# MODERN DISTRIBUTION MANAGEMENT

*The Newsletter for the Wholesale Distribution Channel*

VOL. 37, NO. 14
JULY 25, 2007

# Why Sales Compensation Plans Fail

*Consider these points before implementing a change*

*With the recent attention in this industry given to strategic pricing, distributors who change their pricing structures must consider developing new sales compensation plans that reward improved profits. Before attempting a change, consider all appropriate structures and take steps to avoid implementation pitfalls.*

**By Michael Emerson**

According to a recent study, U.S. companies are "markedly more satisfied with their sales compensation programs today than they were two years ago." Having spent the last 10 years designing and implementing sales compensation programs for hundreds of firms, I found this intriguing.

Upon further reading, I discovered that "markedly more satisfied" meant that 59 percent of companies surveyed in 2006 were satisfied compared to 34 percent in 2004. In other words, about four out of 10 sales compensation systems in this country are failing to meet their objectives!

Why such high levels of dissatisfaction? The authors of the study provided descriptions of the disappointments, such as failure to achieve desired results, contributing activities from the sales force not meeting expectations, overcompensation of poor performers, under compensation of high performers, low program understanding, and excessive administration time.

While all these factors clearly lead to dissatisfaction, the question as to why the problem continues to go unsolved went unanswered. My experience is that the core issues leading to unresolved dissatisfaction around sales compensation programs are the result of three factors:

**Fear**. Today's dissatisfaction is tolerated because it's perceived to be better than what might happen if change were attempted.

**Misdiagnosis**. Sales compensation program changes do not produce the expected improvements they expect because the program itself is not the real problem.

**Lack of awareness**. Companies have a difficult time coming up with structural alternatives to the program that is currently in place.

### Fear

Companies with long-tenured sales reps and compensation programs that haven't changed in several years are often very reluctant to change. Their executives may fear that changing the compensation program will irrevocably destroy the cultural dynamic that has served the company well over the years, threatening its long-term vitality.

They tolerate their dissatisfaction with the plan because they perceive that it is better than what might happen if they changed it.

Concerns about disrupting the company culture are very legitimate. Changing compensation programs is risky. If the programs are not well conceived, clearly communicated and properly implemented there is a high probability that an unintended, negative and permanent culture shift can occur. Sometimes, of course, cultural shifts are the whole point, but the law of unintended consequences should not be ignored.

To combat these unintended consequences follow these steps:

**Don't do it yourself**. Enlisting individuals from different functional areas of your company (accounting, IT, HR, etc.) will ensure that all angles that need to be considered are considered, i.e. it's affordable, the information needed is available in

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the computer systems, no employment laws are being broken, etc.).

**Ensure that agreement and clarity exist on objectives**. It is vital that a clear and detailed answer exists to the question, "How will results be different next year if we've done a good job?"

**Be open-minded**. Invest the time to become aware of the different compensation structures that exist (salary, bonus, commission, multipliers, thresholds, etc.). There are some compensation structures that are very poor matches for certain situations and others that fit very well. Many companies get into trouble trying to tweak what they are currently doing or copying the competition when neither of these is well aligned with their strategy.

**Don't be surprised**. The saying "measure twice, cut once" applies here. The consequences of failing to consider different scenarios or not examining the personal impact on important individuals can be severe and irreparable. Make sure enough modeling is performed before making any changes. Adjustments after the fact will erode credibility, encourage ongoing lobbying for special consideration and may be too late to fix the damage.

**Communicate**. There are two messages that are important. One is how the program works. A well designed compensation program is one where the more program participants earn the happier the company is. Therefore, it is critical that program participants understand how they can maximize their incomes.

The second message is why a change was necessary. Rarely will a sales rep be more attentive than when his or her compensation is being discussed. Do not miss this opportunity to articulate to the troops the strategic direction and business objectives of the company and their role in achieving them.

## Misdiagnosis

As for the second root cause, many companies attribute dissatisfaction to their sales compensation program when the reality is that other factors are the primary reason for substandard market execution.

Rarely will a sales force achieve its objectives if it is unclear as to what it is expected to achieve or does not have the necessary tools, training or inherent capabilities. If conditions such as these exist, efforts made to modify the sales compensation program will generate marginal, if any, improvements.

Sales compensation can be a powerful, tactical tool for driving market execution. Before attempting a change, however, ask your self if the following strategic issues have been addressed:

Are sales roles appropriate? For example, are sales "generalists" still the right approach, or would your company be better off with more focused sales roles such as hunters, harvesters and market specialists? Should you deemphasize the outside role and bulk up inside sales and/or Web site capabilities?

Do sales representatives have the tools they need to succeed? Having the right people is not the end of the sales manager's job. Good manag-

**MODERN DISTRIBUTION MANAGEMENT**

*Founded in 1967 by J. Van Ness Philip*

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Published twice monthly; $345/yr., $365 U.S. funds other countries; $169 each additional subscription to a company ($189 other countries). For group subscription rates and site licenses, please contact Tom Gale at 303-443-5060.



ISSN 0544-6538

ers also ensure that sales reps receive continuous coaching and have appropriate sales, product and market knowledge.

Is there clarity and agreement on the key metrics that define performance for each sales role? What customers, products, markets, etc., is each one targeting?

When prepared sales representatives have clarity around sales roles and key performance metrics exist, a company is in a position where the desired performance improvements from a sales compensation change are likely to be realized. If a company does not have shared agreement that "yes" is the answers to these questions, you can continually change your sales compensation program and will find yourself still dissatisfied.

### Lack of Awareness

I no longer find it surprising but I believe it's pretty insightful that when companies contact me they typically ask for assistance "fixing their commission program." Unfortunately, for many companies the best solution is to abandon their commission program and replace it with a different type of structure.

Most companies do not have in-house expertise in sales compensation design because they make changes so infrequently. Thus, modifications are investigated by someone in his or her "spare time," limiting the amount of time available to research alternatives outside the prevailing structure. This approach can lead to situations in which the new plan perpetuates the errors of the old one, is overly complex or misaligned with the company's evolving strategy or culture.

Ideally, once a company has clearly defined its program goals and concluded that an effective sales organization is in place, it should consider the full range program types available in a modern compensation system.

If the company is focused on increasing revenue, adding a sales goal, with a higher commission payout above it and a lower one below is a simple way to improve alignment.

Companies that are interested in maintaining the positives associated with a commission program (motivation, variable pay, etc.) but are interested in improving margins can benefit from adding a load (fixed percent of sales subtracted from gross profit) to their program.

When trying to build a specific part of the business, e.g. product line/group or customer segment using a multiplier (measuring performance narrowly and applying the result broadly) can be very effective.

There is no reason to accept a sub-optimum sales compensation program. By ensuring that strategic issues are addressed first, considering all appropriate structures and avoiding the common implementation pitfalls, any company can leverage the power of a modern compensation system.

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## Activant to Buy Intuit Eclipse for $100M

Activant Solutions Inc. has agreed to buy the Intuit Eclipse Distribution Management Solutions business from Intuit for $100 million in cash.

The acquisition of the Intuit Eclipse business will augment Activant's customer base and expand its technology offerings in the wholesale distribution segment.

Intuit Eclipse is a provider of business management solutions for wholesale distributors in segments ranging from electrical, plumbing, HVAC and building materials to industrial, janitorial and other durable goods supplies.

"The acquisition of Intuit Eclipse is an important step in Activant's vision to be a leader in vertical business management software solutions," said Pervez Qureshi, president and CEO of Activant Solutions. "Intuit Eclipse has built a loyal customer base with a strong product offering that will complement Activant's technologies, and give customers a broader set of solutions."

"We are pleased to have Activant acquire our Intuit Eclipse business," said David Merenbach, VP of Intuit software businesses.

"The addition of the Eclipse product strengthens Activant's suite of products targeting the wholesale distribution industry, and at the same time the divestiture allows Intuit to focus on its core businesses."

Activant serves three primary segments: automotive aftermarket; hardlines and lumber; and wholesale distribution.

# Get Paid for the Value You Add

*Volume-driven approach is not best for distributor profitability*

*The last five years have been rough for distributors. Price pressure and intense competition have eliminated razor-thin margins, pushing many distributors to the brink. In addition, distributors have gotten into the habit of "giving away" value-added services in hope of winning deals, driving costs to historic heights. The solution: Revamp pricing based on the value you provide in each segment.*

**By Francois Delvaux and Dan McLaughlin**

Many distributors believed that a resurgent economy would allow them to raise prices, but customers have been resistant. For most distributors, attempts at price increases are simply not taking hold.

Fortunately, there is a better, more profitable approach. The solution is to develop products and services that target unique segments with very specific offers. For most distributors, this involves developing a range of offers from the high end (with all the bells and whistles) to the low end (no frills).

The key is to segment the market and build specific offers based on your unique ability to drive economic value (e.g. revenue growth or cost reductions) for each chosen market segment.

For most distributors, this is a fundamentally new approach and supplants their basic one-size-fits all, volume-driven pricing model. And while most distributors conceptually understand this strategy, most fear it because they have become locked into thinking that their products and services are just basic commodities. They couldn't be more wrong.

Based on years of working with distribution companies, we know that most don't fully understand how their customers value their products and services and get caught up in the mindset of "the way things usually work." Even the most commodity intensive business can improve revenue, margins and profits by adopting a value-based strategy that targets specific market segments with products and services that drive the economics of their customer's business.

### Where to Begin

Developing the right go-to-market strategy requires four steps for distributors:

- Develop a deeper understanding of the value drivers for each market segment
- Determine costs to serve those segments
- Design specific offer and pricing structures specifically for those segments
- Create organizational alignment and communicate value to the market

### Understand the Value Drivers

The goal of value analysis is to understand how your products and services create economic value for customers (i.e. how do our services help customers grow their revenue or reduce their costs?) and how value perceptions change across market segments.

We are not referring to customer needs or product features and benefits, but which elements of value drive a customer's business towards higher revenue and profit. Most distributors view customers more or less the same. Yet based on our experience with distributors, we know that there are vast differences in how market segments value what distributors offer.

Often, the most important and differentiated value elements are imbedded in the services that distributors provide, and those services are often given away for free. To understand where differentiated value is created, distributors should take a hard look at critical service elements such as:

- Pre-sale technical support
- Post-sale technical service
- Ordering methods
- Customer service
- Financing options
- Credit terms
- Freight charges
- Returns and claims
- Packaging

For example, we know of one distributor who provided extremely high levels of pre-sales technical support and configuration. So good in fact, that many of their prospective customers used them for technical advice in configuring solutions but then went on to procure the end product from a competitor at a lower price.

A good place to gain comprehensive knowledge of your value across customer segments is by reviewing your customers' historical usage of those services (i.e. how often did they use a particular service during a set time frame?).

It is also important to conduct in-depth interviews with customers to determine their motivations, the financial impact that the service created and where they would turn if your company did not provide a particular service (i.e. understanding their next best alternatives).

### Determine Cost-to-Serve

Most distribution companies have good visibility of their product costs but a poor understanding of their costs to serve customers. By assigning costs to services your company provides, distributors can assess true cost. However, simply knowing the cost-to-serve is insufficient.

Costs must be compared to the prices actually paid by customers to understand where problems reside and where the potential for improvement exists. Especially in distribution companies, where products and services are typically bundled together under one price, there is a high potential to overcharge segments that don't need services and undercharge segments that are heavy consumers of services.

In the first case, you run the risk of losing business because your prices are considered too high and in the second case, you run the risk of conducting highly unprofitable business.

Equipped with the knowledge of price and cost-to-serve, you can find those customers that abuse your services as well as find customers that do not need any service support and may have been overcharged. The end game is to develop a pricing structure that enables you to capture more from heavy users of services while at the same time not penalize light users.

### Design Offering & Pricing Structures

Once a company understands its value and cost-to-serve elements across customer segments, it can design an offering and pricing structure. The goal is to develop offerings that map to the value drivers in different segments while also being aligned with your own costs and capabilities.

Distributors should also consider using a tiered offering structure to capture customer value differences. Each tier of the offering should have a different value proposition and price point (e.g. bronze, silver, gold packages).

This structure can help reframe the value of your offerings by forcing customers to make explicit tradeoff decisions about what they receive for a certain price. Tiered offerings solve the problem of service abusers as well as satisfying "no frills" customers with offers packaged to meet each customer's unique needs.

To ensure your customers don't break pricing tiers and obtain more value for less money, it's important to create price fences to secure the integrity of your strategy. Fences can take a number of forms. In the airline industry, for example, advanced purchase time is used as a fence to prevent business travelers from purchasing discounted fares. For distribution companies, fences to consider include:

- Purchase location (e.g. ordering via web, customer service or field sales)
- Time of purchase (e.g. how far in advance of delivery the order is made?)
- Purchase quantity (e.g. volume, order or quantity requirements)
- Product design (e.g. differing versions of the product and service)
- Product bundles (e.g. different configurations of products and services)

### Create Alignment

For distribution companies, the path to strategic pricing needs to be well-planned and flawlessly executed. In most cases, this can be accomplished by creating a small, cross-functional team with top-management steering where pricing strategies and tactics are developed and monitored.

It's best to start small and identify problem accounts with margin leakages. The magnitude of the problem should be quantified to help raise its importance and bring commitment. Initial success should be made early in the process.

**Optimize pricing strategy until you control the process**. Hold someone responsible. Create a case for change. Articulate pricing policies.

**You can't get the sales force to change how they sell until you bring them on board.** Convince them of the problem. Reward them for solving it.

**You can't expect your customers to change how they think about price and value until you change how you deal with them.** Understand their needs and adapt. Understand and communicate value. Price with integrity.

**You can't control and monitor the process without appropriate systems.** Start with spreadsheet based tools to refine decision making. Build or buy systems that fit your needs.

When it comes to the introduction of new pricing strategies, the "make-or-break issue" is often an organization's ability to implement them. These changes are not easy. However, most distributors don't have a choice. They must make changes to their pricing strategy or their competitors will beat them to it.

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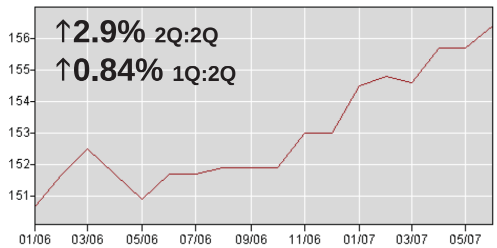
## Inflation by Commodity Group

*Product pricing trends for the second quarter 2007*

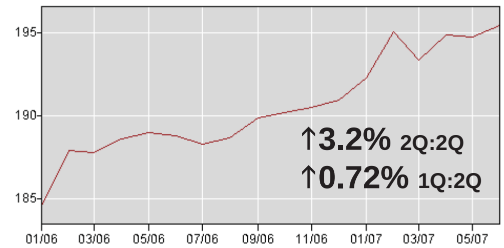
These 16 select product groups provide a snapshot of inflation trends. Second quarter 2006 is compared with second quarter 2007, and the first quarter 2006 with the second quarter 2007.

**Key**
**↑11.6%** **2Q:2Q (2Q '06 with 2Q '07)**
**↑1.8%** **1Q:2Q (1Q '07 with 2Q '07)**

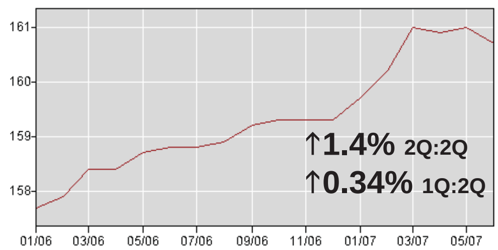
### Abrasives



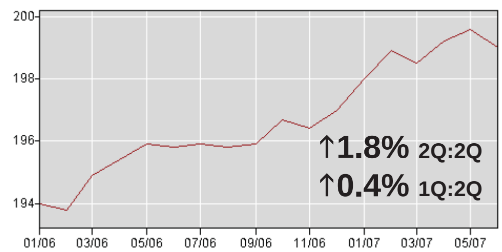

### Adhesives & Sealants



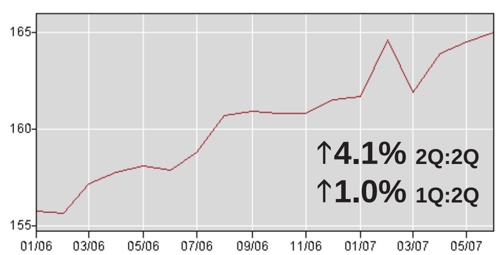

### Cutting Tools & Accessories



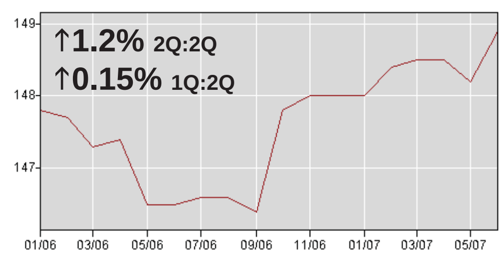

### Hand & Edge Tools



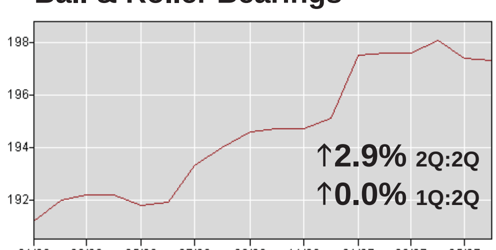

### Fasteners



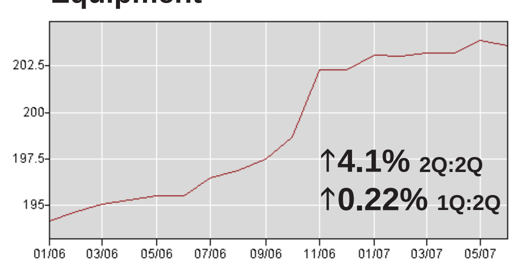

### Power-Driven Hand Tools



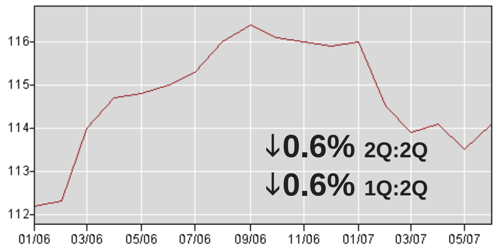

### Ball & Roller Bearings



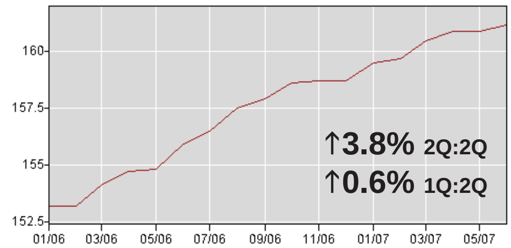

### Mech. Power Transmission Equipment



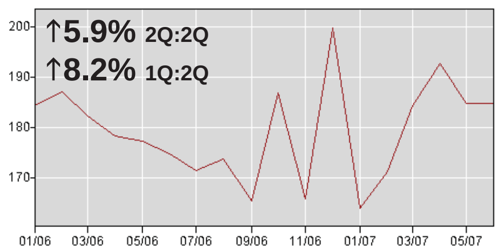
### Electrical Machinery/Equipment



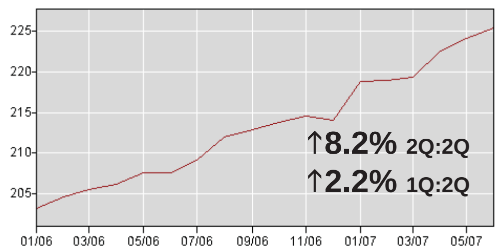

### Material Handling Equip. (Ind)



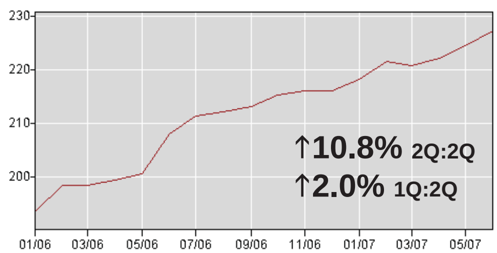

### Industrial Gases



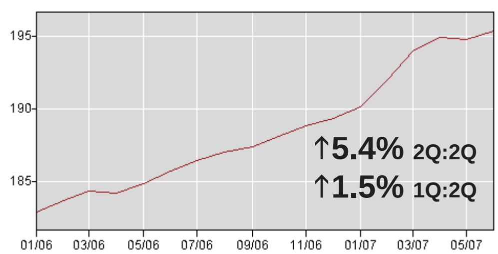

### Welding Machinery/Equipment



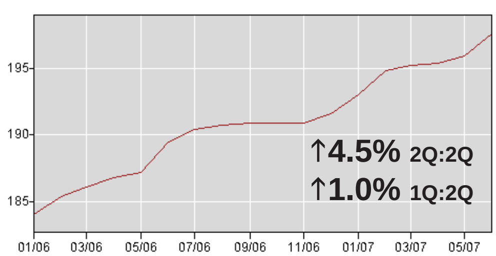

### Valves, Except Fluid Power



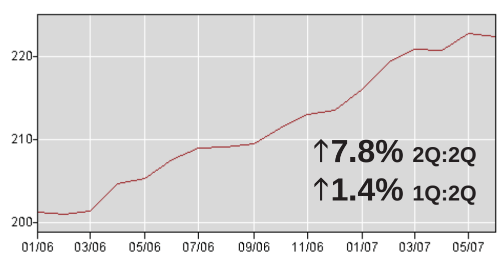

### Pumps, Compressors & Equip.




### Fluid Power Equipment




### Plumbing Fixtures & Fittings



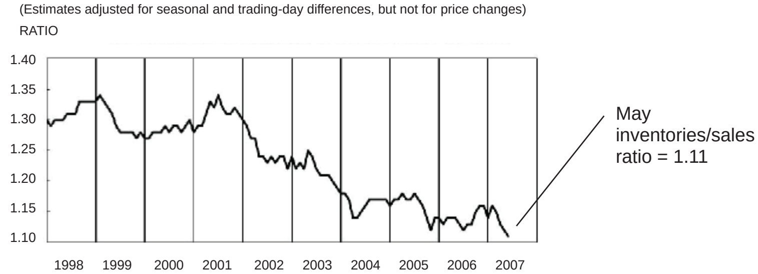
## Monthly Wholesale Trade: Sales and Inventories for May 2007

May 2007 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 $357.2 billion, up 1.3 percent from the revised April level and were up 8.7 percent from the May 2006 level. The April preliminary estimate was revised upward $0.8 billion or 0.2 percent. May sales of durable goods were down 0.5 percent from last month, but were up 4.2 percent from a year ago. Compared to last month, sales of motor vehicle and motor vehicle parts and supplies were down 5.3 percent. May sales of nondurable goods were up 2.9 percent from last month and were up 13.1 percent from last year.

**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 May, up 0.5 percent from last month and were up 6.7 percent from a year ago. The April preliminary estimate was revised upward $0.3 billion. End-of-month inventories of durable goods increased 0.6 percent from last month and were up 5.0 percent from last May. Inventories of metals and minerals, except petroleum increased 2.5 percent from last month and inventories of electrical and electronic goods increased 1.9 percent. End-of-month inventories of nondurable goods increased 0.2 percent from April and were up 9.7 percent compared to last May.

**Inventories/Sales Ratio**. The May inventories/sales ratio for merchant wholesalers, except manufacturers' sales branches and offices, based on seasonally adjusted data, was 1.11.The May 2006 ratio was 1.13.

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 May 2007

| NAICS Code | Business Type | Sales $ millions | Inventories $ millions | Stock and Sales ratio | % Change in Sales 4/07-5/07 | % Change in Sales 5/06-5/07 | % Change Inventory 4/07-5/07 | % Change Inventory 5/06-5/07 |
|---|---|---|---|---|---|---|---|---|
| 42 | U.S. Total | 357,166 | 396,664 | 1.11 | 1.3 | 8.7 | 0.5 | 6.7 |
| 423 | Durable | 168,937 | 250,281 | 1.48 | -0.5 | 4.2 | 0.6 | 5.0 |
| 4231 | Automotive | 26,617 | 36,859 | 1.38 | -5.3 | -1.8 | 1.3 | -5.0 |
| 4232 | Furniture & Home Furnishings | 6,368 | 7,879 | 1.24 | 3.8 | 15.4 | -0.6 | 8.2 |
| 4233 | Lumber & Other Construction Materials | 11,127 | 14,309 | 1.29 | 0.8 | -10.9 | -1.2 | -4.9 |
| 4234 | Prof. & Commercial Equip. & Supplies | 29,451 | 32,076 | 1.09 | 0.5 | 8.1 | 0.3 | 9.2 |
| 42343 | Computer Equipment & Software | 15,531 | 11,901 | 0.77 | 3.7 | 12.0 | 1.4 | 8.6 |
| 4235 | Metals & Minerals | 14,089 | 24,656 | 1.75 | 0.0 | 7.9 | 2.5 | 16.1 |
| 4236 | Electrical Goods | 24,970 | 32,575 | 1.30 | -0.5 | 3.4 | 1.9 | 7.0 |
| 4237 | Hardware, Plumbing, & Heating Equipment | 7,658 | 15,086 | 1.97 | -2.3 | -4.4 | -0.8 | 5.4 |
| 4238 | Machinery, Equipment & Supplies | 28,504 | 63,687 | 2.23 | 1.4 | 8.1 | 0.7 | 7.1 |
| 4239 | Miscellaneous Durable | 20,153 | 23,154 | 1.15 | 0.5 | 10.9 | -1.1 | 3.2 |
| 424 | Nondurable Goods | 188,229 | 146,383 | 0.78 | 2.9 | 13.1 | 0.2 | 9.7 |
| 4241 | Paper & Paper Products | 8,137 | 6,651 | 0.82 | 0.3 | 2.1 | 0.4 | 5.8 |
| 4242 | Drugs | 32,860 | 31,923 | 0.97 | 0.4 | 4.1 | 1.5 | 6.0 |
| 4243 | Apparel, Piece Goods & Notions | 10,666 | 14,959 | 1.40 | 1.7 | 8.2 | 0.6 | 4.0 |
| 4244 | Groceries &Related Products | 42,927 | 27,236 | 0.63 | 0.3 | 16.3 | 1.6 | 19.7 |
| 4245 | Farm-product Raw Materials | 14,790 | 14,605 | 0.99 | 9.5 | 35.7 | 0.8 | 34.4 |
| 4246 | Chemicals &Allied Products | 8,499 | 8,883 | 1.05 | 1.7 | 10.1 | -0.3 | 3.2 |
| 4247 | Petroleum &Petroleum Products | 41,928 | 13,441 | 0.32 | 5.3 | 16.0 | -3.4 | 0.1 |
| 4248 | Beer, Wine & Distilled Beverages | 8,553 | 10,051 | 1.18 | 3.1 | 9.7 | -1.1 | 7.1 |
| 4249 | Miscellaneous Nondurable Goods | 19,869 | 18,634 | 1.94 | 5.5 | 12.8 | -1.4 | 6.2 |

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. 14
JULY 25, 2007

# Industrial & Construction Markets Update

## PERSPECTIVE

Despite pressures from commodity price increases the past few years, many distributors are finding it hard to raise prices. The traditional method of price increases has too often been to throw five percent (or another guesstimate) against the wall to see if it sticks.

The authors of the article on page 4 argue that there is a better, more profitable approach. The solution is to develop products and services that target unique segments with very specific offers. For most distributors, this involves developing a range of offers from the high end (with all the bells and whistles) to the low end (no frills).

The key, the authors say, is to segment the market and build specific offers based on your unique ability to drive economic value (e.g. revenue growth or cost reductions) for each chosen market segment.

This article gets to the heart of why many distributors have trouble differentiating themselves:

"Most distribution companies have good visibility of their product costs but a poor understanding of their costs to serve customers. By assigning costs to services your company provides, distributors can assess true cost. However, simply knowing the cost-to-serve is insufficient.

"Costs must be compared to the prices actually paid by customers to understand where problems reside and where the potential for improvement exists. Especially in distribution companies, where products and services are typically bundled together under one price, there is a high potential to overcharge segments that don't need services and undercharge segments that are heavy consumers of services."

Distributors have to shed their unprofitable business or get taken out by competitors who are happy to have them focus on it.

Two major distributors of industrial and oilfield PVF supplies, **McJunkin Corporation**, with nearly $2 billion in annual revenues, and **Red Man Pipe and Supply Company**, nearly $1 billion in annual sales, have announced a "merger of equals." Charleston, WV, and Tulsa, OK , will serve as co-headquarters for the new company. McJunkin Corporation CEO and President H.B. Wehrle III and Red Man Pipe and Supply Company President and CEO Craig Ketchum will serve as Co-CEOs for the new company.

**Wolseley plc** has reported it will close 24 more **Stock Building Supply** branches, primarily in the Midwest. The closures include a 370 headcount reduction. The announcement comes after closing 22 branches and reducing headcount by about 4,500 in the past year, or a quarter of total employees.

**Lewis-Goetz and Company, Inc**., Pittsburgh, PA, has acquired **Samson Industrial**, expanding its reach further into the Southeast and solidifying its presence in the Gulf Coast. Samson is a distributor and fabricator of specialty industrial supplies specializing in fluid and material conveyance, fluid sealing, vibration and dampening, fastening, personal safety and industrial tools. Samson has 15 locations, including its headquarters in Tulsa, OK. Lewis-Goetz has more than $200 million in annual sales.

**Kendall Electric** has purchased **Roden Electric**, an electrical distributor in the South Central U.S. with more than $120 million in annual sales. Kendall has more than $400 million in annual sales. It serves the industrial, OEM, and construction markets.

Shareholders of **Myers Industries, Inc**., Akron, OH, have approved the plan of merger, where Myers Holdings Corp., controlled by **GS Capital Partners**, would acquire the polymer product manufacturer and distributor of tools, equipment and supplies for $1.1 billion, including the assumption of debt. The company had sales of $780 million in 2006.

**Womack Machine Supply Company** has acquired Birmingham, AL-based **FPS Technologies**. FPS distributes many of the same product lines as Womack and operates a hydraulic repair center near Birmingham. The combination of both companies allows Womack Machine Supply to expand distribution and service of fluid power and automation products into Alabama, Mississippi, and the Florida panhandle.

**Saint-Gobain** has acquired the **Norandex** group from **Owens Corning**. Norandex group is split into two units: building materials distribution and vinyl siding manufacturing. The deal values Norandex at $343 million. Norandex had sales of $866 million in 2006.

**Pearlman Industries, Inc**., Commerce, CA, a **Harbour Group** company and the parent of **Pearl Abrasive Co**. and **Keystone Tools**, has acquired

continued on next page

**MARKETS UPDATE SUPPLEMENT P. 2**

**Stone Tool Supply, Inc**., Atlanta, GA. Stone Tool Supply is a distributor of tools, equipment and accessories to the stone fabrication market.

Through its **Trelleborg Sealing Solutions** business unit, Sweden-based **Trelleborg** has acquired distributor **AFM Inc**., Portland, OR, which has 45 employees and sales of US$12.8 million. AFM is a distributor of hydraulic seals and customized rubber components. Products include dynamic seals, static seals and rotary seals. The bulk of AFM's current sales are to OEM customers in several industrial segments.

**3M**, St. Paul, MN, has created the 3M eStore. At the new site, customers in the 48 contiguous United States can purchase 3M products with a credit card. H.C. Shin, executive vice president, 3M Industrial and Transportation Business said: "We know that our customers aren't aware of our full product line. By opening the 3M eStore, we are placing our products in more locations where our customers can purchase them. In addition, if they tell us they're interested, we'll connect them directly to one of our authorized distributors to set up an ongoing relationship."

**May U.S. manufacturing technology consumption** totaled $313.74 million, according to the American Machine Tool Distributors' Association and the Association For Manufacturing Technology. This total, as reported by companies participating in the USMTC program, was up 6.5 percent from April, but down 6.5 percent from the total of $335.52 million reported for May 2006. With a year-to-date total of $1,606.13 million, 2007 was up 7.5 percent compared with 2006.

The **Producer Price Index for Finished Goods** decreased 0.2 percent in June, seasonally adjusted, the Bureau of Labor Statistics of the U.S. Department of Labor reported. This decline followed advances of 0.9 percent in May and 0.7 percent in April. During the first 6 months of 2007, the finished goods index rose at a 6.4-percent seasonally adjusted annual rate after no change during the latter half of 2006.

**Industrial production** rose 0.5 percent in June after a decrease of 0.1 percent in May. Total industrial production was 1.4 percent above its year-earlier level. Capacity utilization for total industry moved up to 81.7 percent in June; the rate was 0.6 percentage point below its level in June 2006 but 0.7 percentage point above its 1972-2006 average.

After a slight decrease in April, **manufacturing shipments in Canada** remained virtually unchanged in May (-0.1 percent) at $49.7 billion. Manufacturing shipments had trended slowly downwards throughout most of 2006, before posting a strong first quarter in 2007. On a sector by sector basis, only 9 of 21 manufacturing industries decreased in May, but they represented about 57 percent of total shipment outputs.

**May 2007 sales of U.S. wholesalers** were $357.2 billion, up 1.3 percent from the revised April level and were up 8.7 percent from the May 2006 level.

**Kennametal Inc**., Latrobe, PA, has signed a product supply agreement with **Kyocera Corporation**, Kyoto, Japan. The agreement includes initiatives such as private labeling, cross-licensing and sales and marketing. Te agreement is global in scope and is designed to complement the suppliers' existing product lines. Kennametal and Kyocera plan to grow sales of each others' product lines worldwide.

Private equity firm **CVC Capital Partners** has offered to buy Dutch chemicals distributor **Univar NV** for US$2.04 billion (1.5 billion euro), a premium of about 37 percent to Univar's closing price July 6. Univar operates more than 200 distribution centers across the U.S., Canada, Europe and Asia. In 2006, Univar had sales of $8 billion.

**NorthEast Electrical Distributors/Eagle Electric Supply**, a subsidiary of **Sonepar USA**, has agreed to buy **Ralph Pill Electric Supply**, Boston, MA. RPESCO has 16 locations in Massachusetts, New Hampshire and Maine. RPESCO's 2006 sales rank them as one of the largest independently-owned electrical distributors in New England and among the top 100 in the country.

Private equity firm **The Carlyle Group** has agreed to buy **Sequa Corporation**, a diversified manufacturer, for $2.7 billion. Sequa Corporation has seven discrete operating units in the following industries: aerospace, automotive, metal coating, specialty chemical, industrial machinery, and other products.

**SKF**, Stockholm, Sweden, reported sales grew 11 percent in the second quarter 2007. Sales were strongest in the Industrial Division and Service

Continued on p. 4 of this section

## Distribution Financial Metrics and Trading Multiples

**(Data as of June 30, 2007)**

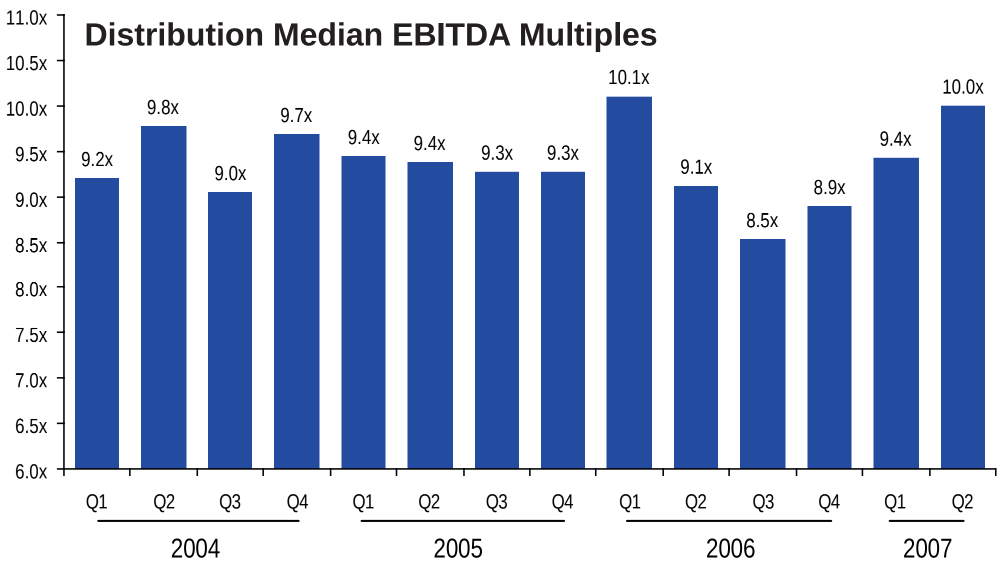
*($ in millions)*

| Company | Ticker | Enterprise Value | Sales | LTM Sales Growth | LTM Gross Margin | EBITDA | EBITDA Margin | EV to LTM Sales | EV to LTM EBITDA | ROIC | Working Capital/Sales |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Airgas Inc. * | ARG | $5,225 | $3,205 | 13.3% | 51.1% | $516 | 16.1% | 1.6 x | 10.1 x | 9.0% | 6.0% |
| AM Castle & Co. | CAS | 994 | 1,274 | 28.4% | 18.2% | 115 | 9.0% | 0.8 | 8.6 | 13.9% | 18.5% |
| Anixter International Inc. * | AXE | 3,681 | 5,197 | 28.6% | 24.3% | 404 | 7.8% | 0.7 | 9.1 | 14.9% | 24.3% |
| Applied Industrial Technologies Inc. | AIT | 1,261 | 1,990 | 7.6% | 27.1% | 144 | 7.2% | 0.6 | 8.8 | 19.9% | 15.4% |
| Barnes Group Inc. * | B | 2,098 | 1,320 | 17.0% | 37.3% | 187 | 14.2% | 1.6 | 11.2 | 11.5% | 14.9% |
| Beacon Roofing Supply Inc. * | BECN | 1,074 | 1,506 | 31.8% | 24.0% | 110 | 7.3% | 0.7 | 9.7 | 8.3% | 14.6% |
| BlueLinx Holdings Inc. | BXC | 969 | 4,480 | (20.7%) | 10.1% | 84 | 1.9% | 0.2 | 11.5 | 4.7% | 14.2% |
| Builders FirstSource, Inc. * | BLDR | 774 | 2,062 | (14.7%) | 26.2% | 144 | 7.0% | 0.4 | 5.4 | 16.1% | 9.0% |
| Building Materials Holding Corp. | BLG | 822 | 2,930 | (9.1%) | 22.4% | 199 | 6.8% | 0.3 | 4.1 | 10.6% | 9.7% |
| Bunzl plc | BNZL | 5,731 | 6,679 | 14.0% | 22.7% | 489 | 7.3% | 0.9 | 11.7 | 15.4% | 6.7% |
| DXP Enterprises Inc. | DXPE | 262 | 301 | 46.0% | 28.6% | 23 | 7.5% | 0.9 | 11.6 | 16.4% | 15.3% |
| Fastenal Co. * | FAST | 6,256 | 1,867 | 16.6% | 50.3% | 367 | 19.6% | 3.4 | 17.1 | 23.5% | 32.9% |
| Genuine Parts Co. | GPC | 8,762 | 10,553 | 5.6% | 31.3% | 884 | 8.4% | 0.8 | 9.9 | 17.4% | 23.0% |
| Hagemeyer NV | HGM | 3,361 | 8,393 | 11.3% | 23.3% | 337 | 4.0% | 0.4 | 10.0 | 9.6% | 11.4% |
| Houston Wire & Cable Company * | HWCC | 602 | 339 | N/A | 28.6% | 57 | 16.7% | 1.8 | 10.6 | 35.6% | 26.7% |
| Huttig Building Products Inc. | HBP | 217 | 1,044 | (7.5%) | 18.7% | 13 | 1.2% | 0.2 | 17.4 | 2.4% | 11.1% |
| Industrial Distribution Group Inc. | IDGR | 131 | 543 | 0.3% | 22.5% | 14 | 2.6% | 0.2 | 9.3 | 7.6% | 17.4% |
| Interline Brands Inc. * | IBI | 1,228 | 1,138 | 29.3% | 38.3% | 124 | 10.9% | 1.1 | 9.9 | 9.4% | 22.5% |
| Kaman Corp. | KAMN | 840 | 1,227 | 8.1% | 27.7% | 79 | 6.4% | 0.7 | 10.7 | 10.8% | 24.1% |
| Lawson Products Inc. | LAWS | 340 | 517 | 8.6% | 58.9% | 33 | 6.3% | 0.7 | 10.4 | 8.0% | 21.6% |
| MSC Industrial Direct Co. Inc. * | MSM | 3,809 | 1,624 | 34.4% | 46.2% | 316 | 19.5% | 2.3 | 12.0 | 20.5% | 26.6% |
| Park-Ohio Holdings Corp. | PKOH | 672 | 1,064 | 10.3% | 14.0% | 76 | 7.1% | 0.6 | 8.9 | 9.9% | 25.3% |
| Pool Corp * | POOL | 2,254 | 1,935 | 18.3% | 28.2% | 183 | 9.4% | 1.2 | 12.3 | 19.1% | 16.1% |
| Reliance Steel & Aluminum Co. | RS | 5,566 | 6,597 | 86.2% | 26.0% | 780 | 11.8% | 0.8 | 7.1 | 14.1% | 19.1% |
| Ryerson Inc. | RYI | 2,006 | 6,124 | 7.7% | 14.6% | 240 | 3.9% | 0.3 | 8.4 | 7.4% | 22.0% |
| Smith International Inc. | SII | 13,789 | 7,759 | 29.9% | 32.1% | 1,336 | 17.2% | 1.8 | 10.3 | 25.3% | 30.2% |
| Watsco Inc. * | WSO | 1,524 | 1,783 | 3.0% | 25.8% | 142 | 8.0% | 0.9 | 10.7 | 16.5% | 18.8% |
| WESCO International Inc. * | WCC | 3,970 | 5,506 | 17.2% | 20.6% | 421 | 7.6% | 0.7 | 9.4 | 14.5% | 14.7% |
| Wolseley plc | WOS | 22,247 | 30,648 | 27.9% | 27.8% | 2,114 | 6.9% | 0.7 | 10.5 | 8.8% | 16.6% |
| WW Grainger Inc. * | GWW | 7,459 | 6,011 | 7.1% | 40.2% | 763 | 12.7% | 1.2 | 9.8 | 21.5% | 14.5% |
| Median | | $1,765 | $1,963 | 13.3% | 26.7% | $185 | 7.6% | 0.8 x | 10.0 x | 14.0% | 17.0% |

** = 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.

## A 'Merger of Equals': McJunkin and Red Man Pipe & Supply Form $3B Co.

Two distributors of industrial and oilfield PVF supplies, McJunkin Corporation, with nearly $2 billion in annual revenues, and Red Man Pipe and Supply Company, nearly $1 billion in annual sales, have announced a "merger of equals" that will make the new company a leading industrial and oilfield PVF supplier in North America.

Charleston, WV, and Tulsa, OK , will serve as co-headquarters for the new company. McJunkin Corporation CEO and President H.B. Wehrle III and Red Man Pipe and Supply Company President and CEO Craig Ketchum will serve as Co-CEOs for the new company.

"It is an exciting time for Red Man with great opportunities in today's energy business," Ketchum said.

"This combination will give us more geographic locations, expanded service capabilities for our customers, and increased growth potential, as well as presenting professional opportunities for our combined team members."

The merger, which is expected to close within 60 days, is subject to customary closing conditions, including regulatory approvals.

Founded in 1921, McJunkin Corporation is headquartered in Charleston, WV, and distributes industrial pipe, valves, fittings and other products to a wide variety of industries including oil and gas exploration, refining, chemical and petrochemical, power generation steel manufacturing and others. In January 2007,

Goldman Sachs Capital Partners became a substantial investor in McJunkin Corporation.

Red Man Pipe & Supply Co., Tulsa, OK, was founded in 1977 as a distributor of oilfield and industrial supplies to the oil and gas, petrochemical, refining, pipeline, transmission, utility and chemical industries.

### MDM News Digest

Continued from p. 2 of this section

Division, as well as strong in the Automotive Division. SKF saw better sales growth in Europe, Asia and Latin America than in North America.

**Grainger**, Chicago, IL, reported sales of $1.6 billion for the second quarter ended June 30, 2007, up 8 percent versus the same period a year ago. Profit was up 12 percent. For the six months ended June 30, 2007, sales were $3.1 billion, up 8 percent, and profit up 15 percent.

**The Fastenal Company**, Winona, MN, reported sales of $519,706 for the second quarter ended June 30, 2007, an increase of 13.3 percent over sales in the second quarter of 2006. Profit increased 17 percent. Sales for the six-month period were $1 million, an increase of 13.3 percent over the first six months of 2006. Profit increased 15 percent.

**Genuine Parts Company**, Atlanta, GA, reported sales increased 4 percent in the second quarter 2007 to $2.77 billion. Profit was up 8 percent. **Motion Industries**, GPC's industrial group, increased sales by 9 percent. **EIS**, the electrical group, reported a 7 percent jump, and the **Automotive Group** had a 2 percent increase in sales. **Office Products** was up 1 percent.
For the six months ended June 30, 2007, overall Genuine Parts Company sales were up 4 percent and profit up 7 percent.

**ACR Group, Inc**., Houston, TX, distributor of heating, ventilation and air conditioning equipment and supplies, reported profit dropped more than 50 percent in the first quarter ended May 31, 2007. Sales were down 4 percent to $59.5 million.

Diversified industrial manufacturer **Eaton Corporation**, Cleveland, OH, reported sales of $3.25 billion in second quarter 2007, up 4 percent over the same period a year ago. Profit was $246 million, a decrease of 3 percent. End markets were reported to have declined by 4 percent, due principally to the anticipated decline in the NAFTA heavy-duty truck market. The manufacturer reported slightly stronger growth in the electrical markets, offset by weaker-than-anticipated conditions in the North American hydraulics markets.

**MODERN DISTRIBUTION MANAGEMENT**

*Founded in 1967 by J. Van Ness Philip*

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ISSN 0544-6538

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