MODERN DISTRIBUTION MANAGEMENT

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Private Label Use to Grow

Strategy will strengthen but also strain relationships

Private label products—products branded by a wholesaler-distributor—represent a break from the more traditional wholesale distribution approach of reselling manufacturers' branded products. In our new research study, Facing the Forces of Change®: Lead the Way in the Supply Chain, *we found that private label strategies by wholesaler-distributors will expand substantially over the next five years.*

By Adam J. Fein, Ph.D.

Private labels will strengthen wholesaler-distributors' relationships with their customers. However, they will strain distributors' relationships with their suppliers by challenging the wholesale distribution channel's traditional role as an extension of a manufacturer's sales and marketing activities.

Wholesaler-distributors will need to build new capabilities in manufacturing and design in order to create products with unique, premium benefits. They will also have to select the right opportunities for private labels and manage the new supply chain risks associated with global sourcing.

Future Growth

We use the term private label to include products manufactured by a wholesaler-distributor under contract as well as more traditional branded products that are owned or acquired by a wholesale distribution company. A private label product's brand may incorporate the wholesaler-distributor's company name or it may use a distinct name. In both cases, marketing of these brands contrasts with a more traditional approach of reselling manufacturers' branded products.

Exhibit One shows the current and projected prevalence of private labels for the six major markets covered in *Facing the Forces of Change®: Lead the Way in the Supply Chain*. On average, 43 percent of wholesaler-distributors currently sell their own private label products, although there are substantial differences between the six major product types in our study. For example, almost one-half of building materials wholesaler-distributors currently offer private label products, compared to only 23 percent of contractor supplies wholesaler-distributors. Keep in mind that every company is unique. Your company may

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Exhibit One:
Percent of Wholesaler-Distributors Offering Private Label Products

Type of Product	2006	2012 Forecast
OEM and Production Materials	61%	77%
Finished Retail Goods	54%	73%
MRO Supplies (Industrial and Commercial)	49%	69%
Building Materials	47%	74%
Machinery and Equipment	35%	55%
Contractor Supplies	23%	52%
Average	**43%**	**65%**

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participate in multiple markets regardless of the products sold.

The lower costs and ready availability of overseas sourcing opportunities in Asia and South America accelerate the ability of wholesaler-distributors to get their own value-priced private label products manufactured. About 57 percent of wholesaler-distributors with private labels currently source their private label product from an overseas plant. By 2012, 81 percent of these wholesaler-distributors expect to be sourcing overseas.

For example, Do it Best Corp., a U.S.-based member-owned distributor of lumber, hardware, and building materials with annual revenues of more than $3 billion, opened Asian offices in Hong Kong and Hangzhou in 2006. Although the company has sourced from China since the mid 1990s, the new offices put company management physically closer to manufacturing, packaging, design, and inspection.

Business Benefits

Private label products offer three major benefits to wholesaler-distributors:

- Buy-side margin. Private label products can be priced lower than comparable national brand products, especially when sourced directly from an overseas manufacturer. Since private label products are less expensive to purchase, a distributor can earn a higher margin even when the products are priced at a discount to national brand products. This option simultaneously grows margins for the distributor and aligns the distributor more closely with its customer's objectives.
- Sell-side profitability. A wholesaler-distributor's private label products offer the opportunity for increased profitability by capturing the branded margin that would otherwise flow to an upstream manufacturer. The distributor also gains the ability to control the entire profit stream from production to sale, allowing for more flexible sales compensation models and higher commissions to drive sales. For example, a distributor can reduce the advertising overhead of a national brand manufacturer, especially on certain products for which customers see no value differentiation.
- Differentiated product assortment. A private label brand name can be exclusive to a wholesaler-distributor and provide a point of differentiation. For example, some wholesaler-distributors find that they can fill gaps in the marketplace by offering the good (value) alternative in a good/better/best hierarchy. Availability can be another point of differentiation. A private label product can be sourced from multiple manufacturing companies and this gives a distributor the opportunity for more consistent product availability than when sourcing from uniquely branded manufacturers.

W.W. Grainger, Inc., a distributor of facilities maintenance products, currently has more than 9,000 private label SKUs equaling $400 million in sales. These products, which came primar-

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ily from China and Taiwan, had gross margins that are 20 percentage points higher than other products sold through the company's branch network.

Strengthening Customer Relationships

The most innovative wholesaler-distributors are also using private label products to strengthen customer relationships and grow their businesses.

Consider Arbill Safety Products, a third-generation distributor that provides safety products and services to customers in a wide range of industries. In addition to stocking more than 4,000 products from all major branded manufacturers, Arbill has offered its own private label products for more than 20 years. As part of the company's growth to serve larger, national customers, Arbill began branding its private label product line under the TRULINE® brand.

Arbill can differentiate the brand in the marketplace by controlling the entire value chain from design to delivery. Customers can request specific features to existing TRULINE® products. This allows Arbill to produce a customized, unique product for customers with special requirements. To meet customer demand, Arbill even offers a better quality product in selected product lines than the manufacturer-branded products on the market.

Other wholesaler-distributors are using control over a private label to create new tools for their customers.

Interline Brands, a direct marketer and distributor of MRO products, receives 25 percent of its sales from private label brands. To support its Premier plumbing products, Interline operates a consumer-oriented product marketing Web site for the Premier Faucet Collection.

This Web site features images and technical information so that Interline's plumbing contractor customers can showcase the products to household consumers. The Web site also allows Interline to provide new project leads to its contractor customers because the "where to buy" section states: "Premier Faucets are sold exclusively to trade professionals. Please complete the following form and you will be contacted by a Premier representative."

Building Your Strategy

Wholesaler-distributors with private labels have deepened their knowledge of their customers' true needs by taking on the role of brand developers and marketers. However, a private label strategy requires the courage to walk away from supplier rebates on selected products in favor of increased margins from customers and buy-side sourcing activities.

The ready availability of global supply sources will lead many wholesale distribution executives to consider private labels. Consider the following questions at the next off-site meeting of your company's top executives:

- What are the most successful private label brands offered to customers by wholesaler-distributors (our company or a competitor) in our line of trade? Why have these products been so successful? Will a private label allow us to get higher product margins?
- Do private labels align us more appropriately with customers' needs in our industry? How can we improve our marketing or product features to achieve premium positioning for our private label products?
- Can we build the brand management capabilities needed for maintaining success over time? Will our shareholders and owners accept higher investments in marketing and product development?
- What funds are at risk from the loss of potential supplier rebates or discounts? At what point would our suppliers perceive private labels to be a threat to the relationship?
- How will our corporate culture adjust to an evolution from the sales channel on behalf of manufacturers to a marketer and developer of unique products?
- Will our new supply chain expenses and risks reduce or eliminate any potential savings from global sourcing? How might geopolitics affect future currency rates and our relative cost advantages?

The world is changing, and wholesaler-distributors must keep evolving in order to stay relevant in their respective industry's supply chain. Wholesale distribution executives who understand the big picture trends behind private labels will have the opportunity to lead the way in their lines of trade.

© 2007 Pembroke Consulting, Inc. Adam J. Fein, Ph.D. is the founder and president of Pembroke Consulting, a firm that provides business and marketing strategy advice to executives operating in channel-intensive industries. He can be reached at 215-523-5700 or on the Web at www.PembrokeConsulting.com. This article is adapted from the new report Facing the Forces of Change®: Lead the Way in the Supply Chain, *which is available online from the National Association of Wholesaler-Distributors at www.naw.org/ftf07.*

■ *Case Study*

Routing Costs

Electrical distributor improves transport efficiencies with new system

Beacon Electric Supply in Southern California implemented a fleet management system to increase the number of deliveries drivers could make in a day. The system has also helped Beacon improve customer service levels and keep salespeople apprised of issues at the delivery site.

By Lindsay Young

At Beacon Electric Supply Inc., San Diego, CA, the burden of making deliveries on time used to lay on the drivers. "They would get a pile of orders and it would be up to the drivers to best determine the routes," says CFO Dan Vivier. "They supposedly knew their areas better than anyone else."

While that was true, fingers were inevitably pointed at the driver whenever something went wrong with a delivery.

So Beacon implemented a fleet management software package from RouteView a year ago to automate routing and shift the responsibility to a central dispatcher who directs drivers from both of Beacon's distribution centers. The trucks are equipped with GPS so that the company can track delivery progress. When deliveries are made, an email is automatically sent to the salesman on that account.

Beacon has 75 employees, and seven delivery vehicles serving San Diego County and the Riverside and San Bernadino areas inland.

"The driver now has a game plan handed to them everyday. Before he was expected to be quarterback, the receiver and all of that. And anytime there wasn't a touchdown, everything came down on him," Vivier says.

The System

On-time delivery is critical to your customers, who are either trying to satisfy their own customers or meet internal requirements.

Fleet management software is gaining traction as a way to trim costs for distributors and their customers and more accurately predict delivery times. More distributors, big and small, are moving this way – Sonepar USA, for example, has three distributors using this software and is moving toward universal implementation.

The software uses advanced routing capabilities to determine the most efficient route for a set of deliveries. It also provides maps to help drivers find their way and lets distributors track drivers via GPS to ensure they are following the pre-set routes. This also helps detect breakdowns, allowing a distributor to respond quickly to ensure service levels stay constant. Wireless GPS is available with or without the map-based routing.

Some systems allow you to identify conditions ahead of time that may cause delays in service. The system also automatically alerts headquarters and salespeople to completed deliveries, late deliveries, damaged goods and refusals.

In addition to tracking and routing trucks, some systems allow you to track real-time operational information, including fuel usage and on-board diagnostics, which encourages preventive maintenance.

Because it tracks driving patterns, the records the system produces can help in driver evaluations at the end of the year.

Increased Capacity

The software can make distributors so efficient in deliveries that many end up cutting trucks or labor. Many software providers use this as a selling point.

For Beacon however, this was never part of the plan. Beacon lets its drivers work in the warehouse when they are not on the road. "We never approached it so we could cut a truck. Could we have cut a truck? Yes, without a doubt. …We've done it to increase our capacity. We're able to handle more deliveries than we have in the past," Vivier says.

Before implementing the software, deliveries were open-ended. "The guys would end up back between 1 and 2:30, and their shifts went from 6-2, so that was not just a coincidence," Vivier says.

Now the delivery drivers are back before lunch with the same amount of deliveries. The company has been able to increase the number of deliveries from 13 to 16 per truck per day, as well as improve same-day service.

In addition, the distributor used to see three to four customer complaints a day with deliveries, but that number has been cut to three to four per quarter.

Communication

One of the best features of the system is the email notification, Vivier says. Salespeople are told automatically about late deliveries and refusals and other delivery details. The drivers can also communicate whether a delivery was damaged or other information such as if no one was at a job site.

"It's their order start-to-finish," Vivier says of the salespeople. "They have to deal with the customer. They should know what's going on, and they do. This has added that to us."

Winning drivers over to the new system can be a challenge. "The suspicion was that you have Big Brother settling in here," Vivier says. Drivers' reactions may depend on how distributors' current system is set up. For Beacon, the new system won the drivers over because it shifted responsibility to a central dispatcher.

When making the transition to a fleet management program, don't run concurrent systems or use two sets of manifests. "Once you make the jump, make the jump," Vivier advises. Results were immediate, Vivier says. Within a month, the system was operational. The next step for Beacon is to integrate its fleet management system with its new ERP system.

More distribution case studies at www.mdm.com/stories/distcasestudies.html.

Single-Sourcing on a Smaller Scale

Distributor turns loss of customer into opportunity

1sourcesupplies is an alliance of distributors who want to offer single-sourcing programs to smaller customers, including inventory management, supply chain automation, streamlined billing and information analysis.

Mark Hill's cutting tool distributorship, I.M.C. Supply Co., Memphis, TN, lost its biggest customer in 1997. "The customer we lost really wanted us to have their business, but we didn't have the programs they needed," Hill says.

Instead of folding, or scrambling to make ends meet, Hill pushed forward with a plan to find a way to offer single-sourcing solutions to his customers. Since that year, his business has doubled. About 65 percent of his business is now single-source.

Hill has decided to pass on his newfound knowledge in the form of a separate business that helps smaller distributors provide single-sourcing solutions for their customers, including inventory management, supply chain automation, streamlined billing and information analysis.

1sourcesupplies sells the program and implements it for independent specialty distributors – right now in industrial MRO. "They may not have any knowledge of how to go about it," Hill says. "We offer the expertise and the support."

Nine distributors, mostly in the East, have joined so far.

"When a customer really respects a distributor and really likes working with them, they try to find more ways to give them business. But unfortunately if they don't have a single-sourcing program, then there's no way for the distributor to offer the opportunity to the customer to buy more product from them," says Cary Rawlings, 1sourcesupplies vice president of sales and marketing.

"With our program, we're able to go in and show them a system that is simple and allows the customer to give them more business."

The program does not attempt to compete with large integrators, Hill says. Instead, 1source targets small to mid-sized distributors ($3 million to $20 million on average) and their smaller customers with potential total available sales per year of up to $1.5 million. These customers are not typically approached by larger distributors for a single-sourcing contract.

"Smaller customers want vendor reduction, they want cost savings, and they want an easier, simpler way to get their product in the door without having to order it when they're out," Rawlings says. "This system offers us a way to do that for the customer."

As a result, many of the distributors who have signed on with 1sourcesupplies have broadened their product lines to include safety products or other non-technical lines. Or they can provide branded lines they are not authorized to sell to the general market but receive permission from manufacturers to sell to "specified accounts."

When a customer wants welding supplies, but the distributor specializes in cutting tools, 1sourcesupplies will combine alliance members and use one invoice.

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Eventually, Hill and Rawlings want to have specialty distributors from different commodity groups work together on a larger scale to provide one solution for all commodities, whether in a single location or multiplant situation.

"Eventually when we get into multiplant situations, we will be able to use the distributors in different market areas where they are needed, but we aren't to that point yet," Hill says. "But that is where we are headed."

1sourcesupplies is just starting to branch out. "We've been careful about not getting ahead of ourselves," Hill says. It is looking to add distributors with "solid growth." "We're selective," Hill says. "We need solid distributors for our alliance – down the road that is going to make a difference when we get into multiplant situations."

The cost to belong is $300 per month plus a transaction fee based on customer product usage. More information can be found at www.1sourcesupplies.com.

Construction to Moderate in 2007

Nonresidential should balance residential downturn

Overall U.S. construction in 2007 is forecast to slow from previous levels, thanks to a downturn in residential building, according to recent reports. But nonresidential construction should stay relatively strong in the new year, with institutional and commercial building leading the way.

McGraw-Hill Construction reports total construction starts will drop 1 percent in 2007. Housing starts will fall 5 percent, with both single and multifamily housing taking a hit.

A large backlog in unsold homes suggests home construction may be slow to turn around, but most analysts expect declines to moderate in 2007, according to the Fed. Housing demand may also improve in 2007.

McGraw-Hill reports that retail construction will decline as housing starts slow. Retail starts were estimated to drop 2 percent by the end of 2006. It will fall 7 percent more in 2007.

Warehouse construction is expected to increase by 5 percent, office buildings by 5 percent and hotel construction by 4 percent. Educational building and public building construction will also rise. McGraw-Hill also forecast rises in religious, amusement-related and transportation terminal buildings. Other increases will be seen in manufacturing building and highway and bridge construction, predicted to rise 9 percent.

Optimism for 2007

Construction distributors and contractors are generally optimistic for 2007, reports financial services firm CIT Construction in its annual forecast. Most CIT survey participants expect construction activity will come close to equaling that in 2006. Those in the South and West are more optimistic than those in the Northeast, Midwest and North Central parts of the country.

Thirty percent of contractors said local construction will increase in 2007, while almost half said there would be no significant change. Last year, a third of contractors thought activity would increase compared with 2005.

Almost 60 percent of distributors surveyed expect residential construction to at least equal 2006 levels, but that's down from the 84 percent who thought activity would increase or hold steady last year. More than 80 percent this year expect non-residential construction to be at least equal to 2006 levels.

Concerns highlighted in the CIT survey include rising interest rates and slowing economic growth as possible indicators of a slowdown in the construction industry. Of distributors predicting less activity overall in construction, more than 40 percent cited interest rates as one reason for a slowdown.

But some contractors and distributors expect increases in the areas they serve thanks to "more opportunities, a stronger economy and a growing population."

Equipment Plans

According to the CIT survey, contractors are planning to spend more on equipment this year, with pre-owned equipment leading the way. Nearly half of those surveyed plan to buy equipment this year. Contractors also plan to increase their equipment budgets – they will spend about 11 percent more than last year's estimate. Pre-owned equipment demand continues to rise.

Contractors plan to buy (in order of preference) highway trucks, hand tools, hydraulic excavators, rubber-tire backhoe loaders, skid steer loaders, elevating work platforms, off-highway trucks, wheel loaders and cranes. More than one in five expect to buy hand tools this year.

Few distributors expect their new-equipment sales to increase. About a third said revenue from new-equipment sales will rise in 2007. They are more optimistic about used equipment sales, with 36 percent expecting sales to grow and 52 percent expecting them to stay steady.

Canada

Construction will cool in 2007, led by a small decline in residential activity, according to the Canadian Construction Association and the Construction Sector Council. The overall construction industry is expected to grow 1.7 percent in 2007, 2008 and 2009.

Residential construction is expected to fall slightly 0.1 percent, and nonresidential will grow 3.2 percent. The report says the residential construction sector should recover in 2008. Nonresidential will progressively slow.

The leading sub-sectors of the nonresidential sector will be engineering construction and industrial construction. Commercial and institutional/government construction are also expected to make gains in 2007.

In nonresidential, Newfoundland, Nova Scotia and Manitoba will be strong, and Ontario and Prince Edward Island will see slower growth. In residential construction, according to the report, British Columbia, Ontario and Manitoba are expected to post growth. All other provinces – notably Alberta, Nova Scotia and Prince Edward Island – will see drops in residential investment.

Construction employment in Canada is expected to level off in 2007, slowing to 0.9 percent.

Changes to employment vary by province. Newfoundland is expected to grow by more than 10 percent, and employment in Quebec and Prince Edward Island will drop. Ontario will remain unchanged.

Find links to forecasts at this story online at www.mdm.com.

MAPI: U.S. Export Expansion Continues

Global forecast: Growth moderates, faces headwinds

An assessment of key regions and markets supports the view that global economic growth has peaked, the dollar will undergo a sporadic decline, and that U.S. export demand will grow at a moderate pace, according to the most recent MAPI quarterly forecast.

In the MAPI Quarterly Forecast of U.S. Exports, Global Growth, and the Dollar: Fourth Quarter 2006 Through Fourth Quarter 2008, economist Cliff Waldman concludes that, after growing at the strongest pace in three decades, the world economy has entered the early stages of a widespread slowdown that will significantly impact regions that are critical to U.S. manufacturers.

Persistent strength in regional and global growth rates and a somewhat weaker dollar over the past 12 months are expected to lead to a solid 8.7 percent growth in U.S. exports in 2006 when final data are released.

Export growth is predicted to be relatively unchanged during 2007, decelerating slightly to 8.6 percent, as the weaker dollar offsets concurrently weaker growth rates. A modest recovery in growth rates, especially in industrialized nations, is projected to propel export growth to 9.7 percent in 2008.

Growth in the industrialized countries, which includes Canada, the Eurozone, and Japan, will likely slow from an estimated 2.5 percent during the fourth quarter of 2006 to 2.2 percent during the first quarter of 2007.

The pace is then expected to accelerate to 3.2 percent by the first half of 2008, influenced by a reacceleration of growth in the U.S. economy from a projected slowdown. The non-U.S. industrial country growth rate is forecast to moderate to 3.0 percent during the second half of 2008.

Growth in the developing countries, which includes China, India, Latin America, Mexico, and the Pacific Rim (excluding Japan), is projected to slow from an estimated 5.7 percent during the fourth quarter of 2006, gradually reaching bottom at a 4.9 percent pace during the first half of 2008 before rebounding to 5.3 percent during the second half of that year.

"The absence of a full developing country growth recovery in the forecast is predicated on the belief that China and India will not resume their current growth rates after their slowdown periods," Waldman said. "The high current growth levels in both countries is unsustainable, given the investment excess in China and inflation in India."

The recent volatility in the value of the dollar, the outsized U.S. current account deficit, a slowing U.S. economy, and tightening global monetary policies outside the U.S. all suggest at least a modest decline for the greenback in the near-term forecast.

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MAPI expects the dollar to fall by 2 percent against the currencies of the industrialized countries during the fourth quarter of 2006 and remain flat in the first quarter of 2007.

MAPI projects a 7 percent decline in the dollar during the second and third quarters of 2007, followed by a 3 percent decline in the subsequent two quarters. After a flat performance during the second quarter of 2008, the report predicts a modest recovery in the dollar by 3 and 4 percent, respectively, during the third and fourth quarters of 2008.

Waldman does not expect the dollar to decline against the currencies of the developing nations until the third quarter of 2007 by which time the political tension in Mexico might ease and China will likely allow for more flexibility of the yuan.

MAPI expects declines of 2 percent against these currencies during the third and fourth quarters of 2007 and 5 percent during the first and second quarters of 2008. Subsequently, MAPI envisions a slight rebound of 2 percent during the second half of 2008.

Response to ISM Report

The following is an analysis from Daniel J. Meckstroth, Ph.D., chief economist for the Manufacturers Alliance/MAPI, regarding the December 2006 Institute for Supply Management (ISM) Index:

"The December ISM index at 51.4 percent was above the 50 percent threshold point for growth and was a definite improvement over the November level of 49.5 percent," Meckstroth said.

"The ISM index averaged 54.9 percent in the first nine months of 2006 but only averaged 50.7 percent in the fourth quarter. Manufacturing activity came to a virtual halt in the last three months of last year. The December ISM report suggests the pronounced slowing over the last three months is temporary and that manufacturing activity may be beginning to pick up again.

"For the years as a whole, manufacturing grew much faster than the general economy in 2006. The outlook for 2007 is for manufacturing production to approximate the growth rate for the general economy."

MSC Keeps Eye on ISM Index

Slowdown in growth expected in coming quarters

MSC Industrial Direct Inc., Melville, NY, said in a recent conference call with investors that it has seen a slowdown in revenue growth in the past few months.

"We're mindful of the ISM index and its historic correlation to our growth rate," CEO David Sandler said of the Institute for Supply Management's monthly manufacturing report. "While we believe a number of marketing and sales initiatives will moderate its impact … it is apparent that three to six months of ISM weakness has modestly affected our revenue growth and will probably continue to do so in the next couple of quarters if past experience proves out."

Still, thanks in part to its acquisition of J&L Industrial Supply last year from Kennametal, the industrial MRO distributor recorded an increase in sales of 35.9 percent to $402 million in the first quarter 2007. Profit increased 26.2 percent to $40.3 million from the year-ago period.

"We are increasing focus on imported products that generate better margins than their counterparts," Sandler said. He also said MSC would step up its focus on reducing the prices it pays its suppliers.

MSC has seen copper prices stabilize, but other raw materials, including stainless steel, aluminum and nickel, have jumped. About 14 percent of sales growth in the first quarter was from pricing.

J&L Industrial Supply, purchased from Kennametal last year, accounted for two-thirds of the growth. "We are aggressively investing in areas we believe have the best potential for growth" in a period of slowing growth, Sandler said. He would not specify which areas MSC plans to focus on.

Sandler did say however that MSC will continue to grow its sales force, which at the end of the first quarter stood at 739 associates. Plans are for 750 by the end of the second quarter.

MSC will also continue focus on growth in the western U.S., as well as building out its value-added services and reaching into new customer segments.

Sandler said the integration of J&L is going as planned, and that MSC should be able to generate the forecasted $20 million in margin improvements and cost savings that was originally anticipated. In addition, MSC is on track to convert J&L's computer system and integrate its distribution centers into MSC's network by the late spring 2007.

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Industrial & Construction Markets Update

PERSPECTIVE

Hype and speculation tend to follow an industry consolidator. The announcement last week that Home Depot CEO Bob Nardelli was ousted from his position over pay issues and lagging stock gains generated an inordinate amount of buzz. Some even claimed it is a repudiation of the Home Depot model itself and its relatively recent strategy to aggressively grow the wholesale distribution division.

Hardly. All we know versus a week ago is that HD has $210 million less to fund acquisition activities that instead went to Mr. Nardelli's severance package (Wouldn't you like to be chastised like that?). Now that will really slow the acquisition pace of HD Supply….

What's lost in the shock value of the pay deal is that Home Depot's net income in the most recent quarter, ended October 2006, was up 129% and revenue doubled from the same quarter of 2000, just before Nardelli was hired. Compare that to S&P 500 companies, whose composite income and revenue were up about 65% over that same time. As hard as it is to apply the term to a pariah who just got one of the prettiest parachutes for Christmas, Nardelli is in fact more a victim of Wall Street, not the architect of a failed strategy.

The real story for those in distribution is that Joe DeAngelo, head of the wholesale division, now takes on the responsibilities of the retail division as well. Based on the challenge at hand, which just got a blazing spotlight thanks to you-know-what, Mr. DeAngelo needs someone to continue to execute on the wholesale side. Will HD Supply lose its way because of distraction? Not likely. Their strategy and team have been well developed. The question is execution and how well HD Supply can build out its platform with the right additions. That hasn't changed in a week.

Strategic Distribution, Inc., Bristol, PA, has agreed to be bought out by Platinum Equity in a deal worth $30 million. The deal stipulates that Strategic Distribution will merge with Project Eagle Holding Corp. and Project Eagle Merger Corp., each a Platinum Equity portfolio company. Strategic reported revenues of $136.9 million in 2005 and a net loss of $3.4 million. Platinum Equity has been busy in the industrial sector, recently buying Textron Fastening Systems for $630 million and PNA Group Inc., a $1.2 billion processor and distributor of steel products. See article p. 4.

Kennametal Inc., Latrobe, PA, has agreed to acquire **Federal Signal Corporation**'s cutting tool business comprised of **Manchester Tool Company**, **ClappDiCO Corporation** and **On Time Machine, Inc**. for $67 million. With annual sales of $40 million, the cutting tool business produces, markets and services super hard polycrystalline diamond and cubic boron nitride cutting tools, tool holding systems and certain specialized turning tools complementary to Kennametal's product range. See article p. 3.

Sonepar USA, Philadelphia, PA, has acquired Dallas, TX-based **Crawford Electric Supply Company, Ltd**. Crawford Electric had sales of $175 million in 2005, according to Electrical Wholesaling's 2006 top 200 issue. The acquisition extends Sonepar USA's reach into the fast-growing Texas market. The purchase is Sonepar USA's seventh acquisition in less than two years. See article on electrical distribution M&A activity on p. 4.

Another Sonepar company, **Cooper Electric Supply Co**., Tinton Falls, NJ, has acquired **Fairview Electrical Supply Corp**., Fairview, NJ. Cooper Electric serves the New Jersey, New York and Pennsylvania markets. This acquisition increases its presence to 30 locations in the tri-state area.

Border States, Fargo, ND, has agreed to buy **Minnesota Electric Supply Company**, a full-line provider of electrical products with eight locations in Minnesota and more than 3,000 customers. According to Electrical Wholesaling's top 200, Border States had 2005 revenues of $601 million, and Minnesota Electric had sales of $78.3 million.

Hagemeyer has acquired **BREVA**, an electrical distributor of MRO products in Belgium. About 70 percent of BREVA's sales go to industrial customers. BREVA gives Hagemeyer entrance to the Belgian market and will allow it to serve the Belgian subsidiaries of several of its large global industrial customers.

Philadelphia, PA-based **Hajoca Corp**. has agreed to buy **Richards Plumbing, Heating & Industrial Supplies**, Grand Rapids, MI. The 71-year-old CEO of Richards told the *Grand Rapids Press* that he and his sons sold to the national plumbing and heating wholesaler because of growing national competition in that market. The firm has annual sales of about $25 million, according to the paper.

US Electrical Services, LLC, Exton, PA, has agreed to buy **Hampden/Zim-**

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merman Electric Supply Co., with three locations in central and western Massachusetts. The company has 80 employees. US Electrical Services is a distributor of electrical products and related services.

The Home Depot's Bob Nardelli has resigned from his posts as president, CEO and chairman of the board as of Jan. 2, 2007. Frank Blake, the company's executive vice president, succeeds him. The move comes amid criticism from investors over Nardelli's pay and slow stock gains during his reign. The board also announced that CFO Carol Tome and head of the wholesale division, Joe DeAngelo, will be assuming additional responsibilities. DeAngelo was appointed to the newly created position of Chief Operating Officer. He will continue to oversee HD Supply and will assume additional responsibilities for the retail business.

Graybar, St. Louis, MO, distributor of electrical and communications products, reported $3.78 billion in sales through the first three quarters of 2006, an increase of 18.9 percent over the same period last year. Graybar's net income of $46.7 million for the first three quarters is more than triple last year's performance for the same period. This year, the company has opened several new locations and expanded its security product line, adding customers such as security dealers and installers.

MSC Industrial Direct Inc., Melville, NY, distributor of MRO supplies to industrial customers, reported sales of $402 million for the first quarter 2007, an increase of 35.9 percent from the same period in fiscal 2006. Profit increased 26.2 percent to $40.3 million from the year-ago period. J&L Industrial Supply, purchased from Kennametal last year, accounted for two-thirds of the growth.

Praxair Distribution, Danbury, CT, a division of **Praxair Canada Inc.**, has acquired the Canadian propane tank-exchange business of **Blue Rhino**, a **Ferrellgas Partners L.P.** company. Praxair acquired more than 900 propane tank-exchange display cages at retail locations across Canada.

Airgas, Inc., Radnor, PA, has acquired **CFC Refimax, LLC**, a full-service refrigerant supplier and reclamation company based in Atlanta, GA. The business, which has about 50 employees, had about $21 million in sales in 2006.

Air Products, Lehigh Valley, PA, has agreed to acquire the industrial gas business of Central Europe-based **BOC Gazy Sp z o.o.** from **Linde Gas** for 370 million euros (US$481 million). For regulatory purposes, BOC Gazy was required to be sold by Linde as a result of its purchase of The BOC Group plc in September 2006. The BOC Gazy business had fiscal year 2006 sales of 126 million euros ($164 million). The business

Calculation of MDM Inflation Index for November 2006

		BLS Price Indices Nov. '06	BLS Price Indices Oct. '06	BLS Price Indices Nov. '05	% Sales Weight	Weighted Indices Nov. '06 (1)X(4)	% Change Nov. '06 Oct. '06	% Change Nov. '06 Nov. '05
1136	Abr. Prod.	450.9	450.9	426.6	19.1	86.13	0.00	5.71
1135	Cutting Tools	431.9	432.2	426.8	18.9	81.64	-0.06	1.21
1145	Power Trans.	625.4	619.5	601.7	15.4	96.32	0.96	3.95
1081	Fasteners	435.6	435.1	413.2	9.0	39.20	0.12	5.42
1149.01	Valves, etc.	758.0	756.3	695.0	7.6	57.60	0.21	9.05
1132	Power Tools	325.9	326.1	328.1	6.5	21.18	-0.07	-0.68
1144	Mat. Handling	455.8	454.7	436.6	6.2	28.26	0.25	4.40
0713.03	Belting	537.2	537.2	512.1	6.1	32.77	0.00	4.90
1042	Hand Tools	669.1	670.1	659.9	8.1	54.20	-0.15	1.39
108	Misc. Metal	410.8	410.5	397.8	3.1	12.74	0.07	3.26
"New" November Index		266.5	November Inflation Index			510.04	0.20	4.04
"New" October Index		265.9	October Inflation Index			509.02		
			November 2005 Inflation Index			490.24		

New index reflects 1977=100 base. Other numbers=1967 base. To convert multiply by .52247

MARKETS UPDATE SUPPLEMENT P. 3

has 750 employees, five industrial gas plants and six cylinder transfills.

Prices for manufactured goods in Canada remained unchanged for a second consecutive month in November, while prices for raw materials increased after three months of significant declines. Prices charged by manufacturers, as measured by the Industrial Product Price Index (IPPI), were unchanged from October to November, as downward pressure from declining petroleum prices eased. Lower prices for primary metal products and petroleum products were offset by higher prices for chemical products, fruit, vegetables and feed products and pulp and paper products.

Construction spending during November was estimated at a seasonally adjusted annual rate of $1,184.1 billion, 0.2 percent below the revised October estimate of $1,186.7 billion. The November figure is 0.1 percent above the November 2005 estimate of $1,183.1 billion. During the first 11 months of this year, construction spending amounted to $1,110.5 billion, 5.4 percent above the $1,053.4 billion for the same period in 2005.

Diversified industrial manufacturer **Eaton Corporation**, Cleveland, OH, has agreed to buy **AT Holdings Corporation**, the parent of **Argo-Tech Corporation**, for $695 million. Argo-Tech's aerospace business, which had sales for the fiscal year ended Oct. 28, 2006, of $206 million, is a producer of aerospace engine fuel pumps and systems, airframe fuel pumps and systems, and ground fueling systems for commercial and military aerospace markets.

Ellison Technologies, Inc., Cleveland, OH, provider of engineered systems and industrial equipment to metal-working and metal-cutting manufacturers, has acquired **Jackson Machinery Company**, a privately held distributor based outside of Cleveland. The acquisition provides Ellison a stronger position in northern Ohio, a strong manufacturing base.

Reliance Steel & Aluminum Co. has agreed to acquire the **Encore Group** of metals service center companies (Encore Metals, Encore Metals (USA), Inc., Encore Coils, and Team Tube) headquartered in Edmonton, Alberta, Canada. Encore specializes in the processing and distribution of alloy and carbon bar and tube, as well as stainless steel sheet, plate and bar and carbon steel flat-rolled products, through its 17 facilities located mainly in Western Canada. Encore's sales for the 12 months ended Dec. 31, 2005, were C$254.8 million.

Brady Corporation, manufacturer of identification solutions and specialty materials, has expanded its manufacturing operations near Bangkok, Thailand, and in Penang, Malaysia, and has opened a new manufacturing center and shared services center in Bangalore, India.

Actuant Corporation, Milwaukee, WI, has purchased Veha Haaksbergen B.V. Headquartered in Haaksbergen, The Netherlands, Veha has sales of $5 million, including those to Actuant's Enerpac, and manufactures machined products, including hydraulic cylinders.

Kennametal to Buy Federal Signal's Cutting Tool Business

Kennametal Inc., Latrobe, PA, has agreed to acquire Federal Signal Corporation's cutting tool business comprised of Manchester Tool Company, ClappDiCO Corporation and On Time Machine Inc. for $67 million.

With annual sales of about $40 million, Federal Signal Corporation's cutting tool business produces, markets and services super hard polycrystalline diamond and cubic boron nitride cutting tools, tool holding systems and certain specialized turning tools complementary to Kennametal's product range.

"We are pleased to add yet another component to our metalworking business that will better enable us to serve our customers globally," said Ron Keating, corporate vice president and president of Metalworking Solutions and Services Group.

"These technologies are an exciting addition to our current metalcutting capabilities and will provide additional opportunities for us to serve rapidly growing industry segments such as aerospace, energy and die and mold.

"This bolt-on acquisition helps us to further round out our portfolio in high value niche segments, expanding our existing product lines and our reach into new markets."

Kennametal says the acquisition is consistent with its growth strategy and with the company's previously stated intentions for the use of cash.

MARKETS UPDATE SUPPLEMENT P. 4

Platinum Equity to Buy Strategic Distribution for $30M

Publicly-traded Strategic Distribution, Inc., (NASDAQ:STRD) Bristol, PA, has agreed to be bought out by Platinum Equity for $30 million.

The transaction is expected to be complete by the end of March. The deal stipulates that Strategic Distribution will merge with Project Eagle Holding Corp. and Project Eagle Merger Corp., each a Platinum Equity portfolio company.

The MRO distributor reported revenues of $136.9 million in 2005 and a net loss of $3.4 million. Its numbers haven't improved much in fiscal 2006, with the company recording losses in the first and second quarter, and a slight gain of $0.2 million in the third.

In November, Strategic announced its board of directors had received a letter from the board's Chairman William R. Berkley, detailing that a firm he controlled, Interlaken Capital, proposed to buy the outstanding equity interests of the company for $8.30 per share in cash. Berkley owns about 22.5 percent of outstanding common stock.

The board of directors formed a committee to consider strategic alternatives for the company and solicited parties that had expressed interest in buying the company and also solicited additional potential acquirers. At the conclusion of that process, the committee and its advisors negotiated a merger agreement with Platinum Equity.

Each member of the board of directors, including Berkley, has agreed to support the merger.

Platinum Equity recently bought Textron Fastening Systems for $630 million and PNA Group Inc., a $1.2 billion processor and distributor of steel products.

Electrical M&A Market Stays Active

The past couple of weeks have been busy in the electrical distribution world.

Sonepar USA, Philadelphia, PA, has acquired Dallas, TX-based Crawford Electric Supply Company, Ltd. Crawford Electric had sales of $175 million in 2005, according to *Electrical Wholesaling* magazine.

The acquisition extends Sonepar USA's reach into the fast-growing Texas market.

Crawford has locations in Dallas, Fort Worth, Houston and San Antonio. The company offers electrical and lighting products to commercial and residential contractors.

The purchase is Sonepar USA's seventh acquisition in less than two years. Consistent with all Sonepar USA acquisitions, Crawford will retain its brand identity and autonomy.

Another Sonepar company, Cooper Electric Supply Co., Tinton Falls, NJ, has acquired Fairview Electrical Supply Corp., Fairview, NJ.

Cooper Electric serves the New Jersey, New York and Pennsylvania markets. This acquisition increases its presence to 30 locations in the tri-state area.

Border States, Fargo, ND, has agreed to buy Minnesota Electric Supply Company, a full line provider of electrical products with eight locations in Minnesota and 3,000 customers.

According to *Electrical Wholesaling*, Border States had 2005 revenues of $601 million, and Minnesota Electric had sales of $78.3 million. The combined organization will have more than 1,200 employees and 51 branch operations in 11 states and Mexico.

US Electrical Services also made a buy in the past couple weeks, with its purchase of Hampden/Zimmerman Electric Supply Co. The distributor has three locations in central and western Massachusetts.

Netherlands-based Hagemeyer NA has acquired BREVA, an electrical distributor of MRO products in Belgium. About 70 percent of BREVA's sales go to industrial customers. BREVA gives Hagemeyer entrance to the Belgian market and will allow it to serve the Belgian subsidiaries of several of its large global industrial customers.

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