MODERN DISTRIBUTION MANAGEMENT The Newsletter for the Wholesale Distribution Channel

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# Weighing In on the Economy

*Economists: U.S. has largely absorbed blow from downturn in housing*

*To gauge the effect of economic trends on distributors, MDM tapped two economists to gain a snapshot of current economic conditions. MDM spoke with Alan Beaulieu of the Institute for Trend Research (603-226-9331, www.ecotrends.org), and Bill Dunkelberg of the National Federation of Independent Businesses.*

*What is the state of the economy?*

**Alan Beaulieu**: The U.S. economy is in better shape than most people think it is. We have largely absorbed a significant blow in the form of the downturn in the housing market.

It is not hard to imagine that in past decades this would have sent us into a recession, but this time we have "taken the hit" and are continuing to grow, albeit at a noticeably slower pace. To put this in context, the decline in housing starts over the last 16 months is the steepest in the post-WWII period and yet GDP and Industrial Production are continuing to grow.

**Bill Dunkelberg:** Things have been slow – the NFIB's Small Business Optimism Index a year ago in March signaled a slowdown in the economy. … We haven't had the index above 100 since then. But on the other hand we have no real recession signals in the data at all.

So it's just slow growth – we have had a good party since the expansion started in '03. You always slow down and take a breath. We don't see a whole lot happening in the economy one way or the other. ... Everything is holding up.

*Reports are that business spending will slow significantly by the end of the year.*

**Beaulieu**: Business spending is more than just slowing down; New Orders for the last 12 months are flat. …We are anticipating an increase in the New Orders figures later this year and into 2008. A pick-up in activity is consistent with healthy levels of profitability and the amount of cash on hand in U.S. businesses. Both of these factors – profits and cash – are likely to be diminishing in the latter half of 2008 and on into 2009. The New Orders trend will likely follow suit.

*Will the reported "credit crunch" filter down to business lending?*

**Beaulieu**: The credit crunch is probably an overstatement of what is in reality a swing back to normal credit conditions. Too much money was made too available and an asset bubble resulted. The fact that lenders are now requiring deposits coupled with income documentations does not measure up to a "crunch" but in our minds would be best called "good business."

People with a solid credit rating can still get a loan, they just might have to pay a little more for it and in the business realm they may have to provide some personal guarantees, which is also normal at this juncture of the business cycle.

The Federal Reserve Board deserves high marks for how it handled the crisis. Dr. Bernanke et al provided a strong measured response by lowering the discount rate in lieu of a panicked reduction in the Federal Funds Rate.

It was also crucial that they extended the terms from overnight to 30 days with a promise to renew the extended terms as necessary. This allowed banks to trade their "junk" paper for hard cash, thus providing liquidity and allowing for ongoing loan operations at the banks who took advantage of the opportunities afforded them by the Fed.

**Dunkelberg**: Nobody is having problems getting loans, contrary to popular belief.

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Three percent of our owners (in NFIB's monthly survey) say that credit and rates are their No. 1 business problem, and that's been that way for 15 years. Thirty-six percent of owners say their credit-borrowing needs are met. Four percent said they weren't and that's actually a better number than we usually see.

*What should MDM readers do?*
**Beaulieu**: This would be great time to take action in preparation for a rough 2009-10. Business leaders should take a hard look at their balance sheets and concentrate on having enough cash on hand to weather the economic storm of 2009-10.

Debt reduction should also be considered. Watch long-term capital expenditures and check the impulse to add to fixed costs.

Lastly, but perhaps most importantly, this is the time to develop a plan for "what's next." By that we mean that business leaders need to prepare to take their businesses into areas that will be less impacted by a downturn or entirely immune to a global slowdown. Missionary efforts into new markets or services should be begun now.

## Transform a Downturn into a Strategic Opportunity

*During an economic slowdown, a "siege mentality" is understandable but not always productive, says Steve Deist of Indian River Consulting Group. Though many industries are still seeing growth, some – including the housing industry – are struggling. This is a timely excerpt from a piece by Deist on how to turn a downturn into a strategic opportunity.*

### No. 1 Focus on the Other Guys

Customers, employees, competitors and suppliers are facing many of the same challenges you are. Many are probably playing defense and are reluctant to make long-term commitments. They likely have reduced expectations of performance in profitability and sales growth.

**Commit to sustained and improved customer service.** Reducing inventory and cutting staff can have a major negative impact on customer service. Gain market share and maintain sales volume by resisting this temptation.

**Revisit your value-added services selling proposition.** When companies are looking for true cost reductions, you will find a more receptive audience for cost containment value-added services like inventory consignment, integrated supply and vendor managed inventory.

**Add new product lines.** During times of lower demand, suppliers are more anxious to expand their channels and find new partners.

### No. 2 Don't Downsize, Upgrade

Personnel costs are a tempting target for cost reduction. Many companies however make the mistake of approaching a reduction in force

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solely from a budgetary standpoint instead of considering the value of their most important asset.

If a force reduction is needed, think strategically to get the most benefit from a painful exercise.

**Don't rely solely on department managers to select the staff cuts.** Use recent performance appraisals and solicit input from additional sources like customer surveys and other managers.

**Don't depend on voluntary early retirement.** You will tend to lose the best performers who are most marketable elsewhere.

**Don't cut "rank and file" pay.** Pay cuts leave affected people in place to spread bitterness and resentment. Reductions in upper management pay, however, are a viable tactic. Top management has a bigger stake in the company's future so will likely be more receptive.

### No. 3 Use a Process Approach to Cut Costs

Most managers start the cost-cutting process by looking at the income statement for the last quarter and identifying expenses to cut. This is appropriate; do it if you haven't already. But some companies are looking for new ways beyond the traditional to reduce expenditures.

The process approach looks at costs from a value standpoint. Follow a few customer orders from order entry to shipment to understand the steps required, the number of people involved and the opportunity for error. The key is identifying opportunities that offer incremental payback. A few basic principles:

**Document the way the process really happens –** not the way it should.

**Attempt to do steps in parallel (at the same time) rather than sequentially.**

**Avoid unnecessary handoffs between people.** This is typically a large source of error.

**When in doubt, choose error reduction over speed.** An estimated 25 percent of labor cost in distribution is in correcting errors.

**Consider using a fresh set of eyes to examine basic processes.** An outsider can avoid the company culture and politics that can cause a faulty internal diagnosis.

*Steve Deist can be reached at 321-956-8617. Indian River Consulting Group specializes in Distribution and can be found on the Web at www.ircg.com.*

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# A Credit Crunch for M&A?

*Deal market to slow; private equity activity wanes in August*

*Tight credit markets are affecting sizable deals in progress and may dampen historically high valuations. But it's unclear whether the current state of credit will curb interest in distribution by financial buyers.*

Firms making sizable acquisitions are now having a tough time getting the loans they need to pay the agreed-upon purchase price.

As a result, several billion-dollar-plus deals are being renegotiated, including the recent HD Supply deal. The trio of private equity firms buying the $12 billion unit is now paying $8.5 billion, instead of the original price, $10.3 billion.

Seemingly overnight, banks have find it tougher to spread the risk of a loan largely due to a drop in interest from outside investors in buying some of that debt. So lenders have not been as aggressive as in the past 18-24 months.

"If you can't sell off as much of the risk, it means you have to hold more and lend less," says Rick Cravey, a managing director of MCG Capital in Atlanta, GA, a private equity firm focused on transactions up to $200 million.

### The HD Supply Factor

Talk of a credit crunch increased significantly when it was announced that the purchase price of HD Supply would go down.

Bain Capital, Clayton Dubilier & Rice, and The Carlyle Group will now pay about $2 billion less than what was agreed upon in June. Home Depot will finance $1 billion of that, and will retain a 12.5 percent share of the $12 billion wholesale unit.

While it's true that the drop in purchase price was in part due to tightening credit markets, the deal for HD Supply likely also changed because of the company's exposure to a weak residential market.

This factor seems to have affected the initial bidding for HD Supply, as a number of private equity firms were rumored to have bowed out due to market conditions.

HD Supply's sales in the latest quarter fell

continued on next page

by 7 percent; organic growth for HD Supply was down 10 percent.

### Deal-Making Slows

As many news outlets have reported, August deal-making fell significantly from the same month a year ago.

Dealogic numbers indicate that announced mergers and acquisitions fell by a quarter in August due to a drop in deals by private equity firms and the tightening credit markets. Just three $1 billion-plus buyouts were reported in August, down from more than two dozen in May.

In addition to holding onto an unprecedented chunk of cash to play with, financial buyers have benefited in recent years from highly liquid debt markets that facilitated the funds' ability to pay premium prices. That in turn increased median valuations to historic highs.

Average total debt/EBITDA advance rates to fund leveraged buyouts rose from a low of 3.6X in 2001 to 5.2X in 2005.

"It's not that difficult to get a 7X purchase price multiple when you can borrow 5X, especially when you are under pressure to deploy your equity capital," Vetus Partners Managing Director Jim Miller told MDM in early 2006.

Because of the recent credit turmoil, firms will likely borrow less and valuations are likely to fall from their historically high levels.

But though debt markets have suddenly grown tighter, the amount of money available for investment remains high.

In addition, earnings have not fallen off outside of industries not tied to the residential market.

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# NAW Takes Action on Liability Case

*Case examines strict liability actions against non-manufacturer product sellers*

Distributors may be better protected from strict liability actions if a Supreme Court case in Ohio is overturned.

The National Association of Wholesaler-Distributors is one of nine organizations that filed a "friend of the court" brief in the Supreme Court of Ohio in a case focused on the retroactive application of the doctrine of strict liability in product liability actions brought against non-manufacturer product sellers, including wholesalers, distributors and retailers.

Strict liability is based on the condition of a manufacturer's product rather than the conduct of the defendant.

According to NAW President Dirk Van Dongen, the association views DiCenzo as a "major, even seminal case that carries with it profound legal and economic ramifications for wholesaler-distributors in Ohio and across the nation."

In their brief, amici support appellants' effort to overturn a State appeals court's June 28, 2007, decision in DiCenzo v. A-Best Products, Co., Inc. et al. (Court of Appeals Case No. CA 06-088583).

In DiCenzo the Appeals Court held that strict liability in product seller liability actions, first recognized in Ohio in 1977 in Temple v. Wean United, Inc., may be applied retroactively back to 1966, when the Ohio Supreme Court's decision in Lonzrick v. Republic Steel Corp. was issued.

In Lonzrick, Ohio's high court first "imposed a type of limited strict liability on manufacturers, but it did not address the liability of sellers."

The amicus brief contends that the appellate court erred when it applied strict product liability to non-manufacturer suppliers to pre-1977 sales, complaining that the lower court's decision is inconsistent with Ohio law before 1977 and will have significant negative impacts on smaller and medium size Ohio businesses unless it is overturned."

The DiCenzo case revolves around workplace exposure to asbestos. In their brief, NAW and its fellow amici outline the nature and dimension of the asbestos litigation crisis, pointing out that "the net has spread from the asbestos makers to companies far removed from the scene of any putative wrongdoing … Nontraditional defendants now account for over half of asbestos expenditures."

The brief contends that "(i)f the appellate court's decision is permitted to stand … non-manufacturer suppliers would be subject to strict liability in many (if not most) of the 35,000 or more asbestos personal injury cases pending in Ohio state courts."

NAW and its fellow amici conclude, "Countless Ohio businesses would face liability beyond any amount they reasonably could have anticipated prior to 1977. "

# 10 Things to Consider in a Non-Compete

*How to protect your time and investment in training*

*More frequently, employers are asking or requiring employees to sign non-competition agreements – employment contracts that restrict the rights of employees to set up shop across the street, or take your trade secrets with them when joining a rival.*

**By Risa Boerner and Susan Guerette**

After training and grooming a green employee into a highly productive and valuable member of the team, employers are frequently frustrated to learn that the employee is now their chief competitor.

Of course, it's a free country and people are allowed to make a living any honest way they can. Balancing those two competing philosophies is what judges are often called upon to do.

If you are considering establishing a non-competition agreement for your employees, here are 10 things you should think about:

**1. Tailor restrictions to the jurisdiction in which the employee works or resides.** In some states, a two-year non-competition clause may be invalid, while in others, it's standard. Some states may permit a customer restriction to take the place of a geographic restriction, whereas others will require a geographic limitation.

These details are important because an overly broad non-competition clause can be fatal to the entire employment agreement in some jurisdictions.

This doesn't mean that a nationwide company must draft a separate non-competition agreement for each state in which it operates.

A handful of versions – a few for "problem" states and others for "typical" states – would be sufficient to account for most variations in the law.

**2. Include a choice of law provision.** Generally this should be the state where the employee works or resides. Although companies sometimes provide for the application of a specific state's law and a particular venue, this can be problematic.

The law of the particular state could change and become unfavorable or a court might not apply the law of the specified state if it believes the law of that state is contrary to the public policy of the state where the employee works or resides.

By tying the choice of law provision to the state where the employee works or resides, a company can spread its risk and minimize the chance that the choice of law or venue provision will be rejected or will result in the application of an unfavorable precedent at some time in the future.

**3. Tailor the contract to the employee's position.** In most jurisdictions that enforce non-competition agreements, an employer must demonstrate that the covenant is reasonable and protects the legitimate interests of the employer.

An employee with nationwide responsibilities, for example, may merit a covenant with a broader geographic restriction than an employee who works within a narrow territory.

Tailoring the duration, scope, and geographic restrictions of the covenant to the particular position of the employee (or category of employees) is likely to enhance the enforceability of the agreement.

**4. Determine what constitutes sufficient consideration for the covenant.** Where a restrictive covenant is given to an employee after the start of employment, some states (such as Pennsylvania and North Carolina) hold that continued employment alone is not sufficient consideration for the covenant.

In those situations, new consideration must be provided to the employee in exchange for signing the restrictive covenant. The law is vague in many states regarding what, precisely, is sufficient to constitute adequate additional consideration. It's a good practice to identify the particular consideration and include an acknowledgement of the sufficiency of that consideration within the contract.

**5. Determine what type of restrictions would best serve the interests of the company.** Your options may include non-competition, non-solicitation of customers, non-solicitation of employees and non-disclosure provisions.

In some cases, all four are necessary to protect the interests of the company.

But remember that if all four restrictions are contained within the contract, the court may determine that the company is adequately protected by the non-solicitation and non-disclosure provisions alone, and may strike the non-competition restriction, unless the company can demonstrate that the non-competition provision protects an interest that is not adequately addressed by the other provisions.

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**6. Include provisions regarding injunctive relief.** It's generally a good idea to include provisions providing for a presumption that any harm done is irreparable and difficult to quantify. That sets the groundwork for obtaining an injunction in the event of a violation, or threatened violation, of the contract.

This provision will typically state that injunctive relief is in addition to other available remedies.

While these terms are often included as a matter of course, courts don't always allow a presumption contained in a contract to take the place of a legal finding that there is a threat of immediate and irreparable harm. You should be prepared to satisfy this burden when seeking to enforce your contact.

**7. Consider including an attorneys' fee provision.** It is advisable to include a provision providing that the company will be reimbursed for reasonable attorney's fees and costs in the event that litigation is required to enforce the restrictive covenants. This gives an employer a significant amount of leverage in the litigation and will make litigation more palatable when necessary.

**8. Include provisions requiring the return of confidential documents and information.** Contracts should include provisions requiring employees to return any information or documents relating to the company within a short time following their termination of employment.

These provisions should be broad enough to cover copies, derivations of company documents, and information contained on electronic devices.

You may also want to include a specific provision providing that the employee must return any company-provided electronic devices, including palm pilots, cellular telephones and laptop computers, back to the company In this information age, confidential information is more likely to walk out of the door on a tiny flashdrive or portable storage device rather than in paper form.

**9. Include an assignability provision.** These provisions generally state that the company may assign the covenant to an affiliated company or successor in interest without notifying the employee. In some states, in the absence of such a provision, the covenant can't be enforced by a successor or affiliated company.

**10. Include language extending the term of the covenant in the event of a breach.** If a former employee's violation of a non-competition agreement is not discovered until months after it has begun, a provision stating that the time period covered by the covenant will automatically be extended by a length of time equal to the time period during which such a violation occurred can provide the company with a means of obtaining extended injunctive relief.

Consulting with an expert and remembering these tips will help you protect your investment in time and training of your valuable human resources – and help you sleep at night.

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## Labor Productivity Improves in Wholesale Sector 2005-2006

Labor productivity – defined as output per hour – increased 4.3 percent in wholesale trade in 2006, according to the U.S. Bureau of Labor Statistics. From 1987-2006, labor productivity increased at an average annual rate of 3.5 percent.

### 2005-2006 Change in Wholesale Trade

Output per hour grew 4.3 percent, as output increased 6.6 percent and hours advanced 2.2 percent. Labor productivity rose 5.1 percent in durable merchant wholesalers and increased 2.7 percent in nondurable merchant wholesalers.

Labor productivity rose in 15 of the 19 detailed wholesale trade industries in 2006, as output grew in 17 industries while hours fell in four. The largest increases in productivity – 13 percent and 11.8 percent - occurred in motor vehicles and parts wholesalers, and farm product raw materials wholesalers, respectively.

Unit labor costs declined in seven of the 19 detailed industries, but grew 0.5 percent in wholesale trade overall.

### Long-Term Trends

Output per hour increased 3.5 percent per year, on average, between 1987 and 2006. Output grew 4.2 percent per year and hours rose 0.7 percent per year.

At the subsector level, productivity advanced 5.6 percent per year in durable merchant wholesale trade, and increased 1.3 percent per year, on average, in nondurable merchant wholesale trade.

Labor productivity increased in 17 of the 19 detailed industries. Commercial equipment wholesalers and electric goods wholesalers, had the largest average annual increases in labor productivity of 15.6 percent and 9.1 percent per year, respectively. Output grew in all but one industry, while hours decreased in six industries.

Unit labor costs increased in all but three of the wholesale trade industries over the period, and rose 0.7 percent per year.

## Percent change in output per hour, output, hours, compensation, and unit labor costs 2005-2006

| | 2006 Employment (thousands) | Output per Hour | Output | Hours | Labor Comp. | Unit Labor Costs |
|---|---|---|---|---|---|---|
| **Wholesale Trade** | **6118.0** | **4.3%** | **6.6%** | **2.2%** | **7.2%** | **0.5%** |
| | | | | | | |
| **Durable Goods** | **3185.0** | **5.1** | **8.3** | **3.0** | **7.0** | **-1.2** |
| Motor Vehicles & Parts | 365.0 | 13.0 | 12.7 | -0.2 | 3.1 | -8.5 |
| Furniture & Furnishings | 123.0 | 7.4 | 8.7 | 1.2 | 5.8 | -2.7 |
| Lumber & Construction Supplies | 274.0 | -2.5 | 2.8 | 5.5 | 8.3 | 5.3 |
| Commercial Equipment | 667.0 | 10.0 | 14.0 | 3.6 | 6.8 | -6.3 |
| Metals & Minerals | 128.0 | -3.1 | 1.0 | 4.2 | 5.4 | 4.4 |
| Electric Goods | 351.0 | 10.6 | 9.5 | -0.9 | 8.0 | -1.4 |
| Hardware & Plumbing | 260.0 | 0.9 | 5.6 | 4.7 | 6.9 | 1.2 |
| Machinery & Supplies | 694.0 | 3.8 | 6.1 | 2.2 | 7.7 | 1.6 |
| Miscellaneous Durable Goods | 324.0 | -10.2 | -2.6 | 8.5 | 9.1 | 11.9 |
| | | | | | | |
| **Nondurable Goods** | **2143.0** | **2.7** | **4.3** | **1.5** | **5.4** | **1.0** |
| Paper & Paper Products | 161.0 | -1.3 | 0.9 | 2.2 | 4.6 | 3.6 |
| Druggists' Goods | 217.0 | 6.7 | 9.2 | 2.4 | 3.9 | -4.9 |
| Apparel & Piece Goods | 166.0 | 6.8 | 8.5 | 1.6 | 8.5 | 0.0 |
| Grocery & Related Products | 747.0 | 0.7 | 3.6 | 2.8 | 6.5 | 2.8 |
| Farm Product Raw Materials | 77.0 | 11.8 | 6.3 | -4.9 | 0.5 | -5.4 |
| Chemicals | 137.0 | 1.3 | -0.8 | -2.1 | 6.3 | 6.3 |
| Petroleum | 103.0 | 3.4 | 3.4 | 0.0 | 6.5 | 6.5 |
| Alcoholic Beverages | 155.0 | 2.6 | 5.1 | 2.4 | 1.5 | 1.5 |
| Miscellaneous Nondurable Goods | 382.0 | 2.0 | 3.1 | 1.1 | 1.8 | -1.3 |

Source: Bureau of Labor Statistics

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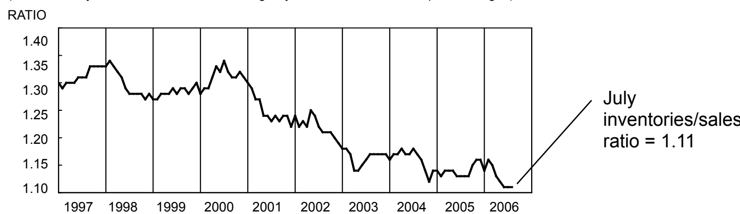
## Monthly Wholesale Trade: Sales and Inventories for July 2007

July 2007 sales of merchant wholesalers, except manufacturers' sales branches and offices, were $359.0 billion, up 0.8 percent from the revised June level and were up 7.2 percent from the July 2006 level. July sales of durable goods were virtually unchanged from last month and were up 4.3 percent from a year ago. Compared to last month, sales of lumber and other construction materials were down 3.2 percent. July sales of nondurable goods were up 0.1 percent from last month and were up 10.0 percent from last year. Sales of drugs and druggists' sundries were up 1.4 percent from last month.

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

### Inventories

Total inventories of merchant wholesalers, except manufacturers' sales branches and offices, after adjustment for seasonal variations but not for price changes, were $398.8 billion at the end of July, up 0.2 percent from the revised June level and were up 5.5 percent from a year ago. End-of-month inventories of durable goods were down 0.5 percent from last month and were up 2.1 percent from last July. Inventories of motor vehicle and motor vehicle parts and supplies were down 1.7 percent from last month and inventories of metals and minerals, except petroleum, were down 1.6 percent. End-of-month inventories of nondurable goods increased 1.5 percent from June and were up 11.5 percent compared to last July. Inventories of farm product raw materials were up 7.5 percent and inventories of chemicals and allied products increased 3.0 percent from last month.

### Inventories/Sales Ratio

The July inventories/sales ratio for merchant wholesalers based on seasonally adjusted data, was 1.11. The July 2006 ratio was 1.13.

## Monthly wholesale trade: Sales and inventories July 2007

| NAICS Code | Business Type | Sales $ millions | Inventories $ millions | Stock and Sales ratio | % Change in Sales 6/07-7/07 | % Change in Sales 7/06-7/07 | % Change Inventory 6/07-7/07 | % Change Inventory 7/06-7/07 |
|---|---|---|---|---|---|---|---|---|
| 42 | U.S. Total | 359,072 | 398,834 | 1.11 | 0.1 | 7.2 | 0.2 | 5.5 |
| 423 | Durable | 169,974 | 247,493 | 1.46 | 0.0 | 4.3 | -0.5 | 2.1 |
| 4231 | Automotive | 26,933 | 36,564 | 1.36 | 1.3 | 0.6 | -1.7 | -5.8 |
| 4232 | Furniture & Home Furnishings | 6,264 | 8,046 | 1.28 | 1.2 | 10.7 | 1.0 | 8.8 |
| 4233 | Lumber & Other Construction Materials | 10,785 | 14,167 | 1.31 | -3.2 | -12.1 | -0.5 | -7.7 |
| 4234 | Prof. & Commercial Equip. & Supplies | 30,515 | 32,142 | 1.05 | 0.0 | 11.1 | 0.2 | 8.5 |
| 42343 | Computer Equipment & Software | 16,167 | 11,926 | 0.74 | -1.9 | 13.5 | 0.8 | 9.9 |
| 4235 | Metals & Minerals | 13,840 | 24,029 | 1.74 | 0.6 | 2.0 | -1.6 | 6.4 |
| 4236 | Electrical Goods | 25,311 | 31,971 | 1.26 | 0.2 | 3.2 | -0.7 | 2.6 |
| 4237 | Hardware, Plumbing, & Heating Equipment | 7,784 | 15,244 | 1.96 | -0.3 | 0.5 | 1.7 | 3.8 |
| 4238 | Machinery, Equipment & Supplies | 28,884 | 63,095 | 2.18 | 0.7 | 8.2 | 0.1 | 4.2 |
| 4239 | Miscellaneous Durable | 19,658 | 22,235 | 1.13 | -1.7 | 7.3 | -1.8 | 0.1 |
| 424 | Nondurable Goods | 189,098 | 151,341 | 0.80 | 0.1 | 10.0 | 1.5 | 11.5 |
| 4241 | Paper & Paper Products | 8,066 | 6,937 | 0.86 | 0.5 | 2.3 | 1.4 | 10.3 |
| 4242 | Drugs | 33,181 | 31,449 | 0.95 | 1.4 | 5.0 | 0.0 | 2.2 |
| 4243 | Apparel, Piece Goods & Notions | 10,894 | 15,682 | 1.44 | 0.1 | 5.1 | 1.2 | 7.0 |
| 4244 | Groceries &Related Products | 42,562 | 27,728 | 0.65 | -0.7 | 13.1 | 0.1 | 16.7 |
| 4245 | Farm-product Raw Materials | 14,947 | 17,041 | 1.14 | 1.4 | 29.7 | 7.5 | 46.6 |
| 4246 | Chemicals &Allied Products | 8,364 | 9,297 | 1.11 | 1.4 | 4.6 | 3.0 | 7.8 |
| 4247 | Petroleum &Petroleum Products | 42,827 | 13,815 | 0.32 | 1.5 | 9.9 | -0.1 | 1.6 |
| 4248 | Beer, Wine & Distilled Beverages | 8,564 | 10,487 | 1.22 | -0.8 | 7.5 | 1.8 | 14.2 |
| 4249 | Miscellaneous Nondurable Goods | 19,693 | 18,905 | 1.96 | -4.2 | 10.0 | 1.8 | 10.0 |

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.

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MODERN DISTRIBUTION MANAGEMENT VOL. 37, NO. 16 AUGUST 25, 2007

# Industrial & Construction Markets Update

## PERSPECTIVE

We are at a point again in the business cycle where the national media holds a powerful tool and heavy responsibility when it comes to accurately reporting on economic trends. The danger is that one-line headlines and sound bites about recession can spook U.S. consumers into their shells and create the proverbial self-fulfilling prophecy.

The first three articles in this issue offer a few different viewpoints from economists on the state of the economy, the impact of the "credit crunch," and what our readers might consider based on the current climate. We do not predict the falling of the sky. And as economist Alan Beaulieu notes in the cover story: "The U.S. economy is in better shape than most people think it is."

That's not to discount the very tough conditions selling into automotive and any housing-related industries, but the structure of the U.S. economy looks very different than six years ago, when the national media missed the severity of the industrial downturn. Export industries are stronger today. Distributors selling into energy-related sectors, from oil and gas to electrical utilities, have seen continued good growth.

So it should concern us all when headlines and pictures focus on the extremes in specific sectors, within a narrow snapshot of time. It is another reminder that the best strategy is to build in diversity into not just your customer base, but your product and service offerings as well.

In our effort for accuracy, MDM has expanded its coverage of European and global markets in the past two years to reflect the growing impact and opportunities for distributors. As a resource, we have expanded our online statistics page, www.mdm.com/databank, to include key monthly economic indicators for the U.S., Canada and Europe.

**Airgas, Inc**., Radnor, PA, has acquired **Dantack Corp.**, a Grand Prairie, TX-based safety distributor with branches in Columbus, OH, and Richmond, VA. The business generated more than $18 million in sales in 2006. Airgas' safety distribution business had $438 million in sales in fiscal 2007 through telesales and field-based safety specialists within its regional companies.

**The Home Depot** has completed the sale of **HD Supply** to a trio of private equity firms – **Bain Capital, Clayton Dubilier & Rice,** and **Carlyle Group**. As announced earlier, the terms were as follows: Purchase price of $8.5 billion, The Home Depot to own a 12.5 percent equity interest for $325 million, and The Home Depot guaranteed a $1 billion senior secured loan. The acquisition includes a portfolio of 11 businesses and HD Supply Canada. The company will retain the HD Supply name.

**3M**, St. Paul, MN, has agreed to acquire **Venture Tape Corp**., a supplier of pressure sensitive adhesive tapes based in Rockland, MA. Venture Tape manufactures tapes used in construction, oil and gas, heating, ventilation and air conditioning (HVAC), electronics, aerospace, marine and appliance markets. "This acquisition broadens our pressure sensitive adhesive tape platform, brings new channels to 3M, and allows us to expand into adjacent markets such as construction," said Patrick Deconinck, division vice president, 3M Industrial Adhesives and Tapes Division.

Diversified industrial manufacturer **Ingersoll-Rand Company Ltd.** has agreed to buy privately owned **Officine Meccaniche Industriali srl**, a European supplier of compressed-air treatment equipment. OMI develops and manufactures compressed-air treatment products, including air dryers, filters, chillers, and system controllers. OMI is based in northeast Italy with an additional facility in Slovenia.

**Edgen Murray Corp.**, Baton Rouge, LA, the U.S. subsidiary of Edgen Murray II, L.P., has acquired **Equipment Valve & Supply, Inc**. Equipment Valve, from its locations in Houston, TX, and Broussard, LA, is a distributor of specialized valves and actuation packages to the oil and gas exploration and production, natural gas transmission, petrochemical, processing, and industrial market segments.

Private equity firm **Singer Equities** has completed its purchase of **National Hose & Accessory**, Houston, TX. Mike Deem, the former owner of the company, will continue to manage the day-to-day operations as a standalone business.

**Fairmont Supply Company**, Canonsburg, PA, a national full-line distributor of industrial maintenance, repair and operating supplies has announced the acquisition of **Brite Stars Sales**, Elko, NV. Brite Stars Sales, an industrial distributor serving the northern Nevada industrial and mining market, specializes in automotive and filtration products sold primarily to the gold mining customers in Nevada.

continued on next page

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**MARKETS UPDATE SUPPLEMENT P. 2**

**Regal Beloit Corp.**, Beloit, WI, has acquired **Jakel Inc**. and completed the announced $220 million acquisition of the **FASCO Residential/Commercial** and **FASCO Asia/Pacific** operations from **Tecumseh Products**. The two independent businesses are anticipated to add $355 million in sales to 2008.

**Economic activity in the manufacturing sector** expanded in August, according to the latest Manufacturing ISM Report On Business. Viewed from the manufacturing sector, the overall economy continues to grow at a significant rate, according to ISM. In comparing August to July, the rate of growth in manufacturing was slightly less but expansion continues, although at the slowest pace in the past five months.

In July, falling prices for metals and the strength of the Canadian dollar drove the **prices of manufactured products** down for a third consecutive month, while a jump in crude oil prices pushed raw materials prices upward. From June to July, prices charged by manufacturers, as measured by the Industrial Product Price Index (IPPI), fell 0.7 percent following two consecutive monthly declines. On a 12-month basis, the IPPI edged down 0.3 percent, its first decrease after 22 consecutive advances.

**Real gross domestic product** – the output of goods and services produced by labor and property located in the U.S. – increased at an annual rate of 4 percent in the second quarter of 2007, according to preliminary estimates. In the first quarter real GDP increased 0.6 percent. These GDP estimates are based on more complete source data than were available for the advance estimates released last month. In the advance estimates, the increase in real GDP was 3.4 percent.

**Construction intentions in Canada cooled down in July as the value of building permits declined**, halting two months of record-setting performances. Municipalities issued building permits worth $6.2 billion, down 11.3 percent from $6.9 billion in June. Still, July was one of only a handful of months in which permits exceeded the $6-billion mark. At $6.9 billion in both May and June, the total value of permits was at its highest level on record.

**Graybar**, St. Louis, MO, distributor of electrical and communications products and related supply chain management and logistics services, reported $2.56 billion in sales for the first six months of 2007, an increase of 5.1 percent over the same period in 2006. Sales improved along with moderate growth in the electrical and communications/data markets. In comparison to the first half of 2006, profit rose 37.4 percent.

## Calculation of MDM Inflation Index for July 2007

| | | BLS Price Indices Jul. '07 | BLS Price Indices Jun. '07 | BLS Price Indices Jul. '06 | % Sales Weight | Weighted Indices Jul. '07 (1)X(4) | % Change Jul. '07 Jun. '07 | % Change Jul. '07 Jul. '06 |
|---|---|---|---|---|---|---|---|---|
| 1136 | Abr. Prod. | 465.2 | 464.3 | 453.0 | 19.1 | 88.85 | 0.19 | 2.69 |
| 1135 | Cutting Tools | 436.3 | 435.7 | 430.6 | 18.9 | 82.46 | 0.12 | 1.32 |
| 1145 | Power Trans. | 640.4 | 636.1 | 614.2 | 15.4 | 98.63 | 0.69 | 4.27 |
| 1081 | Fasteners | 448.3 | 445.6 | 429.4 | 9.0 | 40.35 | 0.61 | 4.40 |
| 1149.01 | Valves, etc. | 786.9 | 784.0 | 735.6 | 7.6 | 59.81 | 0.37 | 6.97 |
| 1132 | Power Tools | 329.0 | 329.9 | 324.6 | 6.5 | 21.39 | -0.27 | 1.37 |
| 1144 | Mat. Handling | 463.3 | 462.2 | 447.8 | 6.2 | 28.72 | 0.25 | 3.46 |
| 0713.03 | Belting | 544.3 | 547.9 | 535.6 | 6.1 | 33.20 | -0.65 | 1.62 |
| 1042 | Hand Tools | 678.0 | 678.0 | 667.4 | 8.1 | 54.92 | 0.00 | 1.58 |
| 108 | Misc. Metal | 418.2 | 418.7 | 409.1 | 3.1 | 12.96 | -0.13 | 2.21 |
| "New" July Index | | 272.4 | July Inflation Index | | | 521.28 | 0.23 | 3.16 |
| "New" June Index | | 271.7 | June Inflation Index | | | 520.09 | | |
| | | | July 2006 Inflation Index | | | 505.32 | | |

New index reflects 1977=100 base other #: 1967 To convert multiply by .52247

# U.S. MARKET ANALYSIS: Hoists

**MARKETS UPDATE SUPPLEMENT P. 3**

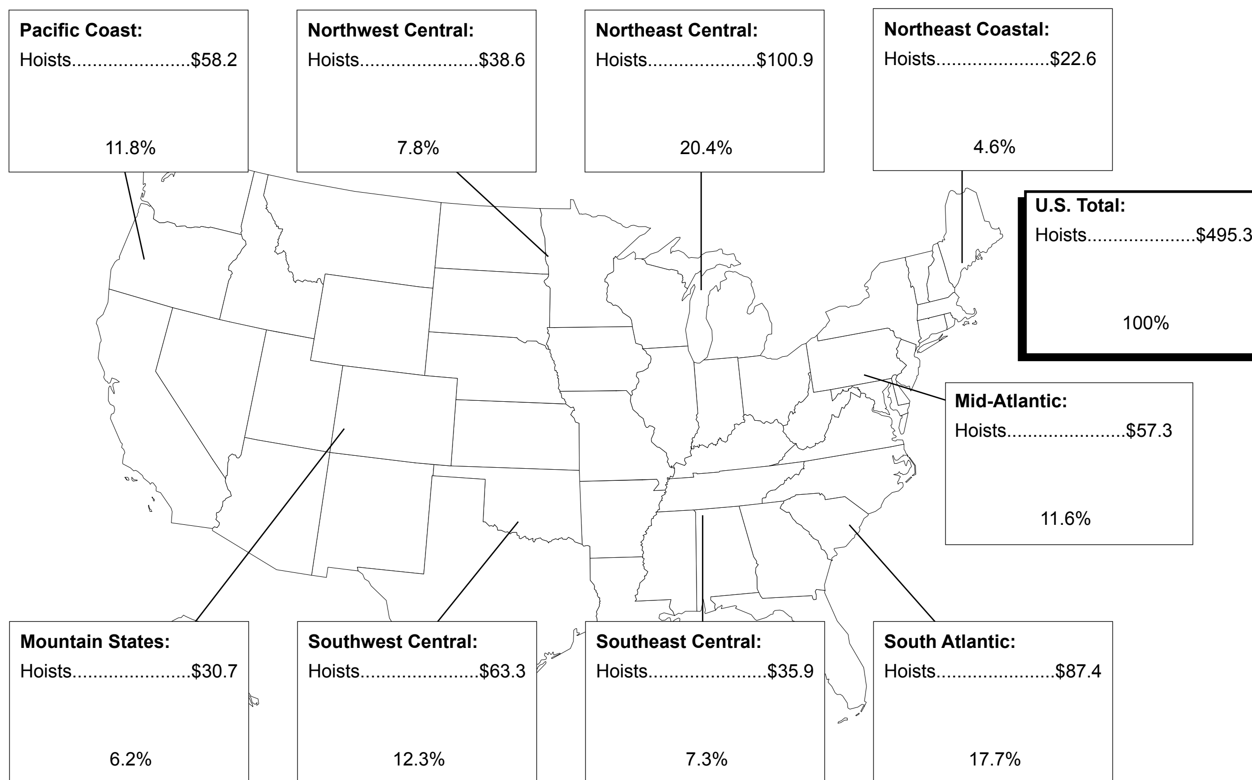
The industrial product group listed here - Hoists - represented a market in 2006 of $495.3 million, according to estimates by Industrial Market Information, Minneapolis.

These charts show the top ten industries, by SIC code, consuming these products; and the 2006 end-user consumption of these groups sorted by the nine government market regions.

## Top ten industries in $ volume, by SIC code consuming Hoists (2006 estimates)

| SIC CODE | Hoists | Companies |
|---|---|---|
| 1542 Nonresidential Construction | 26,925,483 | 46110 |
| 1711 Plumbing Heating & Air Conditioning | 22,521,592 | 145096 |
| 1629 Heavy Construction | 10,054,490 | 16146 |
| 1541 General Contractors-Ind Bldgs & Warehouses | 9,903,942 | 10697 |
| 3441 Fabricated Structural Metal | 9,768,579 | 6275 |
| 3312 Steel Works, Blast Furnaces & Rolling Mills | 8,975,715 | 2312 |
| 3711 Motor Vehicles & Passenger Car Bodies | 8,669,233 | 1917 |
| 1521 General Contractors-Single Family Housing | 8,205,814 | 288236 |
| 3714 Motor Vehicle Parts & Accessories | 7,153,725 | 4996 |
| 1794 Excavation Work | 6,782,353 | 37982 |

## End-user consumption of Hoists by region, millions of $ (2006 est.)




Source: INDUSTRIAL MARKET INFORMATION, INC. (763) 535-7432. © 2007 Industrial Market Information, Inc., Minneapolis, MN. All rights reserved. Industrial Market Information has more than 200 industrial product profiles available at the county level. www.imidata.com

**MARKETS UPDATE SUPPLEMENT P. 4**

## MAPI: Manufacturing 'Showed Resiliency' in Second Quarter

While there will likely be significant deceleration in manufacturing growth in 2007, the second quarter showed signs of resiliency, and 2008 looms as an improvement, according to the MAPI Quarterly Industrial Outlook, a report that analyzes 27 major industries.

Manufacturing industrial production expanded at a 3.9 percent annual rate in second quarter 2007, far better than the weak 0.8 percent in the first quarter.

For the year as a whole, though, the report predicts that manufacturing production growth will decelerate from the 4.7 percent recorded in 2006 to 2 percent growth in 2007, before rebounding to 2.9 percent growth in 2008.

"An improvement in manufacturers' exports in most industries and the end of an inventory drawdown explains the bounce back in second quarter industrial activity," said Daniel J. Meckstroth, MAPI chief economist and author of the analysis.

"Unfortunately, the manufacturing sector cannot completely shake off the depressing effect of the housing collapse and the downward drifting motor vehicles market. Furthermore, we no longer look to strong business investment to lead economic growth."

In a signal that manufacturing continued to face headwinds in the first half of 2007, second quarter figures show that 14 of the 27 industries tracked in the report had inflation-adjusted new orders or production above the level of one year ago, down from 16 industries that reported growth in the previous quarter.

Six industries enjoyed strong double-digit year-over-year growth in the second quarter, including electrical equipment, and mining and oil and gas field equipment, each at 13 percent; and aerospace products and parts; communications equipment; industrial machinery; and private non-residential construction all grew by 12 percent.

Consumer-oriented industries remain the weakest industrial sector, with housing activity plummeting by 22 percent in second quarter 2007. In the equipment industry, construction machinery declined by 13 percent.

Meckstroth concludes that five industries are in the accelerating growth (recovery) phase of the business cycle; 11 are in the decelerating growth (expansion) phase; six industries appear to be in the accelerating decline (either early recession or mid-recession) phase; and five are in the decelerating decline (late recession or very mild recession) phase of the cycle.

The report also offers economic forecasts for 24 of the 27 industries for 2007 and 2008.

The MAPI forecast series predicts two industries will achieve double-digit growth in both 2007 and 2008 – mining and oil and gas field machinery, 12 percent in 2007 and 11 percent in 2008; and aerospace products and parts, with expected growth of 11 percent in each year.

MAPI forecasts two other industries will see double-digit growth in at least one of these years.

Communications equipment should continue its strong showing in 2007, with anticipated growth of 14 percent, followed by an 8 percent advance in 2008.

Electrical equipment is anticipated to grow by 12 percent this year but decline by 1 percent in 2008.

Three industries are forecast to have negative change in both 2007 and in 2008.

Continuing its struggles, housing is likely to decline by 23 percent in 2007 and by 6 percent in 2008; in concert with the housing decline, the household appliance sector is anticipated to drop by 5 percent this year and by 6 percent in 2008; additionally, construction machinery could decline by 15 percent in 2007 and by 7 percent next year.

*More information on this report can be found at www.mapi.net.*

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*Founded in 1967 by J. Van Ness Philip*

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