "Working smart starts here." "We built around that," Guy Mersereau says, and decided more changes were in order.

The marketing consultant said the old name looked like two monikers slapped together after an acquisition – which was true – and recommended using the simpler Vallen. Not only was Vallen a cleaner name, but its new logo stood out on company signage and even on employee shirts, whereas "CenturyVallen kind of got lost," Guy Mersereau says.

More than anything, however, since the company had expanded its offerings over the years, distributing both safety and MRO products to its customers, this switch gave the company a chance to reintroduce itself to existing and prospective customers.

"It was an opportunity for us to reposition ourselves in the market and get people's attention and get employees wound up around something new without taking away from the traditions that made us good, just putting a new spin on it," Guy Mersereau says. "We wanted to convey that we were built on the strength of the old but we are something different, and hopefully look more modern."

Mixing old and new

Many companies are cognizant of the need to retain some of their legacies when they rebrand, even as they reposition with an eye on the future – including a changing marketplace and evolving customer needs.

Last month, WinWholesale announced it had become Winsupply Inc. The Dayton, OH-based distributor began the rebranding process because its chairman, Rick Schwartz, wanted a "single, cohesive powerful brand that creates national presence and position, not only in wholesale distribution but in all of the industries we serve."

"One of the issues we have faced is that WinWholesale doesn't sell anything. To our customer base the name WinWholesale was really irrelevant, because customers didn't do business with WinWholesale, they did business with their local operation," says Steve Edwards, the company's chief marketing officer. "To align our brand with the brands of our locations gives us more ability to market regionally, market nationally and also align with the changing marketplace dynamics and enhance our customer experience."

The company's name, however, was meaningful, Edwards says. "It is part of our heritage and our history, and an important part." Keeping "Win" in the name not only minimized the scope of the rebranding effort, but it was the "one consistent thread that held us together, and it was important that we kept it."

"Coming out of the Great Recession we saw more of our locations that might have been branded Winair or Winlectric or Windustrial – very specific names – branching out into other areas to take advantage of the opportunities that came up through the recession, to expand their offerings for new customers," Edwards says.

Winsupply's CEO, Schwartz, says the new name more accurately describes the company's business today, which is to be the "suppliers of diverse residential and commercial construction and industrial supplies and equipment.

"More and more of our customers are no longer focusing on just one industry, like plumbing," Schwartz says. "They're adding heating and air conditioning equipment, PVF or electrical supplies in order to grow and diversify. Similarly, many of our local companies are doing the same, diversifying to meet the needs of their customers and to grow. The Winsupply name does the best job of capturing that diversification."

Starting over

Winsupply's decision to leave "Win" avoided what Larry Mersereau calls "wiping the slate clean." It preserves "all the work that you've done to build some brand recognition." Yet starting with a clean slate is necessary for some companies, however, especially following a divestiture.

When Anixter International Inc. sold its fasteners segment to American Industrial Partners, the company was reborn a few months ago as Optimas OE Solutions. National Oilwell Varco Inc.'s spinoff of its distribution business became NOW Inc.

But spinning off a new company or divesting part of a business is just one reason companies start over with a completely new name and new identity. As United Stationers grew organically and through acquisition, expanding capabilities with each purchase, it realized that its ordering systems across all of its businesses weren't integrated. Company leaders devised a way to unite them all into one platform, but they also decided its long-standing name no longer quite fit.

The company rebranded as Essendant earlier this year, launching the name at its annual show for customers and suppliers in February and formally changing it June 1.

"United Stationers was a very good name for the company when we were in office supplies exclusively," says Vince Phelan, the company's director of category marketing and communications for business and facility essentials. "But as we started to grow our business in cleaning, facility maintenance categories, as well as breakroom and foodservice, technology and industrial, we quickly realized, particularly when we approached people in the e-commerce space, that we had a lot of capabilities."

Those expanded capabilities led the United Stationers leadership team to create Essendant – a blended word depicting how the company provides business "essentials" to help customers "ascend" – which it felt was more fitting for the company's current business model.

As Phelan noted, when a United Stationers sales rep called on Lowes.com, it became increasingly difficult to explain how a company could enhance its digital capabilities, for example. "That ability to enable their e-commerce didn't match the nameplate on the front of the company. That was the first splash of cold water that told us, 'It might be time to reinvent our identity,'" he says. "That older identity didn't match the current state reality."

Another example is Rocket Industrial, Wausau, WI, which changed its name from Packaging Tape Inc. a few months ago because, as President Ryan Gallagher says, "Packaging Tape, or PTI, was just not who we were anymore. It helped communicate internal changes that had happened within our company, and it helped us get out of a 'packaging tape' perception. We're way beyond packaging tape."

He says sales conversations would get off to a "rocky start" because reps would have to explain to prospects that the company doesn't just sell tape.

Choosing a new name risks the loss of brand recognition, but it has its benefits, as well, especially for companies like Rocket Industrial and Essendant, the latter of which also chose a new word because it operated numerous other entities under the United Stationers umbrella and didn't want to choose one legacy name while leaving others out.

"You want to create the sense that we're all in this together. There is no winner or loser in this journey," Phelan says. "If we adopt United over LaGasseSweet or ORS Nasco, now it feels like those companies have lost. When we're all moving from what we had to Essendant, we're all in this together."

Steps for successful rebranding

Once a company has decided a name change might be in order, the rebranding process will vary depending on the scale of the change and the size of the company. Most distributors say they used a combination of inside and outside help for a rebranding campaign, but all stress that performing extensive due diligence, hiring a third-party marketing firm and seeking feedback from a variety of stakeholders – customers, board of directors, employees, etc. – are critical.

Rocket Industrial's Gallagher says the company looked to three segments for feedback on the new name: current customers, prospective customers and "the industry" (basically vendor partners and competitors, he says). Though the "process was long and involved a lot of research," Gallagher says doing the up-front work to ask the right questions and not rush into a decision was critical for the company's rebranding campaign.

The biggest pitfalls involve legal wrangling – from the minutiae of the formal name change to ensuring the URL of the new company name is available. But once a new name is chosen, the Web domain is secured and the legal papers are squared away, the rest of the process can be simple with the right people spearheading it.

A rebranding campaign shouldn't be taken lightly says PromoPower's Larry Mersereau, but whichever path a company takes to creating a new identity, the surest way to success is by focusing on how the outside world – not just the C-suite or board of directors – will embrace the change.

"Nobody cares how long you've been in business. Nobody cares what your kids or your dog look like. All customers care about is themselves," he says. "So many people spend a whole lot of time talking about how wonderful they are instead of talking about the results their customers are going to get after you do business with them."

■ *M&A Case Study*

Behind the Deal: Anixter & HD Supply

Power Solutions sale expands Anixter's core, sharpens HD Supply's focus

Anixter International Inc. recently announced it would acquire HD Supply's Power Solutions division, one of its core lines of business. This article looks at how the $825 million deal benefits both companies.

By Eric Smith

The roots of Anixter International Inc.'s acquisition of the Power Solutions division of HD Supply Holdings Inc. for $825 million trace back to strategic planning meetings the Glenview, IL, company held over the past few years. During those meetings, Anixter's management team identified a pair of gaps in the company's electrical business and brought those findings to the board, according to President and CEO Bob Eck.

First, the company lacked breadth in its electrical and electronic wire & cable business. As a specialty distributor in that product line, Eck says, Anixter had been "really good at identifying specifications for products that support a specific requirement a customer has and providing supply chain services around that," but Anixter hadn't been able to gain traction in a significant part of the market – mid-size construction projects.

Anixter was capable of meeting customers' needs for smaller day-to-day orders while also satisfying the demands of larger industrial projects, Eck says, but company executives recognized that wire and cable wasn't substantial enough in total spend for customers working on mid-sized projects to break it out separately from the electrical package. That meant customers would buy their equipment and their wire and cable from one source – and Anixter wasn't equipped to be that one-stop shop.

Anixter's second gap was in the utility business. Eck says the company had been losing market share to companies with a broader offering, particularly in the utility MRO space, as well as in transmission and distribution. With the economy finally on the upswing with projects roaring back to life, the company decided now was the time to bolster that platform.

"We believe that we're in the early stages of a capital investment cycle in the utility market in the U.S., particularly, and we wanted to address the weakness in our utility business and take advantage of that capital spend cycle," Eck says.

Addition by Subtraction

As Anixter looked to fill gaps in its business, HD Supply, Atlanta, GA, was looking to simplify. When the company sold its Hardware Solutions division to The Home Depot in December, four core businesses remained: Facilities Maintenance (FY14 revenue of $2.5 billion); Waterworks ($2.4 billion); Power Solutions ($1.9 billion); and White Cap ($1.5 billion).

But shedding one business and keeping those four didn't move the needle enough. And while divesting Power Solutions meant losing nearly a quarter of HD Supply's annual revenue, proceeds from the sale would offer more flexibility for the company to reduce debt.

"If you look at the strategic rationale for the transaction for HD Supply, at the highest level it allows us to enhance our business mix, and it will accelerate our capital structure strategy," says President and CEO Joe DeAngelo. "We're in the process of evaluating the precise application of the proceeds, but we intend to be able to utilize them entirely to reduce debt."

Power Solutions made the most sense as the odd division out, DeAngelo says, because "the other three all have established clear No. 1 positions in their space." In other words, Facilities Maintenance, Waterworks and White Cap segments faced less threatening competition in their space than Power Solutions did, particularly on the low-voltage side.

"There are some formidable global players that have billions and billions of dollars of market share out there," DeAngelo says. "It's a very different business aspect on that side, the low-voltage side. On the high-voltage side, we were clearly No. 1. Anixter's strategy was to be able to extend themselves in the high-voltage side."

Build vs. Buy

Anixter debated two approaches to filling its gaps: building organically or pursuing an acquisition target that would meet its needs more quickly.

Organically solving the problem meant identifying new product lines and suppliers, hiring and training additional salespeople and building up the divisions "one customer at a time," Eck says. "Or, you can go out and do an acquisition and accelerate that process of filling the gaps very dramatically."

Eck says the company steered away from organic growth for another reason – some suppliers maintain a committed channel structure and aren't looking for additional distribution, particularly in the highly fragmented electrical space. "There may not have been enough room for the suppliers to fit us into their distribution strategy," he says.

Around the same time Anixter entered full acquisition mode, HD Supply was entertaining offers for Power Solutions.

"We always have great incoming interest for all our business models," DeAngelo says. "The way I look at it is we have very differentiated business units. They're all very strong, and people would find them attractive additions to their business. There's nothing different in this case. Power Solutions was a sought-after asset."

Finally cultivated and inked last month, the $825 million agreement for Anixter to acquire Power Solutions means it is adding $1.9 billion in revenue, $79 million in EBITDA, 200,000 SKUs, 1,800 employees and 130 branches – but the numbers weren't all that mattered to Eck and DeAngelo.

Cultural Alignment

Anixter's pursuit of Power Solutions as an acquisition target is recent, but its familiarity with the division predates the formation of HD Supply. A few years ago Anixter studied some best-in-class supply chain service providers as a way to benchmark its own successes and weaknesses. One of the companies that Anixter analyzed was Hughes Supply Inc., which, through subsequent acquisitions and spinoffs, ultimately became the Power Solutions division of HD Supply.

Based on the research it had done on Hughes – even though this was a different iteration of the company – Anixter had found not only the right business fit, but the best cultural fit, as well.

"We knew the Hughes background, we knew their reputation for supply chain, we knew the HD Supply reputation for integrity," Eck says. Anixter executives liked what they saw in the company's value-add services, management style and talented employees, the latter of which was most critical because "distribution is all about the people."

That cultural alignment also was important to DeAngelo, who says during a divestiture he always makes sure that "our associates are going to a great home. From day one … it was a good fit. The cultures were very much a match."

"At the end of the day we think this is a very exciting next chapter of our Power Solutions associates joining Anixter," he says. "It's very complementary relative to understanding the profit pools of Power Solutions. There's nice overlap and adjacency for customers, suppliers, products, everything that makes a business work well."

Not only was Anixter a good home for Power Solutions employees, "where they could live to their full potential and execute to their full potential," but the transaction was positive from an HD Supply shareholder standpoint, DeAngelo says. "We were able to hit that. We are very, very pleased with the transaction."

Moving Forward

Anixter looks different now than it did just a year ago due to the $420 million purchase of Tri-Ed that closed last September, the $380 million divestiture of its Fasteners division that closed this June and this $825 acquisition of HD Supply's Power Solutions division that will close in the third quarter. Despite these changes, the company's focus hasn't changed. Rather, it has been "sharpened," according to Eck.

DeAngelo calls the deal mutually beneficial, saying, "it was a good match for them and good divestiture for us."

"If you look at us going forward, our business is going to change but our strategy won't," DeAngelo says. "Our strategy is an organic growth strategy. We execute five growth plays: selling more to existing customers; introducing new products and services; expanding channels to reach customers via catalog and Internet mobility; acquiring new customers; and opening new locations.

"This is a transformational transaction for us. It positions us to get faster and better."

Anixter also sees the deal as transformational, yet different from typical industry consolidation in that it perfectly aligned the needs of the two companies involved without one sacrificing too much.

"Each one of us is good at something different, and when you put them together it becomes extremely powerful," Eck says. "It's not so much consolidation or a market share build opportunity. It is an opportunity to augment our capabilities as a combined organization."

■ *M&A Case Study*

Stellar's Impactful Deal

Union of MRO distributors goes deeper than just a business transaction

MRO distributor Stellar Industrial Supply, Tacoma, WA, found an ideal acquisition target in Impact Industrial Supplies, Tampa Bay, FL. The companies' CEOs spoke with MDM about the deal that merged like-minded organizations with similar goals and cultures.

By Eric Smith

Most of the milestones in Stellar Industrial Supply's acquisition of Impact Industrial Supplies earlier this year are easy to pinpoint, including the June closing date, the April press release announcing the deal, even the January meeting where company executives began mapping out financial, legal and personnel details.

But the transaction's roots predate these events by nearly a decade, beginning with the first meeting between Stellar President & CEO John Wiborg and Impact President John Diaz.

Though they lived and worked in opposite corners of the country – Wiborg in Tacoma, WA, and Diaz in Tampa, FL – their paths began to cross through a variety of networking opportunities. Both were 3M Premier Distributors. Both attended Industrial Supply Association events. And Wiborg recruited Diaz and his company to join Affiliated Distributors.

Wiborg calls Diaz a "kindred spirit" who "thought about his business all the time, invested in his business and thought about ways he could continue to be relevant to the market."

"I've always enjoyed how progressive he is in the way he thinks about his business, delivering value to customers," Wiborg says.

Because their geographic distance and personal closeness precluded competitive fears, the two also found ways to share best practices and bounce ideas off each other as their businesses prospered. "John always opened up his organization and allowed me to tap into it, whether it was an IT question or anything else," Diaz says.

Natural fit

This relationship provided the foundation that could support the union of companies whose philosophical alignment trumped their physical distance.

Established in 1988, Stellar is an MRO distributor whose customer base was traditionally in the Northwest. During the company's 27-year history it acquired a handful of assets, each transaction fitting Wiborg's lofty ideals for both his own business and the targeted company.

"We want to be a dynamic, growing organization, so we're not just sitting here doing the same thing we did 15 years ago," he says. "Also, we're trying to take inertia from a great company and be additive."

Wiborg saw that adding Impact would fit that mold. First, acquiring his friend's company made business sense for Stellar, with the deal adding scale, enhancing partnerships with suppliers, expanding its footprint to new markets and bringing on new product lines.

"For all of those reasons we want to grow," Wiborg says. "We saw an opportunity to not only bring some resources to Impact – and by that I mean not only financial resources but capabilities such as our vending solutions and also our metalworking capabilities. Where he's very strong in MRO and in safety, we think we can help him develop that whole region down there under the aegis of Stellar by going out there and executing the market with some of the resources and knowledge and capabilities we bring."

But bringing the company aboard also met Wiborg's most important criteria. "When we're looking at acquisition possibilities, the first gate that's got to be overcome is, 'Is this organization we're looking at a great organization and are their values and business philosophy compatible with ours?'" Wiborg says. "They're never going to be exactly the same but they have to be compatible."

Positive impact

Over the years, Wiborg learned that "not only is (Diaz) progressive, but he is a person of great character. The value that he brings to his organization, his customers, his supplier partners and his community dovetailed almost to the 'T' with our values." Even more than adding a new region or creating scale, this was the impetus for Stellar to add Impact, which Diaz and his wife formed in 1991.

Diaz also saw this as a good fit. Although the business had enjoyed much success over the years, expanding to 15 employees and enjoying nice market share in the Southeast, Diaz understood the limitations of being a small distributor, and he recognized a vulnerability that he might not be able to fully serve every customer's every need.

Though Diaz wasn't necessarily looking to sell, he entertained offers over the years because he sought ways to create value for company stakeholders. He always turned them down, however, because "it never felt that the buyer was culturally aligned with what I wanted to accomplish with my company and the people that worked for me."

But Stellar's pitch was different. Here was a company led by a friend whom he admired and trusted, a similarly minded distribution leader whose company could provide Impact and its employees unprecedented growth opportunities.

"The big challenge for Impact was growing capacity and scale to stay relevant, and that was what I saw as one of the benefits of joining an organization like Stellar that could provide us that platform and capacity to bring more value to our customers," Diaz says.

Smooth transition

Diaz says his employees weren't surprised or panicked about the news. Most of them knew Stellar, the work it did and the close relationship between the two company presidents.

"When I met with my team and shared with them that this was a journey we were going to go down and this is what could happen, everyone was excited," Diaz says.

Diaz says the level of trust from his team, which was essential for moving forward, resulted from a 24-year history of open communication and "full disclosure" environment. Not only did that culture create a smoother transition and integration process, but without that culture the deal never would have reached that stage.

"If you're trying to do a deal from the seller's standpoint, and you didn't have that kind of organization, that you felt like you had to keep everything from them, at the time of closing the announcement is not going to float as well as it could, and both sides are going to have a lot of headaches that they're going to deal with," Diaz says.

His team also was amenable to the acquisition because Stellar didn't try to impose its corporate model on Impact, a process that was aided by each company already operating on the same ERP and CRM platforms, but mostly by having similar corporate cultures. Wiborg made sure the company wasn't asking its newest asset to blindly assimilate into the "Stellar Way."

"We really are interested in learning new ideas, so that's part of the dynamics of bringing in new folks and new organizations into our company," he says. "It keeps us thinking in a fresh way. We look at practices and different ideas and even success stories with specific vendors or customers and we say, 'Why can't we adopt this value?'"

Lessons learned

Stellar's acquisition of Impact – which the companies call a merger – created a company with 171 employees and 12 branches. The bulk of the integration work was handled by Stellar's cross-functional team that included employees from its supply chain, technology, customer experience and commercial departments.

Now mostly complete, the acquisition serves as a blueprint for other companies in similar situations. While a deal must make business sense, both Wiborg and Diaz say cultural alignment is more critical to a successful transaction once the two organizations begin operating as one.

It also gave Diaz some insight into the approach a company should take if it's looking to sell to or merge with a larger organization. It begins by getting the "financial house in order," he says. "That, at the end of the day, is going to generate the level of interest and excitement from a buyer that a seller is going to want to have."

Next, he says, it's critical to have employees who understand what their role is, as well as understand the role of the distributor in a competitive landscape. Last is the principle that led to his union with Stellar – networking. Company owners can achieve this through associations and buying groups, by getting involved with boards and committees, any outlet that gets you in front of peer distributors both large and small.

"When I've had people reach out to try and express an interest in buying Impact, it immediately was a 'buyer-seller' discussion," Diaz says. "In the Stellar-Impact scenario, it never felt like a seller-buyer discussion. It was a result of a relationship that evolved. There are a lot of great people in our industry and if you're a smaller company and this is a path you want to go down, be proactive in your networking. It's not about positioning yourself to 'be bought,' but rather getting to know people as a peer. Then the offers will emerge."

■ *MDM Interview*

Behind Ferguson's Acquisitive Year

Distributor completed 13 acquisitions during fiscal 2015

Fiscal 2015 was an acquisitive year for HVAC & plumbing distributor Ferguson, Newport News, VA. The distributor more than tripled the number of completed acquisitions it saw in fiscal 2014. CEO Frank Roach recently spoke with Editor Jenel Stelton-Holtmeier about the company's acquisition strategy and how it fits into the overall growth strategy.

MDM: How's business going?

Frank Roach: Business is going well. We just finished our year in July, so it's "Happy New Year" at Ferguson right now.

It used to be more of an uneven recovery; now we see a more consistent one across all our businesses. We're seeing growth in all our markets, albeit somewhat lower than prerecession. The market is good, and we feel like we're in a good place and doing a nice job of taking share.

MDM: Ferguson completed 13 acquisitions in its fiscal year 2015. How does that compare with prior years?

Roach: That's up quite a bit from the prior two years. In fiscal 2014, we had four, and two years ago in fiscal 2013, we did three. So it's up, but we have no specific acquisition target number. We feel like that would drive the wrong behavior. It's not just the quantity we're looking for. It's the shape and the size and the business makeup that we look at, as well.

We look at opportunities for expansion in markets, new product opportunities, ways to complement existing locations, and we do a lot of bolt-ons that are easy to integrate and expand what we do. If you look historically, since I've been with the company, we've done 150 acquisitions. It's an important part of our growth strategy.

MDM: What does that growth strategy look like? What are your strategic priorities for acquisitions?

Roach: It's part of the overall growth strategy. We grow organically through like-for-like and new store openings, and we also look for opportunities for product and business expansion, as well as geographic expansion.

Obviously acquisition is the easiest way to enter a market. Our history of diversification, which goes back some time, really reflects doing a significant acquisition in a new space that gives us a platform for national growth.

The mix of acquisition versus organic has changed significantly since the recession. Before we used to grow 50 percent through acquisition, now we're in most of the geographies we want to be in, and I would say the mix is more like 80/20, or even 90/10 in the last couple of years, organic.

MDM: What do you think is driving the high level of activity this year? What is it about the current conditions have made it possible to complete so many deals?

Roach: Sometimes it's less about the economy and more about the decisions people are making in terms of succession planning, investing in the business, etc. To compete today you really need to be committed to technology, and the investments that technology requires, so that's a consideration too. This was one of those years where a lot of companies, particularly smaller companies, were just making those decisions.

The cultivation of acquisition doesn't happen within a short period of time. It's not like putting public companies into play. Some of the companies that we acquired over this past year we've been having conversations with on and off for a number of years. We're OK with that because it's about relationships, it's about culture. We want them to know as much about us as they can, and we want to know as much about them as we can. The owners are very concerned about what's going to happen to them and what's going to happen to their people.

There was no specific event, no acceleration from us or change in the economy that we can point to. It was just one of those years where a number of those discussions morphed into real acquisition opportunities.

MDM: How do those conversations start? Are these companies that you've reached out to or ones that have put themselves out there where you recognize the opportunity?

Roach: It's a little bit of both. There are companies that make a decision and work through someone else or even contact us directly. There are very good companies out there starting that conversation.

But our approach, particularly if we're going to a new market, is about beginning a conversation. Maybe it's something the owners didn't think about as part of their long-term strategy, but we have the conversation with companies that we think are a very good fit.

The fit – yes it's about geography and yes it's about product expansion, but it's really about people. Our biggest competitor is the local competitor, and we have a great deal of respect for the relationships that our competition has in a market. And it's those relationships that we want to attach ourselves to.

MDM: What's the acquisition outlook for the next year? Do you expect to remain this active or to return to more normal levels?

Roach: I'm not sure what is normal now.

We're very active across the country among all our businesses, and we'll just see how it goes. We never predict; we have some closings coming up but beyond that we just don't know. It's a timing issue – when to close – but we think there are still wonderful opportunities for us to become associated with very good companies in the markets that we serve.

MDM: Some of your acquisitions – notably HP Products – are outside of your main product categories. Is diversification an active strategy for Ferguson right now?

Roach: It is an active strategy. If you look at HP Products and the jan-san category, that's the number one category in the MRO space. We feel like MRO was just a natural move for us, a space to be in because it's about leveraging our people and the product categories that we're already in, and leveraging our supply chain, e-commerce, etc.

For all the right reasons, it just made sense. We had this product offering gap that we felt like we needed to fill, but we didn't rush into it. HP filled that product category. We've now completed our MRO approach on the residential side, in terms of our offering, and we have a very good company that is helping us learn more about that space.

We do spend a lot of time looking for the right company to make sure it's the right fit, particularly if it is going to be a platform that we're going to learn from. It's worked well, and this diversification has served us well particularly with the cycles that we experience in our industry.

Table 1: Timeline of Ferguson Diversification

Business Unit	Platform Co.	Fiscal Year
Plumbing & Mechanical	1953 (start-up)	1954
Waterworks	Pompano WW	1987
HVAC	LBS Supply	1989
Industrial	Integrated	1989
Ferguson Fire & Fabrication	J&G Products	1997
B2C	Improvement Direct	2007
MRO	HP Products	2014

MDM: How does Ferguson approach integration to ensure a more seamless process?

Roach: It's about knowing each other – the approach, the expectations, particularly around growth and opportunities for the leadership team and the associates. We need to understand their needs and desires. Integrations work well when you have great communication and understanding between the two companies. Essentially what that means is there are no surprises once you acquire a company. That's a good thing.

We're pretty good at sticking to a process, a timeline for introducing technology, leveraging supply chain and doing all these things that we need to do to support the new company. We feel like if both sides have done their homework and have been open and honest in conversations, then integrations go well.

And we sometimes use the prior owners and executives from recently acquired companies as references for companies we're looking to acquire. We may say: "Don't listen to us. Why don't you talk to the last three companies that we acquired and get their feedback?"

The roles owners or executives play after acquisition is really dependent on what they want to do. If we're acquiring good companies – and that's what we do – they obviously got there for a reason, because of the leadership and the presence in the marketplace. We want to continue with that; that's very important to us.

It's also not just about serving customers, it's about serving the community. And those leaders can help get that connection started quickly. That's something that we're all committed to.

MDM: What are some of the biggest challenges around integration?

Roach: Our biggest challenge is balancing the desire for bringing all the things that we bring and the need to understand how abrupt change can be disruptive to our new associates. You get into this "stop-go-stop-go" pattern sometimes. That's why it's important to have the conversations up front. If you do, we can move at an appropriate pace with the understanding of what the business requires and what the associates want.

Typically the way it works, when we start bringing in some of the bells and whistles, then they come back and say "Can't we speed this up a little bit?" We get more of that than "Please, we've had enough."

We start by making sure our associates are taken care of, and then when they start seeing the benefits of size and scale, of innovation, when their fill rates in the marketplace become world class, when they have technology and B2B investments – when they see a lot of these things, they recognize these are tools that we can provide to help them compete best in the marketplace.