MODERN DISTRIBUTION MANAGEMENT
The Newsletter for the Wholesale Distribution Channel
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A Look at Inflation in 2006

Lower energy prices at end of year temper price increases

This is an overview of wholesale price inflation trends in the past year for commodities in industrial and construction channels. Overall, core inflation rose 1.1 percent in 2006 – a significant slowdown from 2005. But the Federal Reserve still sees inflation as a potential threat in the next year, albeit at lower levels.

Thanks to a slowdown in energy price increases, wholesale prices rose 1.1 percent in 2006, in contrast to the 5.4 percent rise in 2005, the Bureau of Labor Statistics reported. The government attributed the slower rate to the index of finished energy goods, which fell 2 percent in 2006 after climbing 23.9 percent a year earlier.

Core inflation – wholesale prices except foods and energy – moved up 2 percent in 2006 following a 1.4 percent gain in 2005.

Of more interest however, than the overall price gains in the past year, are gains in areas relevant to most MDM readers. Construction materials and components index was up 4.3 percent, materials for nondurable manufacturing were up 2.1 percent, and materials for durable manufacturing up 13.1 percent. The basic industrial materials index climbed 16.7 percent in 2006.

The other key inflation index, the Consumer Price Index, rose 2.5 percent in 2006, the slowest rate since 2003. In 2005, the Consumer Price Index increased 3.4 percent.

The Chicago Fed Letter reports that economic activity will slow in 2007 and oil prices will remain flat – as a result, inflation should moderate. Oil prices are expected to stay around $60 per barrel through 2007.

But inflation will remain an issue in the next year, making it unlikely that the Federal Reserve Bank will cut interest rates in the first half of 2007, according to various news reports. The Fed meets again Jan. 30-31, 2006, and is expected to keep interest rates steady based on Consumer Price Index data.

Other economic trends of interest: The housing slowdown should moderate in 2007 – a survey of economists by the Federal Reserve Bank of Chicago suggests that residential investment will decline by 4.2 percent in 2007, in contrast to the 10.4 percent expected drop for 2006. Nonresidential is expected to stay strong. That same

continued on next page

Price Inflation Change: 2005-2006

Product Sector	2005 Change	2006 Change
Construction Materials/Components	61%	77%
Materials for Durable Manufacturing	54%	73%
Materials for	49%	69%
Building Materials	47%	74%
Machinery and Equipment	35%	55%
Contractor Supplies	23%	52%
Average	**43%**	**65%**

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panel of economists forecast growth in business fixed investment rising by 5.9 percent, less than the 8.9 percent in 2006. Industrial production should increase 2.6 percent, slower than in 2006.

Below find producer price inflation trends for the past year and December and breakouts by commodity groups for a closer look at annual individual price fluctuations.

Construction Materials/Components: Up 4.3%

Prices for materials and components for construction advanced 4.3 percent in 2006, after climbing 6.1 percent in 2005. In December, the index moved down 0.1 percent after declining 0.5 percent in November. Prices for steel mill products fell 0.4 percent. The indexes for plastic construction products and softwood lumber decreased at slower rates than they had a month earlier. Prices for asphalt felts and coatings, wiring devices, and mineral wool for structural insulation turned up after declining in November. By contrast, the index for nonferrous wire and cable moved down 2.6 percent following a 1.1 percent decline in November.

Associated General Contractors of America Chief Economist Ken Simonson said last month that construction materials will see higher prices than the economy as a whole. "The recent retreat in construction costs was widespread but not universal," he said. "There were price declines in November for diesel fuel and asphalt, plastic construction products, lumber and plywood, gypsum products and steel and copper products. But there were continuing increases in the prices of most concrete products, brick and aluminum mill shapes."

He expects petroleum, cement and metals to remain at historically high levels, tilting nonresidential construction costs up. Gypsum and wood prices will stay low.

Materials for Durable Manufacturing: Up 13.1%

The index for materials for durable manufacturing jumped 13.1 percent in 2006, following a 5.9 percent advance in 2005. In December, the index declined 0.2 percent following a 0.5 percent decrease in November. Falling prices for semi-finished steel mill products; hot rolled steel bars, plates, and structural shapes; thermoplastic resins; copper and brass mill shapes; and building paper and board outweighed price increases for cold rolled steel sheet and strip, hot rolled steel sheet and strip, and primary aluminum (except extrusion billet).

Materials for Nondurable Manufacturing: Up 2.1%

The index for materials for nondurable manufacturing advanced 2.1 percent in 2006, following an 8.9 percent gain in 2005. In December, prices declined 0.5 percent after falling 0.4 percent in November. The indexes for plastic resins and materials, finished fabrics, primary basic organic chemicals, synthetic rubber, and gray fabrics moved down in December. These decreases outweighed rising prices for ethanol, paper, ined-

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ible fats and oils, fertilizer materials, intermediate basic organic chemicals, and basic inorganic chemicals.

Basic Industrial Materials: Up 16.7%
The basic industrial materials index moved up 16.7 percent in 2006 following a 5.2 percent gain in 2005. In December, this index rose 1.0 percent after rising 0.5 percent a month earlier. The month's index included a rise in prices of iron and steel scrap, which turned up 6.8 percent following a 5.6 percent decrease in November. Softwood logs, bolts and timber also increased following a decline in the prior month. Prices for aluminum base scrap increased less in December than a month earlier. The indexes for copper base scrap and for construction sand, gravel, and crushed stone decreased after rising in November. Prices for iron ore fell after no change in November.

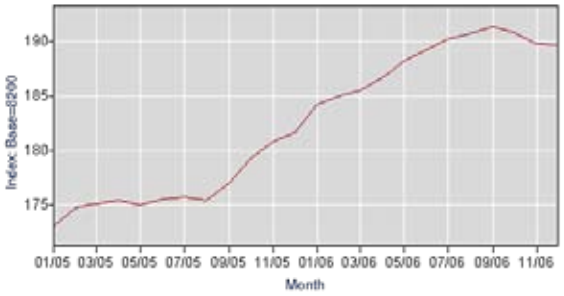
Finished Energy Goods: Down 2.0%
The index for finished energy goods was down 2 percent after a 23.9 percent rise last year. The index rose 2.5 percent in December following a 6.1-percent jump in the prior month. Leading this deceleration, gasoline prices increased 7.1 percent after surging 17.9 percent in November. Prices for finished lubricants were unchanged following gains in November.

Intermediate Energy Goods: Down 4.4%
The index for intermediate energy goods declined 4.4 percent in 2006, after advancing 26.2 percent in 2005. In December, diesel fuel prices moved up 10.2 percent, a deceleration from November. The indexes for gasoline, industrial natural gas and residual fuels also rose less than they had in November.

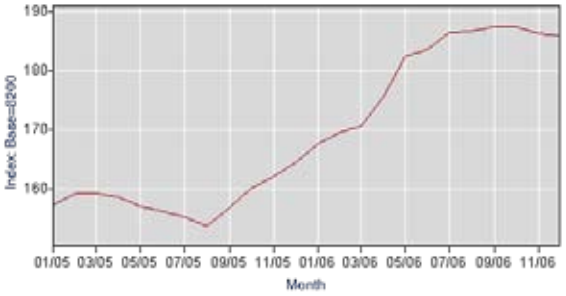
Crude Energy Materials: Down 11.6%
Price increases for crude energy materials slowed to 5.5 percent in December from 35.8 percent a month earlier. For the year, the crude energy materials index fell 11.4 percent after climbing 42.2 percent in 2005. In December, the index for natural gas advanced 6.8 percent after a 92.8 percent jump in November; the coal index decreased 0.6 percent after edging down 0.2 percent the previous month. But crude petroleum prices turned up 5 percent after a 1.2 percent fall in November.

Find the full end-of-year PPI report at this story online at www.mdm.com.

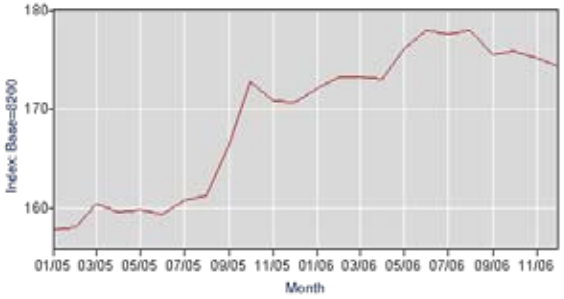
Construction Materials/Components



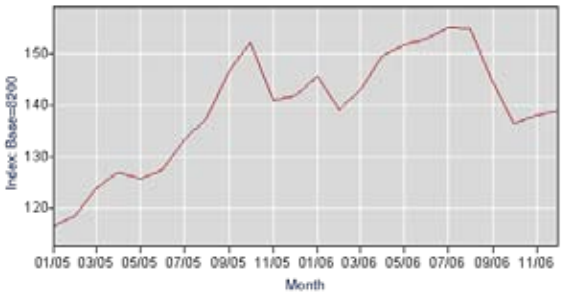
Materials for Durable Manufacturing



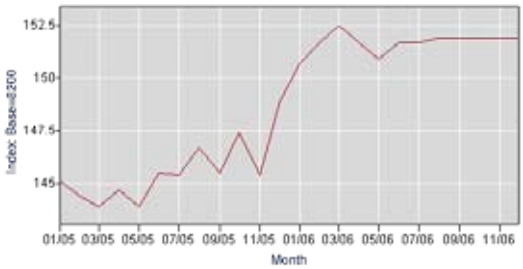
Materials for Nondurable Manufacturing



Finished Energy Goods



Abrasives

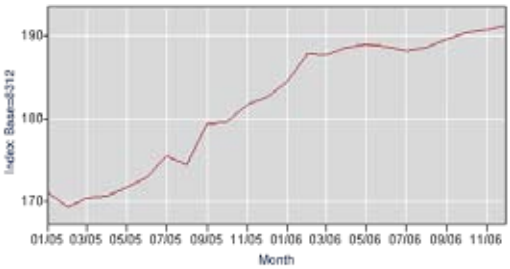


Prices for Abrasives increased 2.0% in 2006.

Electrical Machinery/Equipment

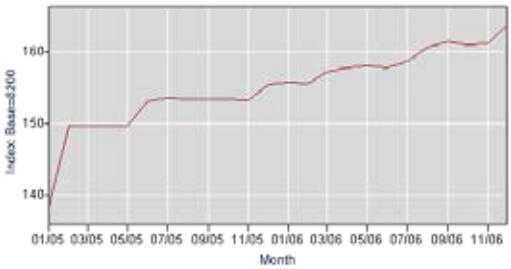
Prices for Electrical Mach/Equip increased 3.7% in 2006.

Adhesives & Sealants



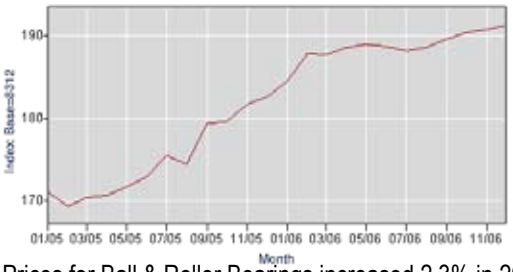
Prices for Adhesives & Sealants increased 4.8% in 2006.

Fasteners



Prices for Fasteners increased 5.3% in 2006.

Ball & Roller Bearings

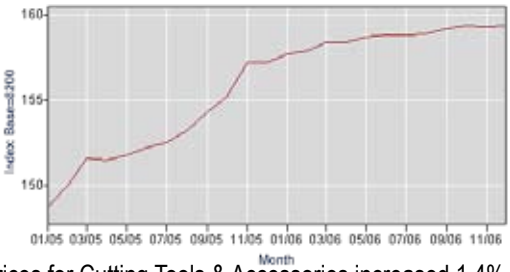


Prices for Ball & Roller Bearings increased 2.3% in 2006.

Fluid Power Equipment

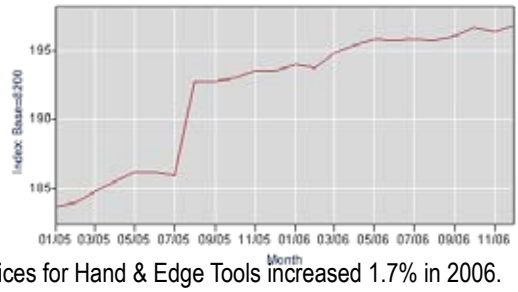
Prices for Fluid Power Equipment increased 5.3% in 2006.

Cutting Tools & Accessories



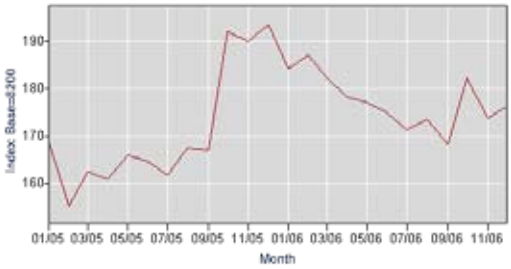
Prices for Cutting Tools & Accessories increased 1.4% in 2006.

Hand & Edge Tools



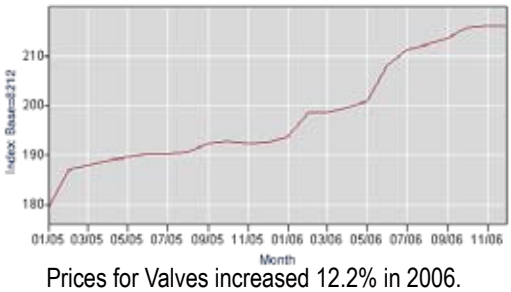
Prices for Hand & Edge Tools increased 1.7% in 2006.

Industrial Gases



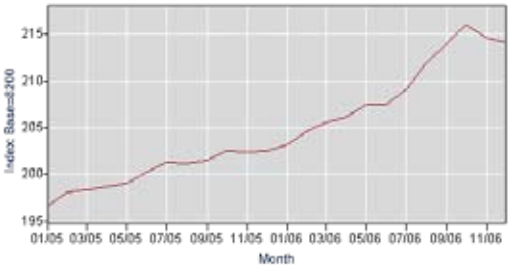
Prices for Industrial Gases fell 9%% in 2006.

Valves, Except Fluid Power



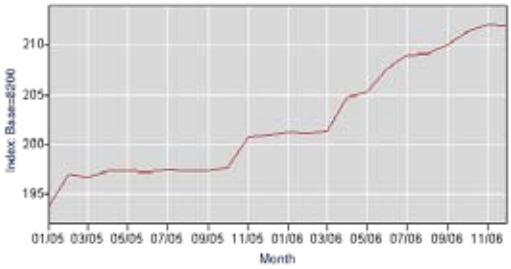
Prices for Valves increased 12.2% in 2006.

Welding Machinery/Equipment



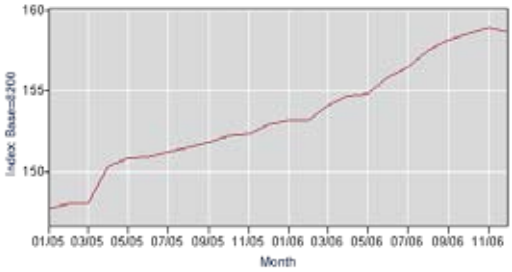
Prices for Welding Machinery/Equipment increased 5.7% in 2006.

Plumbing Fixtures & Fittings



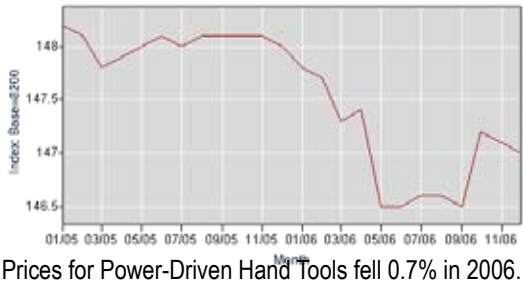
Prices for Plumbing Fixtures/Fittings increased 5.5% in 2006.

Material Handling Equip.-Industrial



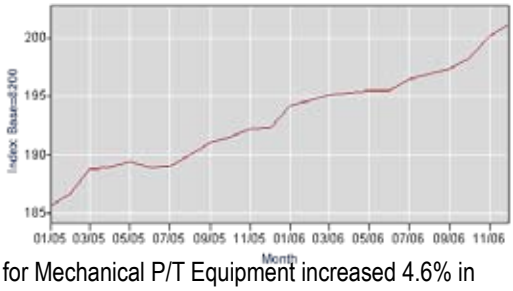
Prices for Material Handling Equip. increased 3.8% in 2006.

Power-Driven Hand Tools



Prices for Power-Driven Hand Tools fell 0.7% in 2006.

Mech. Power Transmission Equipment



Prices for Mechanical P/T Equipment increased 4.6% in 2006.

Pumps, Compressors & Equip.

Prices for Pumps, Compressors & Equipment increased 4.0% in 2006.

■ *Case Study*

Preempting Problems

Distributor conducts maintenance trainings for customers

By LeRoy Burcroff
vice president, sales, Bearing Service Inc.

Company Snapshot

- One distribution center and five branches, based in Livonia, MI.
- Number of employees: 58
- Key products: Bearings and power transmission

We strive to be problem-solvers in the marketplace by providing end-user training. It's a service the customer values and one that our competition can't easily duplicate. It adds real value to what we offer and helps us build stronger relationships with our end users.

More than eight years ago we began receiving requests from customers for maintenance-related training. We viewed these requests as opportunities for us to grow our business.

We sat down with those customers to determine the specific areas where they needed more training. From those meetings, we developed a series of four-hour courses on bearing installation and maintenance, power transmission basics, and precision bearing and spindle maintenance. Just recently we added a linear motion class.

When we train our customers to solve some of their own problems, we're bringing a higher level of service to the marketplace. We're not just people who sell parts.

We're also a better representative for our manufacturer partners. Most manufacturers are trying to differentiate their products. The more information we arm the end user with to solve his own problems, the better the opportunity for both the manufacturer and for us to continue doing business with that customer. And by selling value rather than price, the manufacturer is less likely to feel pressure from us.

We used to just react to end users' issues. After the problem occurred we'd have the manufacturer come in and do a dog-and-pony show for the end user's maintenance people on a specific product.

Since we've started offering end-user training, we've been working proactively with our customers to help them solve their unique problems. We've been able to identify target end users that have specific needs. We can explain how training can help them and then we spend time in class going through their real life issues.

Sometimes a customer has a problem but doesn't know it. I visited an end user that printed instant lottery tickets. Before launching into a discussion about training, I took a plant tour to see how things worked. I walked by one line and saw the press operators replacing printing rolls.

I stopped to talk with one operator and determined the reason they were having so many problems was because they were installing the bearings incorrectly.

I successfully proposed an operator training session to the maintenance supervisor. During the training session, I discovered they had been incorrectly installing these bearings for 15 years. The customer never realized there was a training problem, one that was causing tremendous downtime, resulting in lost productivity and wasted dollars. Training the operators how to do the job correctly did mean we lost bearing sales, but we now have a customer for life.

We're also building stronger relationships with our customers. A salesperson and I were servicing an end user and decided to make an impromptu call to a company across the street.

The maintenance man recognized me from a class he attended while working for a different company. This paved the way for us to start doing business with his new employer.

Over five or six years, that same maintenance person worked for a couple different companies and he brought us in to every one of them. That relationship opened the door and helped us secure the business.

Bottom Line: To hold on to and continue to build your customer base today, you need to do more than just sell a product or offer a standard service. Helping customers solve their own problems results in lifelong partnerships.

LeRoy Burcroff is vice president, sales, Bearing Service Inc., a member of the Power Transmission Distributors Association. PTDA is an association of industrial distributors and manufacturers dedicated to providing solutions to customer needs. For more information, visit www.ptda.org.

■ *Letter to the Editor*

What's HD's Growth Strategy?

A different opinion on Home Depot's market moves

Dear Editor:

I would like to disagree with MDM's editorial on Home Depot (MDM Jan. 10, 2007) – on several levels.

1) The job of company management, within certain limits, is to maximize shareholder value. HD stock was over $43 in 2000. According to the inflation calculator provided (on the Web) by the Bureau of Labor Statistics, that adjusts (for inflation) to about $50 in 2006. I would guess it will adjust another dollar higher in 2007 money, so make it $51.

Essentially, HD paid Bob Nardelli more than $450 million over six years to go backwards. The spending power of the money invested in HD stock by shareholders who bought the stock the day he was named Big Cheese DECLINED. You cite Nardelli's accomplishments. If he's not responsible for increasing the value HD stockholders realize from their investment . . . then who, precisely, is?

2) Yes, that's negative. What follows may seem to undercut that, or might be a debating point, but it's possible that any human on the planet – not just Nardelli – would have failed at the helm of Home Depot. Why? Home Depot stock had been valued forever based on its growth prospects. But: It stopped growing.

A regular feature of HD quarterly earnings reports had been an assessment of how much growth the company lost due to "self-cannibalization," as it expanded the number of stores in the U.S. When you're already everywhere, you can't expand your store count without taking a few bites out of your own thighs!

What was needed was a way to suck more money to the bottom line out of the still-increasing top-line volume. Nardelli led the company in making many moves to get this done, but in the process he literally might have "thrown the baby out with the bathwater."

According to many reports, in order to ratchet costs down, he got rid of full-time employees and in-store experts. That drove gross margins up, but it didn't help the stock's price. In the process, the company seems to have lost one of the core items that made Big Orange . . . Big Orange.

Assuming that had value (and I do assume that) . . . how easy do you think it's going to be for Home Depot to get that back?

3) Having boosted the bottom line to no apparent affect (as judged by the stock price), Nardelli searched for a growth strategy. His choice was to create HD Supply. He then bulked it up by buying companies. Is this strategy like putting months and months of hard work into exercise and good diet . . . or is it like pumping steroids?

Apparently, the drive for at least some of this came from the new CEO, Frank Blake. So maybe there won't be much change in this. However, the execution of this strategy certainly remains open to question. People in industrial distribution marvel at someone willing to pay12x EBITDA, as HD did for Hughes. To my mind, there's a worse number: I understand that the execs that filled most of the top 20 spots at Hughes Supply were gone from HDS within months of the acquisition's completion.

Does grossly overpaying for any acquisition (even a huge one) make sense?

Your publication goes to people who are in the upper echelon of industrial distribution. Does it make any sense to them (or you) to get rid of a huge passel of such execs right after buying a very big company?

Do the combined actions – overpaying and shedding expertise as if it grew on trees – make sense when you put them together?

Was this combination of strategies – which seems, on its face, moronic – the work of Mr. Blake? If so, your next editorial might more profitably speculate on what new idiocy we'll see from him, Joe DeAngelo, and the board members not smart enough to show up for an annual meeting!

Joe Salimando
Writer, TED magazine + TEDmag.com
Proprietor, www.eleblog.com

Salimando notes that the ideas in the above letter are his own, and not those of TED Magazine, TEDmag,com, or the National Association of Electrical Distributors.

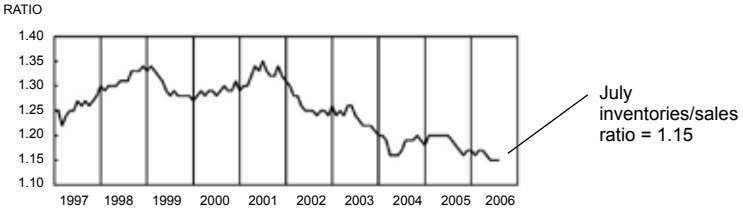
Monthly Wholesale Trade: Sales and Inventories for November 2006

Sales. November 2006 sales of merchant wholesalers, except manufacturers' sales branches and offices, after adjustment for seasonal variations and trading-day differences but not for price changes, were $331.3 billion, up 1.0% from the revised October level and were up 7.9% from the November 2005 level. November sales of durable goods increased 1.2% from last month and were up 7.7% from a year ago. Compared to last month, sales of motor vehicle and motor vehicle parts and supplies were up 5.0% and sales of electrical and electronic goods increased 2.9 %. November sales of nondurable goods were up 0.7% (+/-0.7%)* from last month and were up 8.1% from last year. Compared to last month, sales of petroleum and petroleum products increased 5.7% and sales of beer, wine, and distilled alcoholic beverages increased 2.4%.

Inventories. Total inventories of merchant wholesalers, except manufacturers' sales branches and offices, after adjustment for seasonal variations but not for price changes, were $396.7 billion at the end of November, up 1.3% from last month and were up 10.6% from a year ago. The October preliminary estimate was revised downward $1.3 billion or 0.3%. End-of-month inventories of durable goods increased 0.5% from October and were up 10.1% from last November.

Inventories/Sales Ratio. The November inventories/sales ratio for merchant wholesalers, based on seasonally adjusted data, was 1.20. The November 2005 ratio was 1.17.

Monthly Inventories/Sales Ratios
of Merchant Wholesalers: 1996-2006
(Estimates adjusted for seasonal and trading-day differences, but not for price changes)



Source: U.S. Census Bureau

Monthly wholesale trade: Sales and inventories November 2006

NAICS Code	Business Type	Sales $ millions	Inventories $ millions	Stock and Sales ratio	% Change in Sales 10/06-11/06	% Change in Sales 11/05-11/06	% Change Inventory 10/06-11/06	% Change Inventory 11/05-11/06
42	U.S. Total	331,317	396,654	1.20	1.0	7.9	1.3	10.6
423	Durable	163,355	250,110	1.53	1.2	7.7	0.5	10.1
4231	Automotive	28,641	38,062	1.33	5.0	13.4	0.6	8.8
4232	Furniture & Home Furnishings	6,007	8,380	1.40	1.8	15.4	0.9	7.1
4233	Lumber & Other Construction Materials	10,333	16,360	1.58	-0.4	-12.6	-0.1	9.5
4234	Prof. & Commercial Equip. & Supplies	27,851	31,983	1.15	0.1	7.3	0.4	10.1
42343	Computer Equipment & Software	14,977	11,320	0.76	2.0	13.8	-1.2	7.1
4235	Metals & Minerals	13,137	23,932	1.82	0.7	13.6	0.7	28.8
4236	Electrical Goods	25,538	31,943	1.25	2.9	14.3	0.6	13.4
4237	Hardware, Plumbing, & Heating Equipment	7,178	14,720	2.05	-2.1	-5.2	0.5	10.0
4238	Machinery, Equipment & Supplies	27,305	63,602	2.33	1.5	6.7	0.0	10.3
4239	Miscellaneous Durable	17,365	21,128	1.22	-3.1	5.9	1.5	-6.3
424	Nondurable Goods	167,962	146,544	0.87	0.7	8.1	2.8	11.4
4241	Paper & Paper Products	7,988	7,534	0.94	0.2	3.7	-0.8	0.1
4242	Drugs	30,851	31,180	1.01	-1.1	7.2	3.3	11.4
4243	Apparel, Piece Goods & Notions	11,311	15,825	1.40	0.4	14.8	0.6	-0.6
4244	Groceries &Related Products	37,279	26,913	0.72	-1.7	3.3	2.4	12.2
4245	Farm-product Raw Materials	10,472	17,270	1.65	-1.0	14.8	13.0	58.4
4246	Chemicals &Allied Products	7,948	8,620	1.08	-0.5	3.7	0.4	4.2
4247	Petroleum &Petroleum Products	34,761	10,702	0.31	5.7	12.3	3.1	13.9
4248	Beer, Wine & Distilled Beverages	8,861	9,574	1.08	2.4	11.2	1.6	5.2
4249	Miscellaneous Nondurable Goods	18,491	18,926	1.02	1.0	6.9	-1.2	2.7

U.S. Bureau of the Census, Current Business Reports, Monthly Wholesale Trade, Sales and Inventories Series: MDM compilation and analysis.
Adjusted for seasonal and trading day differences. Figures for sales and inventories are preliminary adjusted estimates.

MODERN DISTRIBUTION MANAGEMENT VOL. 37, NO. 02 JANUARY 25, 2007

Industrial & Construction Markets Update

PERSPECTIVE

As the lead article in this issue illustrates, the inflation threat largely driven in 2005 by energy price hikes has moderated, particularly the last few months of the year. Wholesale prices rose 1.1 percent in 2006, compared to 5.4 percent in 2005. But wholesale prices except food and energy – the core inflation rate – moved up 2 percent in 2006 following a 1.4 percent gain in 2005.

Distributors need to look more closely at the stats in their own sectors, as there are a lot of mixed signals. Materials for durable manufacturing increased 13 percent in 2006; prices for materials/components for construction increased 4.3 percent.

But as these pages pointed out (Adam Fein article in Nov. 10, 2006 MDM), distributors really need to watch "steroid" revenue growth produced by high commodity price inflation. Watch product costs carefully the first half of this year to monitor volume versus price growth.

The uptick in the Institute for Supply Management index in December after a few tough months supports a semi-soft landing, but there is still more confusion than clarity. International markets and a weak dollar appear to be providing what pilots call "ground effect," where a cushion of air supports the plane the last few feet from the runway.

This current climate lends itself to management by rear-view mirror as the safe bet. Many are planning on flat to five-percent growth for 2007. Fewer distributors are identifying customer sets that are core profitability drivers and dedicating the resources to grow those. That decision gridlock will offer some great opportunities this year for those who are nimble and innovative in how they differentiate and focus their service to customers.

Apollo Management, which also recently invested in **Rexnord**, has made an investment in **Bradco Supply Corp**., a roofing distributor based in Avenel, NJ. Bradco has more than 150 branches in the U.S. Bradco founder Barry Segal says the investment is a "great opportunity to significantly grow the company."

Global fastener distributor **The Wurth Group**, based in Germany, recorded 12 percent sales growth in fiscal 2006 to 7.74 billion euro, or US$9.9 billion. Outside of Germany, sales increased by 11.8 percent to 4.62 billion euro, or US$5.96 billion. Profit grew by 16.5 percent overall.

Wholesale prices rose 1.1 percent in all of 2006, in contrast to the 5.4 percent rise in 2005, the Department of Labor reported. The government attributed the slower rate of advance to the index for finished energy goods, which fell 2 percent in 2006 after climbing 23.9 percent a year earlier. Otherwise, wholesale prices except foods and energy moved up 2 percent in 2006 following a 1.4 percent gain in 2005.

As expected, **2006 figures for housing starts and building permits** were down from 2005. Housing starts were 12.9 percent below the 2005 figure and building permits were 14.9 percent down from 2005. However, 2.4 percent more housing units were completed in 2006 than in 2005.

BlueLinx Holdings Inc., Atlanta, GA, distributor of building products, reported revenue for the fourth quarter 2006 declined 29 percent to $945 million from the same period a year ago. The company's business that is tied to new home construction was negatively impacted by the slowdown and depressed wood-based structural product prices. BlueLinx also reported a net loss for the quarter. The company's other end-use markets sectors experienced mixed results. Manufactured housing declined significantly from Katrina-inflated levels a year ago, and industrial applications and non-residential construction showed growth. Repair and remodeling weakened.

Jackson, MS-based **Stuart C. Irby Co**., a subsidiary of **Sonepar USA**, has acquired **Burmeister Electric Company**, Minneapolis, MN, and **High Voltage Testing Laboratories**, Fargo, ND. Burmeister was established in 1919 to serve utility companies in the Upper Midwest. Burmeister is a full-line stocking distributor and manufacturers' agent offering products to the electric utilities for transmission and distribution requirements. HVTL is a testing laboratory offering high voltage testing services and sales of PPE (personal protective equipment) safety products, used by electric utility lineman and field service personnel in the contractor and industrial markets.

In November, **U.S. distributors' year-to-date sales of power transmission/motion control products** climbed 10.7 percent as compared to sales for January through November 2005, according to the latest November trend data released by the Power Transmission Distributors Association. Sales

continued on next page

fell 3.6 percent over the previous month and were up 7.8 percent as compared to November 2005.

Applied Industrial Technologies, Cleveland, OH, reported sales increased 4 percent in the second quarter 2007 to $472.36 million. Profit grew 21 percent to $18.5 million. For the six months ended Dec. 31, 2006, sales increased 7 percent to $964.9 million from $899.3 million in the same period last year. Profit was up 23 percent to $39.7 million.

The Fastenal Company, Winona, MN, reported sales for the year ended Dec. 31, 2006, were $1.8 billion, an increased of 18.8 percent over 2005. Profit increased 19.3 percent to $199,038. Sales for the fourth quarter ended Dec. 31, 2006, were $448,729, an increase of 16.8 percent over the same period last year. Profit increased 16.4 percent to $45,570. In 2006, Fastenal opened 245 new sites.

Industrial production rose 0.4 percent in December after a decrease of 0.1 percent in November. Output in November was previously estimated to have advanced; weaker data for a number of industries, particularly steel, led to the downward revision. For the fourth quarter as a whole, industrial production decreased 0.5 percent (annual rate). In the manufacturing sector, output increased 0.7 percent in December, and most major industry groups registered gains. The output of utilities fell 2.6 percent, the result of relatively mild temperatures during the month.

UK-based **Wolseley plc**, global distributor of plumbing and heating products and supplier of building materials, reported it continues to be affected by the slowdown in housing and lower lumber prices in the U.S. For the first five months to Dec. 31, 2006, Wolseley sales increased 15 percent, with 3 percent organic growth. Profit was slightly lower. Wolseley says the housing slowdown effect was offset by "good organic growth in the U.S. plumbing and heating business (**Ferguson**), an improved performance in continental Europe" and contributions from acquisitions. Organic sales at **Stock Building Supply** fell about 9 percent, and profit was down about 45 percent. Wolseley has cut about 4,000 jobs in the U.S., mostly at Stock.

Rexel reported sales for fiscal 2006 at 9.3 billion euro, or $12.1 billion, up 26 percent from 2005, and up 11.1 percent on a comparable basis (same scope of consolidation, exchange rates and business days). In North America, Rexel sales reached $5.2 billion, up 12.2 percent on a comparable basis from last year. Sales for the fourth quarter were $1.62 billion, up 4 percent from the same period a year ago.

Praxair Distribution, Inc., Danbury, CT, has agreed to buy **Mittler Supply Inc**., distributor of industrial, medical, specialty gases and related welding equipment and supplies, operating in Indiana, Michigan and Illinois. Mittler had sales of $73 million in 2006 and has 210 employees.

Kennametal Inc., Latrobe, PA, reported sales for the first six months of fiscal 2007 were $1.1 billion, level with the same period last year. Sales grew 6 percent on an organic basis, offset by the impact of acquisitions and divestiture of J&L Industrial Supply. Sales for the quarter were $569 million compared with $563 million in the same quarter last year. Second-quarter sales grew 6 percent on an organic basis.

SKF has acquired the **Preventive Maintenance Company Inc**., Elk Grove Village, IL. PMCI has 70 employees with annual sales of about $10 million. PMCI is in Predictive Maintenance services for industrial customers in the pulp and paper, metals, food, automotive and other industries. The PMCI acquisition strengthens SKF in reliability services, condition monitoring products and maintenance strategies.

ElkCorp, Dallas, TX, manufacturer of roofing and building products, has received another offer to purchase all of ElkCorp's outstanding shares for $43.50 a share by an affiliate of **Building Materials Corporation of America**. The special committee and board of directors, consistent with its recently announced merger agreement with **The Carlyle Group**, will review the offer and make a recommendation. The Carlyle Group recently agreed to increase its offer from $40.50 to $42 a share in cash.

Distribution Financial Metrics and Trading Multiples

(Data as of December 31, 2006)

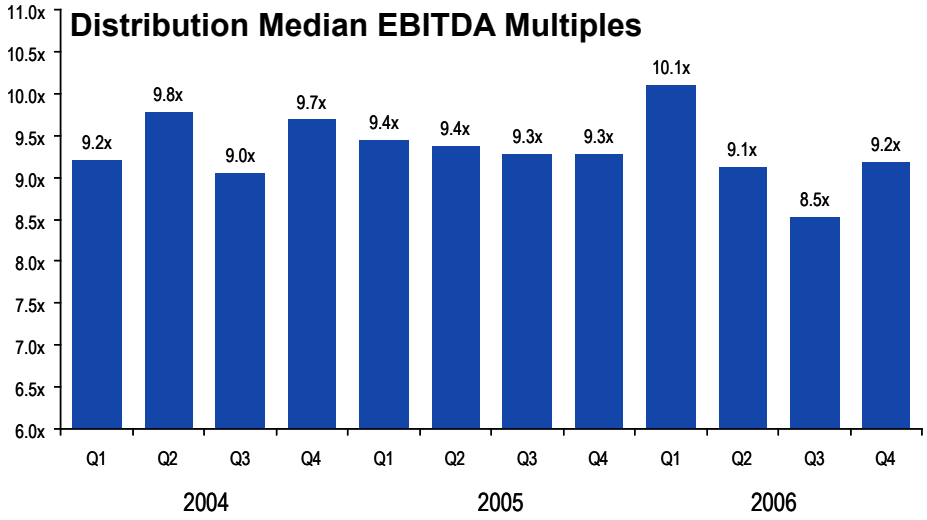
($ in millions)

Company	Ticker	Enterprise Value	LTM Sales	LTM Sales Growth	LTM Gross Margin	LTM EBITDA	LTM EBITDA Margin	EV to LTM Sales	EV to LTM EBITDA	ROIC	Working Capital/Sales
Airgas Inc. *	ARG	$4,088	$3,013	14.8%	50.6%	$452	15.0%	1.4 x	9.0 x	10.3%	5.8%
AM Castle & Co.	CAS	674	1,083	16.5%	18.2%	101	9.3%	0.6	6.7	12.1%	20.7%
Anixter International Inc. *	AXE	2,831	4,666	27.1%	24.3%	325	7.0%	0.6	8.7	12.3%	25.0%
Applied Industrial Technologies Inc.	AIT	1,115	1,950	11.6%	27.0%	139	7.1%	0.6	8.0	20.2%	14.1%
Barnes Group Inc. *	B	1,539	1,207	12.1%	36.1%	147	12.1%	1.3	10.5	9.1%	13.4%
Beacon Roofing Supply Inc. *	BECN	1,140	1,501	76.4%	24.3%	127	8.5%	0.8	9.0	10.4%	14.0%
BlueLinx Holdings Inc.	BXC	998	5,288	(3.9%)	10.0%	134	2.5%	0.2	7.4	7.9%	12.9%
Builders FirstSource, Inc. *	BLDR	869	2,367	3.9%	26.1%	232	9.8%	0.4	3.8	26.5%	9.4%
Building Materials Holding Corp.	BLG	1,076	3,455	31.2%	22.3%	297	8.6%	0.3	3.6	18.0%	7.4%
Bunzl plc	BNZL	4,849	6,193	17.8%	30.6%	451	7.3%	0.8	10.7	16.8%	5.4%
DXP Enterprises Inc.	DXPE	206	255	51.6%	27.9%	20	7.7%	0.8	10.5	19.3%	14.1%
Fastenal Co. *	FAST	5,402	1,745	19.7%	50.3%	341	19.5%	3.1	15.9	22.4%	34.5%
Genuine Parts Co.	GPC	8,427	10,325	7.3%	31.5%	854	8.3%	0.8	9.9	15.7%	23.5%
Hagemeyer NV	HGM	3,442	7,845	9.6%	23.6%	243	3.1%	0.4	14.2	6.5%	12.8%
Houston Wire & Cable Company *	HWCC	457	306	N/A	28.1%	47	15.5%	1.5	9.6	30.9%	28.4%
Huttig Building Products Inc.	HBP	175	1,136	7.4%	19.3%	29	2.6%	0.2	6.0	8.0%	10.8%
Industrial Distribution Group Inc.	IDGR	113	546	0.6%	21.9%	13	2.4%	0.2	8.6	7.4%	16.2%
Interline Brands Inc. *	IBI	1,154	1,000	21.8%	38.2%	112	11.2%	1.2	10.3	8.2%	27.3%
Kaman Corp.	KAMN	625	1,186	10.9%	27.7%	67	5.6%	0.5	9.4	8.4%	23.3%
Lawson Products Inc.	LAWS	370	508	17.6%	59.5%	37	7.2%	0.7	10.1	9.4%	20.7%
MSC Industrial Direct Co. Inc. *	MSM	2,815	1,318	19.8%	46.8%	252	19.2%	2.1	11.2	17.5%	28.5%
Park-Ohio Holdings Corp.	PKOH	534	1,027	13.3%	13.8%	77	7.5%	0.5	6.9	11.8%	22.2%
Pool Corp *	POOL	2,201	1,891	29.3%	28.6%	193	10.2%	1.2	11.4	21.6%	14.5%
Reliance Steel & Aluminum Co.	RS	4,208	5,042	55.6%	27.2%	654	13.0%	0.8	6.4	12.7%	24.2%
Ryerson Inc.	RYI	1,690	5,798	7.8%	15.0%	222	3.8%	0.3	7.6	6.7%	24.0%
Smith International Inc.	SII	10,714	6,865	30.4%	31.5%	1,110	16.2%	1.6	9.7	22.8%	29.3%
Watsco Inc. *	WSO	1,377	1,829	16.3%	25.7%	148	8.1%	0.8	9.3	15.4%	21.8%
WESCO International Inc. *	WCC	3,204	5,181	24.2%	20.3%	379	7.3%	0.6	8.5	23.5%	6.7%
Wolseley plc	WOS	20,274	27,737	25.8%	27.8%	2,002	7.2%	0.7	10.1	12.5%	17.4%
WW Grainger Inc. *	GWW	5,586	5,812	7.6%	40.3%	711	12.2%	1.0	7.9	21.0%	13.8%
Median		$1,458	$1,921	16.5%	27.5%	$207	8.2%	0.7 x	9.2 x	12.6%	16.8%

*=Companies covered by Baird Research

The table above highlights key financial metrics and trading multiples for 30 publicly traded distributors in the industrial and building products industries.

The table below illustrates historical median EBITDA multiples for the above companies calculated using LTM EBITDA as of the quarter shown and the enterprise value as of the last day of the quarter. Please see Definitions at bottom of page.



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Definitions. LTM means latest twelve months. Enterprise Value ("EV") means market capitalization of a company's equity plus preferred stock plus total interest bearing debt (including capitalized leases) net of any cash or cash equivalents. EBITDA means earnings before interest, taxes, depreciation and amortization. In certain cases earnings have been adjusted for certain disclosed income or expense items considered to be non-recurring in nature. ROIC means return on invested capital and is defined as tax-effected EBIT divided by the sum of the book value of equity plus net debt. Working Capital is calculated as current assets, less cash, minus current liabilities excluding short-term borrowings and current portion of long-term debt.

MARKETS UPDATE SUPPLEMENT P. 4

MAPI Business Outlook: Moderation in First Half of 2007

The overall U.S. economy is expected to experience some moderation in the first half of 2007, and manufacturing production will likely play its part in a slowdown, according to the Manufacturers Alliance/MAPI Survey on the Business Outlook.

The December 2006 composite index of 54 is down from 64 reported in the September 2006 survey and breaks an impressive streak of 16 consecutive quarters of 60 or above. The number is the lowest since an index of 52 was recorded in the March 2002 survey, yet continues to indicate that the industrial component of the U.S. economy remains on a growth trajectory.

The composite business index above 50 indicates that overall manufacturing activity is expected to increase over the next three months to six months. It should be noted, however, that the index measures the direction of change rather than the absolute strength of activity in manufacturing.

Seven of the 10 factors measured by the quarterly survey were lower than the previous report, in line with the downward trend of other recent economic indicators, but three indexes did show increases.

The investment index queries executives on their expectations regarding capital investment in 2007 compared to 2006. The index rose eight points, to 64 percent, from 56 percent in the September 2006 survey. The research and development (R&D) index determines how executives see R&D expenditures in 2007 compared with those of 2006.

This index confirms the underlying strength in manufacturing, rising to 74 percent in December 2006 from 70 percent in September 2006. The exports orders index, which measures how fourth quarter 2006 orders are expected to compare with those of Q4 2005, edged up to 77 percent from 75 percent in the September survey.

As might be expected in the softening manufacturing environment, however, the remaining indexes show some retrenchment, yet all still remain above 50 percent. Somewhat troubling, however, is the fact that five indexes fell by double digits.

The backlogs index, comparing fourth quarter 2006 backlogs with backlogs one year earlier, took the biggest hit, dipping to 57 percent in December from 71 percent in the September survey. An accumulation of backlogs usually occurs when new orders exceed shipments. The profit margin index also fell significantly, dropping to 62 percent from 75 percent in the previous report.

The capacity utilization index, based on the percentage of firms operating above 85 percent of capacity, decreased to 38.2 percent in December from 50.8 percent in September, although it remains well above its long-term average of 32.5 percent.

The orders index, which compares new orders for the fourth quarter of 2006 with the same quarter one year ago, fell 11 percentage points, to 66 percent in December from 77 percent in September. The prospective shipments index, based on expectations of anticipated shipments in the first quarter of 2007 compared with the same quarter last year, decreased to 62 percent in December from 73 percent in the September survey.

Two other indexes encountered only a minimal downward trend. The inventory index rose to 76 percent in December from 73 percent in September, indicating inventories to be higher on a year-to-year basis. The forward-looking annual orders index, based on a comparison of expected orders for all of 2007 with orders in 2006, decreased to 78 percent in December from 80 percent in the September survey.

"The decline in the composite index and most of the individual indexes indicates a slowdown in manufacturing activity," said Donald A. Norman, Manufacturers Alliance/MAPI economist and survey coordinator. "Nonetheless, most senior financial executives expect manufacturing activity will expand for all of 2007. The increases in the export and investment indexes also suggest that any slowdown will be of relatively short duration."

Full report is available at www.mapi.net ($50 for MAPI non-members; 703-647-5139).

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