

■ MDM Interview

Busting Profit Myths in Distribution

Al Bates hates dysfunctional financial management

Al Bates, founder and chairman of Profit Planning Group, Boulder, CO, wants to change how distribution executives think about their business. In this interview, he addresses dysfunctional behavior, alternatives to typical mindsets and ways that distributors can manage better in a turbulent economy. Based on his experience as a corporate financial planner and decades of data analysis, he's not afraid to buck conventional wisdom. In fact, he enjoys it.

Bates has studied financial performance across dozens of wholesale distribution sectors for more than 25 years. His firm conducts the annual benchmarking report series, PAR reports, for more than 40 wholesale distribution associations. This interview discusses key themes from his new book, *Profit Myths in Wholesale Distribution: The Truth About Sales, Margins, Inventory, and Expenses*, recently published by the NAW Institute for Distribution Excellence. For the book, Bates distills extensive data analysis to help distribution managers elevate financial planning to a more strategic level.

MDM: What's your mission with this book?

Al Bates: Simply put, the mission is to encourage distributors to forget everything they know about profitability and start over. That's a rather dramatic statement, but I think it is realistic. Most distributors make good profits when the economy is strong, they suffer badly when the economy is weak and they don't do a lot more than muddle through in between. I am convinced the reason they muddle through is that they don't have a complete understanding of the financial side of the business.

The reason they don't have a complete understanding is because financial issues are the most difficult to understand for most managers. As a result, they tend to be susceptible to bad advice. As one example, if I attend an inventory seminar and the seminar leader says that the key to better performance is to lower my inventory, I tend to believe I should lower my inventory. There is not a good mechanism to test whether lowering inventory is a great idea, a terrible idea or a completely neutral idea.

The entire purpose of the book is to give managers the ability to challenge ideas with empirical evidence and analytical models. Once managers have the capability to evaluate actions from a profit perspective, decision making should get a lot better.

MDM: In the beginning of the book, you describe distributors as unique in the degree to which decision making is dispersed throughout the organization. How so?

AB: In most distribution businesses, not all, it's a branch model. It's not centralized. It's 30 guys running 30 branches, making 30 sets of decisions based on local markets. The problem is the branch managers know the nature of the local market very well. They also know their people very well. That is the benefit of a branch model. The very large downside is that they can't see how all of the branches tie together. Different branches may be going in very different directions.

We did a comparison one time of equal-size distribution companies with one doing \$50 million of volume out of one distribution center, and one doing \$50 million in volume out of 10 branches. You

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PERSPECTIVE ■ *Commentary by Thomas P. Gale***A Little Context on the Fight for IDG**

Why have three investors been raising the price for Industrial Distribution Group (IDGR), the traditional whipping post of the investment community?

Last year, when IDG's board pursued an exit strategy to free itself from the constraints of public ownership, the M&A market in distribution was still near its peak. In a year's time, we have shifted dramatically from a financial frenzy to a quieter, more strategic buyer's market. In today's risk-averse debt markets, *show me the money* has taken on new meaning in the bidding war for IDG.

The three bidders active in this deal – Platinum Equity (owns Strategic Distribution), Luther King Capital Management (owns 15 percent of IDG stock), and WESCO (owns Bruckner Supply) – know the strengths and weaknesses in IDG. Based on IDG's performance, the winning bidder has to take the long-term approach to extracting value from this deal.

IDG's history is arguably a Murphy's Law case study in roll-ups. The company dealt – very publicly – with one issue after another. IDG formed with an initial public offering in 1997 with the roll-up of nine strong regional companies. The company had annual sales of \$250 million. By the end of 1999, the company had

grown through acquisition to 13 hub operating companies and 65 operating locations in about half of the top 75 U.S. industrial markets, with \$542 million in sales. But the company suffered major growing pains.

It went through a series of presidents/CEOs trying to align independent former owners. It wrote off \$5.6-million pre-tax in 1999, part of litigation involving one of IDG's founding companies, as well as severance costs for terminated executives. In 2000, it wrote off \$15.1 million in its failed implementation of J.D. Edwards software just as the industrial economy was tanking and its customer base was shrinking.

But IDG, unlike many other roll-ups, was a survivor. The three bidders in this deal are either direct competitors or a significant owner of IDG. In the tightening industrial and integrated supply markets, we are seeing how these assets are being valued by these strategic bidders. WESCO gave its answer by withdrawing when the stakes were raised earlier in the week.

An added wrinkle is that IDG's lower-margin integrated supply business has increasingly accounted for more of its revenues. It just stretches probability for payback further out. At least two buyers feel the rewards are there in this higher-risk environment. ■

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Busting Profit Myths in Distribution

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can make a heck a lot more money when you can centralize things. The economics of consolidation are dramatic. However, the reality is that branches are a way of life in distribution. We need to get everybody on the same page. With any luck they might all be on the right page.

MDM: Is a customer focus model like that diametrically opposed to profitability?

AB: No. But it requires a more sophisticated branch manager. It implies more compensation, better education, more extensive follow-through and the like. Some companies do a very good job in this regard. They view the branch manager as a partner and share the rewards. Unfortunately, way too many view the branch manager as simply another employee. If the manager fails, we will find another one. In the branch model, the manager is running a mini-business. They need to be educated on how to run such a business and compensated on overall performance.

MDM: What should distributors focus on in the current turbulent economy?

AB: Clearly you have to manage the loss of sales volume. For most distributors, a 10- to 15-percent sales decline wipes out profits. If sales are down five or six percent, that's one issue. It's tacky but we can live through it. If sales are down 20 percent, you've got to make dramatic changes. In that scenario, too often distributors do what I think is absolutely the wrong thing in an attempt to free up cash. They try to lower accounts receivable and reduce inventory to make up for selling less. Inevitably, that leads to sales declines getting even worse. Back orders go up. Customer service goes down and what might be a 10-percent sales decline becomes a 15-percent sales decline.

Thinking about cutting inventory and accounts receivable is a very normal reaction, though. It is compounded by the fact that most distributors don't have much cash, even in good times. So the first thing when sales are sluggish, you tend to lower the inventory. I really think you've got to avoid that at all costs.

At the same time, when times are tough, my customers are going to drag another five or six days, and that's just the way life is. You have to ride out the storm on the investment side. Having said that, I've got to make it up somewhere and the best way is on gross margin. Most distributors, even though they will argue they

are doing a good job on gross margin, have inefficiencies they need to address.

The concern is in a down market, most people say, "I can't raise my prices." You can't on faster selling commodity items. But there are many slower moving items where the pricing has been adjusted down for one customer, and then it gets adjusted down for everybody. It's really a time to evaluate pricing. For most businesses, there is potentially enough gross margin to make up for the sales decline – at least two-thirds or three-quarters of the sales decline. If I manage the gross margin area properly, I wouldn't smile through a recession, but at least I wouldn't be frowning as much.

As far as efforts to lower accounts receivable, it's dysfunctional. For one thing, customers don't have the money. They will probably pay when they can. And a down-market is not the best time to hound people. The last time we had a recession in 2001, W.W. Grainger openly detailed how they felt it was a great opportunity, as their cash-strapped competitors were lowering inventory and AR, to increase their investment in those areas to grab market share.

MDM: Can you provide more detail on managing gross margin?

AB: It's a pricing game. Distributors have to stay on top of commodity price inflation, but they can use that to pass on increases. That's a very legitimate source of margin. For example, what we see is that when you do have continual price increases, distributors reach a point where – for whatever reason – they feel they can't pass a full five percent on, so they only pass on three percent. That's a real danger. The fact that the supplier is raising prices is the best reason in the world to go to my customers and say, "This was not my idea! Suppliers did this to us again."

MDM: What about the expense side of the equation?

AB: You also have to look at the expense side, obviously, in any downturn. If you recall in 2001, particularly in the industrial sector, we not only had the recession, but we had a strong movement of factories offshore. A lot of distributors took sales hits of 20-30 percent. I mentioned earlier that a 10 percent sales decline moves the firm to its break-even point. A 20 percent sales decline decimates the firm.

You have to have one set of answers for a

continued on next page

large hit, and another set for a milder impact. If it's going to be traumatic, the answer is: "I have to shed employees." And my recommendation is do it once. Make it large enough to get rid of the people who have not been working since 1984 anyway. If you do it in dribbles, you're dead. If you cut some, then three months later you cut some more, people are going to say, "Who is next?" It is very dysfunctional. As traumatic as it is to cut 20 percent of the workforce, at least it's clean and you're not bleeding by a thousand cuts.

If it's more a manageable sort of recession, which I happen to think it will be, excluding

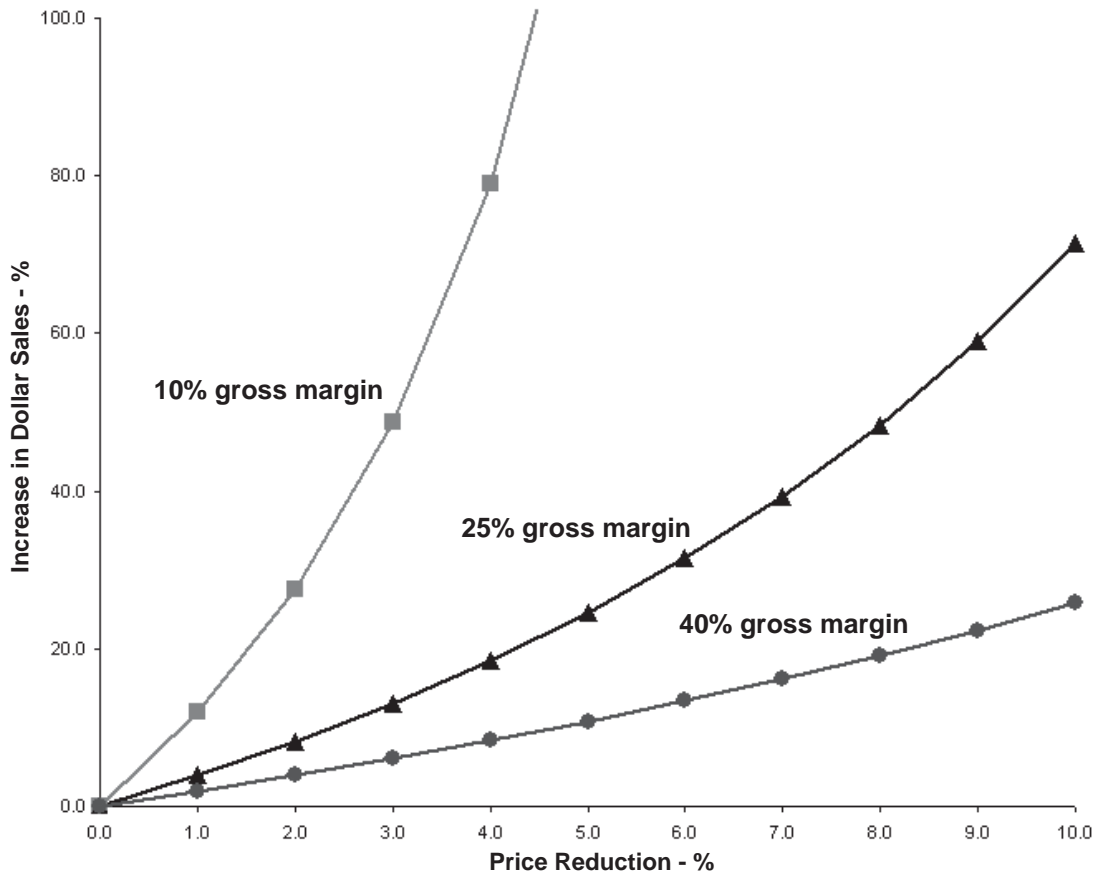
construction, then you be a little more strategic. Here again, branching makes things a little more difficult. Branching gives you tremendous capability to have local market coverage which you have to build on. If there are three or four employees in a branch, it is almost impossible to reduce the workforce by 10 percent.

However, if the branching model is really a hands-on, high customer contact model, you can work with customers to get them to buy better for both themselves and for the distributor. I address changing the order economics in the book. You can change the way people buy if you explain the benefit – fewer daily deliveries, for

The Making It Up With Volume Myth

The larger the price reduction, the harder it is to generate an offsetting increase in sales. The lines represent the point at which dollar profits remain where they are; that is, at every point on all three lines, the firm continues to make the same dollar profit it did before. The lines connect price reductions ranging from 1 percent to 10 percent and increases in dollar sales from 0 percent to 100 percent. The line using squares as data points is for a distributor with a gross margin of only 10 percent. The line with triangles represents a gross margin of 25 percent. The line with circles is for a distributor with a gross margin of 40 percent. For a distributor with a 25 percent gross margin, a 5 percent price cut requires a 24.6 percent increase in sales to maintain that gross margin level.

The Increase in Dollar Sales Required to Exactly Offset a Price Reduction



Source: Profit Myths in Wholesale Distribution, www.nawpubs.org

example. That's critical in a down market. It's a tough but important sale. It is easier to do if you have constant contact and communication with customers which branching facilitates.

Another problem or mistake that people tend to make in a recession is to cut marketing. We see it more in retail than at the distributor level. We tend to look at that marketing budget as discretionary and related to sales. The more you sell, the more you market. I argue that the more you market, the more you sell. There's a relative savings in the short term. But when the recession ends you have lost a lot of momentum. Maybe we think how those dollars are spent, but I still want to go out and tell people, "I love you, man." I want to avoid customers thinking we don't care about them.

MDM: Are things different today than what you have seen in past cycles?

AB: No. We have been here before. We seem to follow this pattern of getting tough on expenses during the downturn. Then things begin to take off and we can do no wrong. So we add more employees than we should and we go through the entire cycle again. That's human nature, incidentally, so I hold no hope of changing it. Ideally, distributors need to plan based on moderating the down cycle, but in doing that will probably moderate the upside as well. That's hard to do. The book makes a strong case for re-thinking your business along those lines, where you manage the return on assets across the entire

business cycle.

MDM: What's the biggest financial myth out there?

AB: That you can make it up on volume. The reality is the lower your margin, the less you can cut. With a low gross margin, the additional volume you have to drive just goes up astronomically (see graph).

If you have a really high gross margin, like McDonalds, in the range of 75 percent gross margin, value meals bring in incremental traffic and have an impact.

So a high-margin business should be doing specials and price cuts of the week. A low gross-margin business can't survive that. Most distribution falls somewhere near a 25-percent gross margin model. It's almost impossible to make up the volume. The workload becomes incrementally more difficult. The graph also assumes no increase in your fixed expenses, and at some point those become unglued.

Most people start out on the volume path with a new type of customer or just for a little while. What tends to happen is that that one-time special event gets transmitted to the existing market the next day. The one-time special price becomes the regular price.

To order the book, Profit Myths in Wholesale Distribution, go to www.nawpubs.org or call the National Association of Wholesaler-Distributors at 202-872-0885.

Bidding War for Industrial Distribution Group Continues

The bidding war for industrial distributor Industrial Distribution Group Inc., Atlanta, GA, continues, but WESCO Distribution Inc., Pittsburgh, PA, has bowed out. At press time (early April 25, 2008), Luther King Capital Management, Fort Worth, TX, had the highest bid with \$12.10 per share in cash, or close to \$134 million.

Luther King Capital current owns 15 percent of IDG's stock. The firm presented IDG with an equity financing commitment letter from an LKCM investment fund.

Platinum Equity, the original victor with its offer of \$10.30 per share for the distributor, had upped its bid to \$11.80 per share in cash in response to WESCO Distribution's bid of \$11.75, or \$130 million.

The back and forth comes after IDG agreed in February 2008 to be purchased by Platinum.

Platinum owns two other related distribution companies – Strategic Distribution Inc. and Ryerson Inc.

Much of Strategic Distribution's business, in particular, is focused on integrated supply; about 60 percent of IDG's sales are in integrated supply, its fastest growing unit.

IDG recently reported sales for 2007 were \$537.5 million, compared with \$547.9 million in 2006, down 1.9 percent. Profit was \$4.1 million, compared with \$6.8 million last year. IDG is an industrial MROP distributor and provider of integrated supply solutions.

IDG was formed in 1997 through a rollup of nine industrial general-line distributors. The distributor first announced it was seeking "strategic alternatives" for the company in August 2007.

Inflation by Commodity Group

Pricing trends for the first quarter 2008

These 24 select product groups provide a snapshot of inflation trends based on the Producer Price Index from the U.S. Bureau of Labor Statistics. First quarter 2008 is compared with first quarter 2007, and fourth quarter 2007 with first quarter 2008.

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Abrasives
Adhesives & Sealants
Cutting Tools & Accessories
Hand & Edge Tools

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Power-Driven Hand Tools
Ball & Roller Bearings
Mechanical Power Transmission Equipment
Electrical Machinery/Equipment
Industrial Material Handling Equipment
Industrial Gases
Welding Machinery/Equipment
Valves, Except Fluid Power
Pumps, Compressors & Equipment

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Hardware
Sanitary Paper Products

Plastic Resins & Materials
Specialty Cleaning, Polish & Sanitary Products
Industrial Safety Equipment
Softwood Lumber
Metal-Forming Machine Tools
Metal-Cutting Machine Tools

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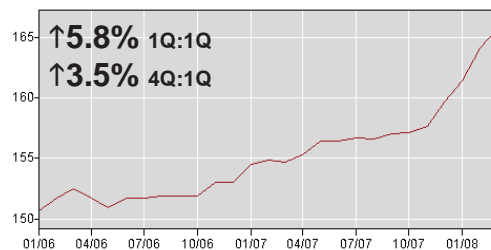
Hardboard, Particleboard, Fiberboard Products
Hardwood Lumber
General Millwork
Plywood
Construction Products from Plastics
Gypsum Products
Air Conditioning & Refrigeration Equipment
Tools, Dies, Jigs, Fixtures, Industrial Molds
Food Commodities (12 product groups)

Key

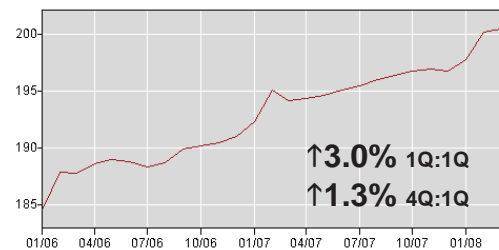
↑11.6% 1Q:1Q (1Q '07 with 1Q '08)

↑1.8% 4Q:1Q (4Q '07 with 1Q '08)

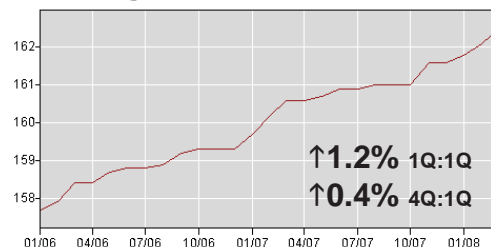
Abrasives



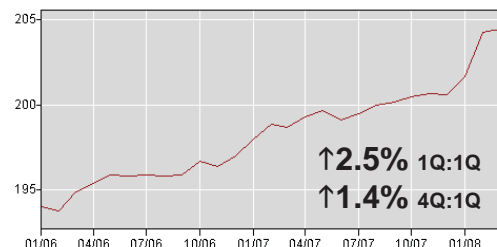
Adhesives & Sealants



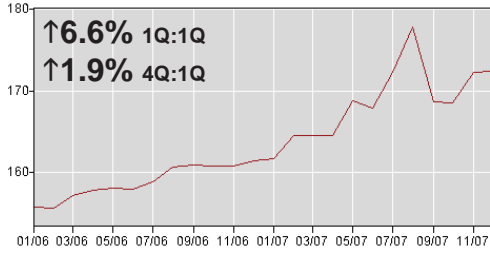
Cutting Tools & Accessories



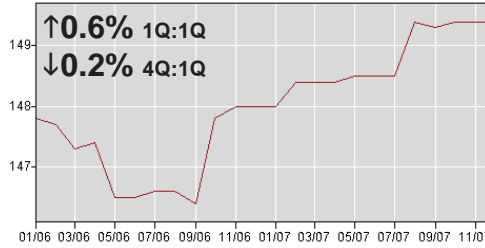
Hand & Edge Tools



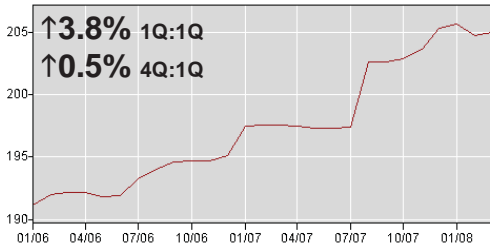
Fasteners



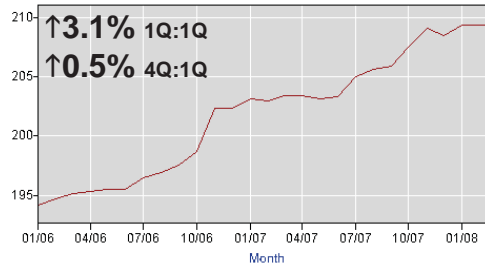
Power-Driven Hand Tools



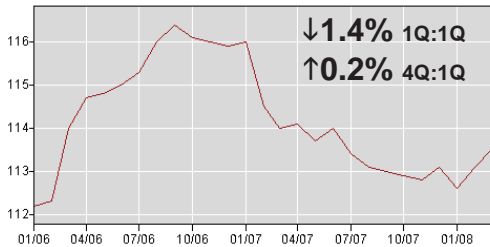
Ball & Roller Bearings



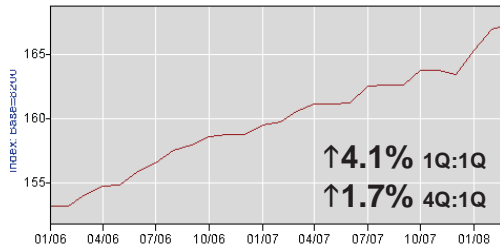
Mech. Power Transmission Eqpt.



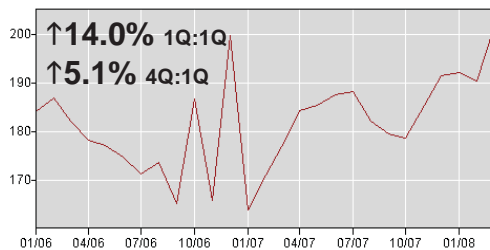
Electrical Machinery/Equipment



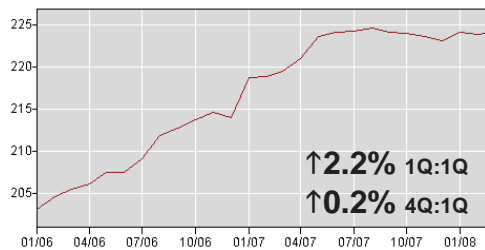
Material Handling Eqpt. (Ind)



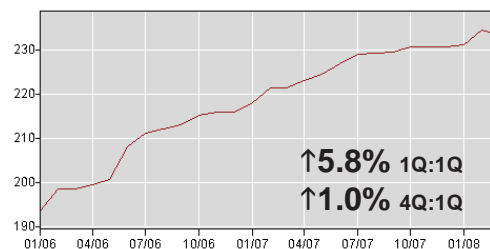
Industrial Gases



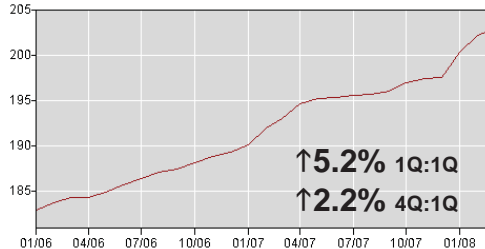
Welding Machinery/Equipment



Valves, Except Fluid Power



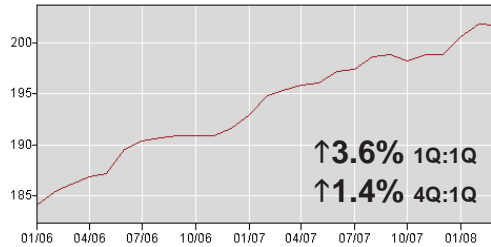
Pumps, Compressors & Eqpt.



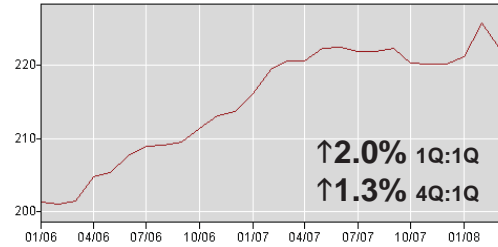
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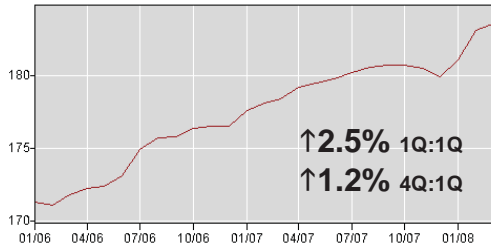
Fluid Power Equipment



Plumbing Fixtures & Fittings



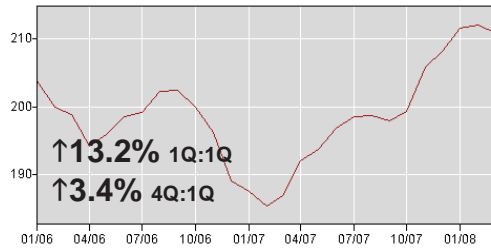
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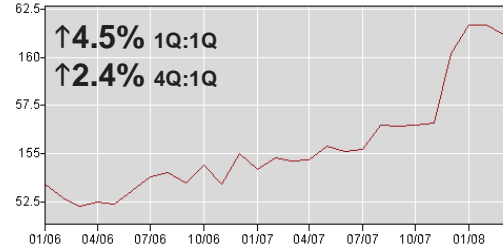
Sanitary Paper Products



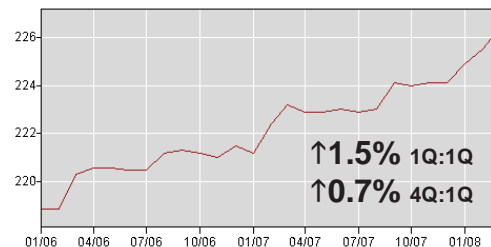
Plastic Resins & Materials



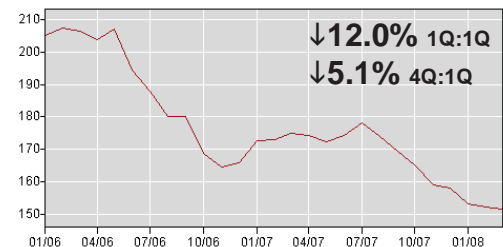
Spec. Cleaning, Polish, San. Products



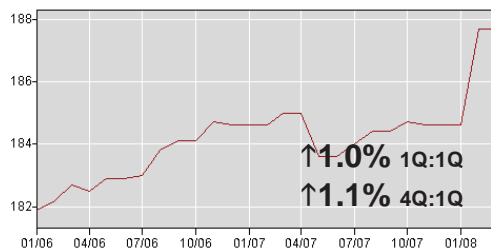
Industrial Safety Equipment



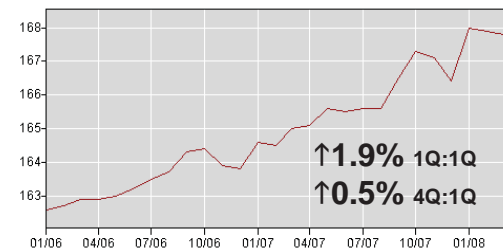
Softwood Lumber



Metal-Forming Machine Tools



Metal-Cutting Machine Tools

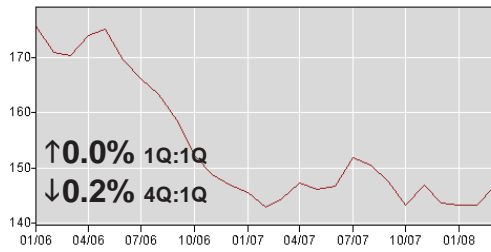


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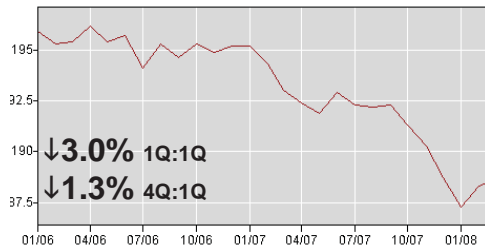
MDM Inflation by Commodity Group

Pricing trends for the first quarter 2008

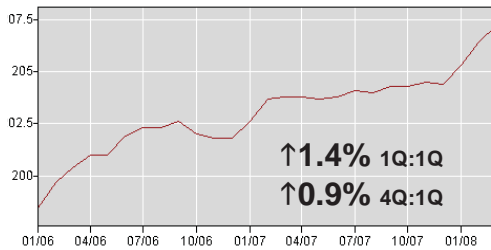
Hardbd, Particlebd, Fiberbd Products



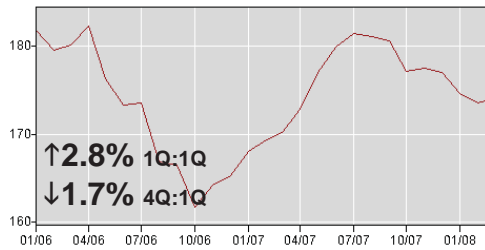
Hardwood Lumber



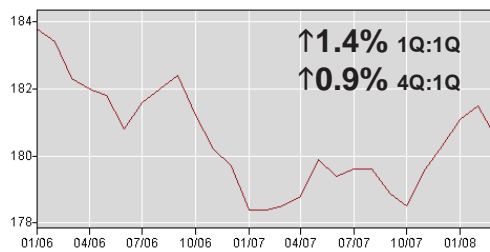
General Millwork



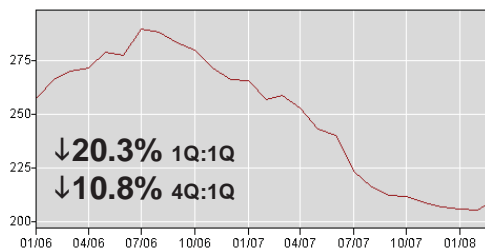
Plywood



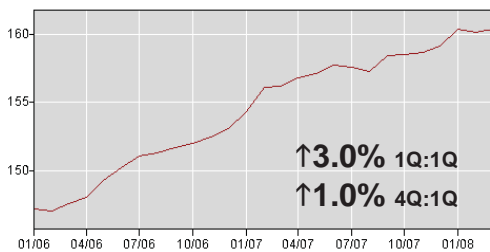
Construction Products from Plastics



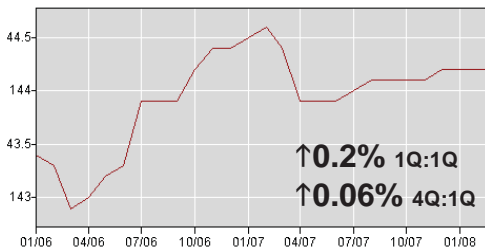
Gypsum Products



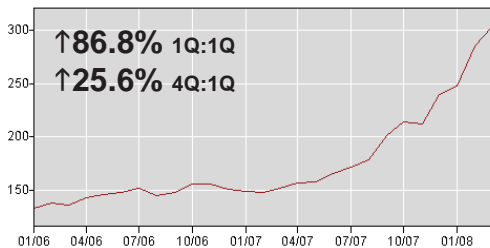
Air Conditioning & Refrigeration Eqmt.



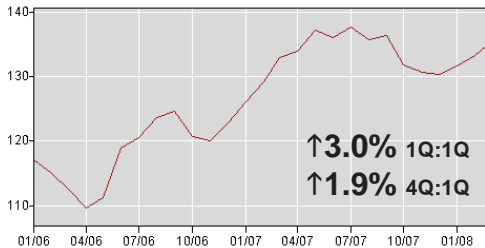
Tools, Dies, Jigs, Fixtures, Ind. Molds



Flour



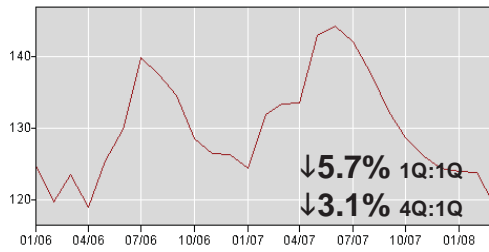
Processed Poultry



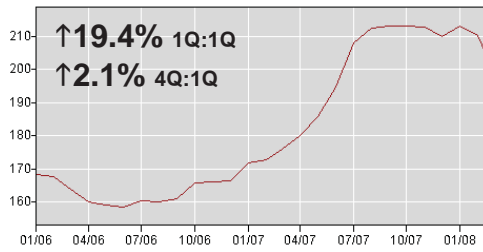
MDM Inflation by Commodity Group

Pricing trends for the first quarter 2008

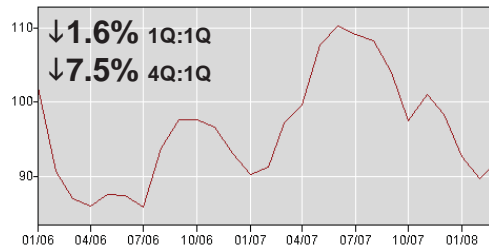
Pork Products



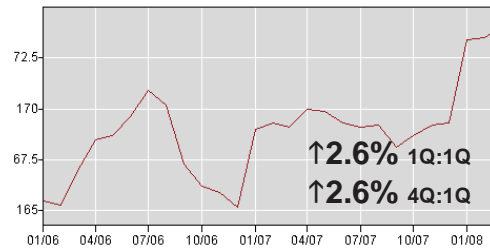
Fluid Milk Products



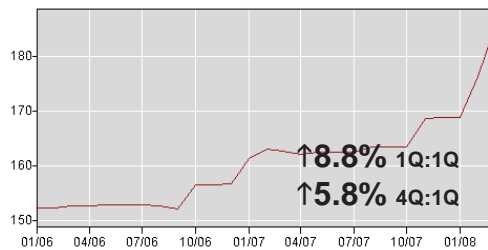
Butter



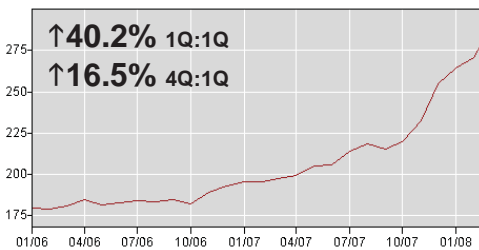
Sugar & Confectionary



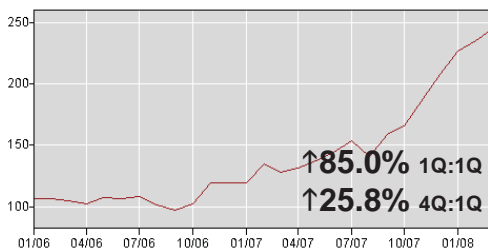
Coffee



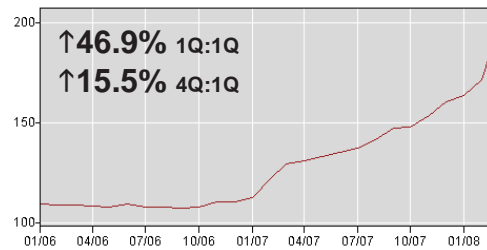
Shortening & Cooking Oil



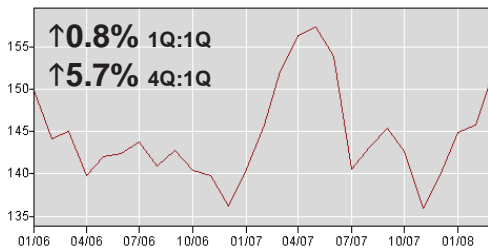
Oilseeds



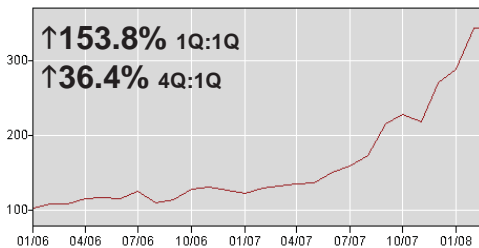
Processed Eggs



Beef/Veal Products



Wheat



Product Mix & Growth for MSC Industrial

MSC Industrial Direct's latest Safety Products Catalog launch is part of its strategy to further penetrate existing customer accounts, according to Erik Gershwind, MSC's senior vice president of product management, marketing and strategy.

"The interest in safety products has been building in our customer base for the past few years," Gershwind said. "We definitely saw a demarcation point after 9/11. Our customer base has a heightened sense of awareness of keeping the workplace safe and protecting the well-being of their employees."

Gershwind said that penetration of existing accounts was a key growth strategy for the industrial distributor, based in Melville, NY. The company is also working to sell more MRO and safety products to customers acquired when it bought J&L Industrial Supply in 2006. The distributor also plans to continue growing its business into new customer and product segments, he said.

"Our customers are dealing with many suppliers, so there continues to be market share opportunities in existing accounts," he said. "It's one of the most exciting opportunities we see. The safety initiative is one example of that." MSC aims to go deeper inside an organization, tapping the end-user, the purchasing director and the safety director or champion whose responsibility is safety at the facility.

Safety Product Catalog

MSC's newest safety products catalog features 40,000 products, a 50-percent increase in SKUs since the company's first safety catalog released in 2005. The distributor broke out a separate safety products catalog in 2005 in response to customer demand.

A portion of the SKU increase was from new products, Gershwind said. "A

Crawford Electric Supply, Dallas, TX, a subsidiary of **Sonepar USA**, has opened a new branch in New Orleans, LA. The facility includes a 48,000-square-foot warehouse, with a full-service counter area focused on the pipe, wire, lighting, and electrical business.

PrimeSource Building Products Inc., Carrollton, TX, will buy Miami, FL-based **Coast to Coast Building Products Inc.**, according to news reports. The acquisition expands PrimeSource's network into the Southeast as well as the Caribbean and Central America.

HD Supply, Atlanta, GA, has launched its two new proprietary brands, **Seasons** and **Brigade**. The **Seasons** brand will be carried on products such as kitchen and bath fixtures and ceiling fans, ultimately used by consumers, while **Brigade** will be carried on heavy duty products, such as tools and hardware, ultimately used by professional contractors and trades people on the job.

Honeywell, Morris Township, NJ, has agreed to buy **Norcross Safety Products L.L.C.**, Oak Brook, IL, a manufacturer of Personal Protective Equipment (PPE), for \$1.2 billion. Norcross, majority owned by Odyssey Investment Partners, manufactures protective and safety equipment for the fire service, utility and general industrial worker segments. Norcross will be integrated into Honeywell Life Safety, part of Honeywell's Automation and Control Solutions (ACS) group. Norcross's revenue was \$609 million in 2007.

The Timken Company, Canton, OH, has opened two new manufacturing facilities in Asia, adding to its ability to serve aerospace and industrial markets.

Swagelok Company, Solon, OH, has acquired **Coreflex LLC**, Bowie, MD, a manufacturer of hose products used mostly in semiconductor, biopharmaceutical, and other applications.

Praxair Distribution, Inc., Danbury, CT, a subsidiary of **Praxair, Inc.**, announced discount reductions and price increases for its industrial, medical and specialty gas cylinder customers in the U.S. and Canada. The company said the price increases were due in part to escalating labor, energy and fuel costs and limited global availability of raw materials for certain products.

U.S. privately owned housing starts in March were down 11.9 percent from February and down 36.5 percent from March 2007, according to the U.S. Census Bureau and the Department of Housing and Urban Development.

U.S. wholesale prices increased 1.1 percent in March, seasonally adjusted, the Bureau of Labor Statistics of the U.S. Department of Labor reported. This advance followed a 0.3 percent rise in February and a 1.0 percent increase in January. The rise in the index for finished goods less foods and energy (core inflation) slowed to 0.2 percent from 0.5 percent in February.

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February U.S. manufacturing technology consumption totaled \$308.50 million, according to the Association for Manufacturing Technology and the American Machine Tool Distributors' Association. This total, as reported by companies participating in the USMTC program, was down 4 percent from January, but up 4.4 percent from February 2007. With a year-to-date total of \$624.28 million, 2008 is up 1.2 percent.

Canadian output in January rebounded smartly from a sharp drop in December, reflecting a widespread increase in demand. This was consistent with employment, which picked up steadily through the first quarter.

Sales of Canadian manufactured goods rose 1.6 percent to \$50.1 billion in February, due in part to a gradual bounce-back by Canada's motor vehicle industry. This marked the second successive increase in manufacturing sales, as manufacturers continued to make up ground lost after a tough December (-3.7 percent).

Industrial production rose 0.3 percent in March after having dropped 0.7 percent in February. For the first quarter as a whole, output declined at an annual rate of 0.1 percent.

Huttig Building Products, Inc., distributor of millwork, building materials and wood products, reported a net loss of \$9.8 million for the first quarter 2008, compared with a net loss of

\$3.4 million in the year-ago period. Sales fell 25 percent to \$166.8 million.

French electrical manufacturer **Legrand** has acquired Estap, manufacturer of VDI enclosures and cabinets in Turkey. The move underscores Legrand's accelerating expansion on emerging markets, which accounted for 50 percent of its organic growth in 2007.

Watsco, Inc., Coconut Grove, FL, reported revenues for the first quarter 2008, were up 3 percent to \$380 million compared with the same period a year ago. The increase includes 63 locations opened or acquired over the past 12 months, adding \$49 million to sales in the quarter. On a same-store basis, sales fell 10 percent.

Chicago, IL-based **Grainger** reported sales of \$1.7 billion for the quarter ended March 31, 2008, up 7 percent from the prior-year first quarter. Profit for the quarter was up 12 percent to \$114 million.

Swedish manufacturer **SKF's** sales for the first quarter 2008 were up 8.5 percent in SEK, with 4.9 percent attributable to volume, 1 percent to structure, 3.8 percent to price and mix, and -1.2 percent to currency effects.

Continued on p. 4 of this section

Calculation of MDM Inflation Index for March 2008

	BLS Price Indices Mar. '08	BLS Price Indices Feb. '08	BLS Price Indices Mar. '07	% Sales Weight	Weighted Indices Mar. '08 (1)X(4)	% Change Mar. '08 Feb. '08	% Change Mar. '08 Mar. '07
1136 Abr. Prod.	491.9	487.1	458.9	19.1	93.95	0.98	7.18
1135 Cutting Tools	440.6	439.5	436.5	18.9	83.28	0.25	0.93
1145 Power Trans.	654.5	654.2	634.8	15.4	100.79	0.05	3.10
1081 Fasteners	476.4	468.8	437.2	9.0	42.87	1.61	8.96
1149.01 Valves, etc.	808.6	798.1	767.0	7.6	61.45	1.32	5.42
1132 Power Tools	333.7	328.8	329.0	6.5	21.69	1.48	1.41
1144 Mat. Handling	479.6	478.5	460.1	6.2	29.74	0.24	4.24
0713.03 Belting	563.0	551.7	540.1	6.1	34.34	2.04	4.23
1042 Hand Tools	696.7	696.0	676.3	8.1	56.43	0.10	3.02
108 Misc. Metal	433.1	427.2	415.0	3.1	13.43	1.39	4.35
"New" March Index	281.1	March Inflation Index			537.97	0.74	4.24
"New" February Index	279.0	February Inflation Index			534.02		
		March 2007 Inflation Index			516.08		

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

Distribution Financial Metrics and Trading Multiples

(Data as of March 31, 2008)

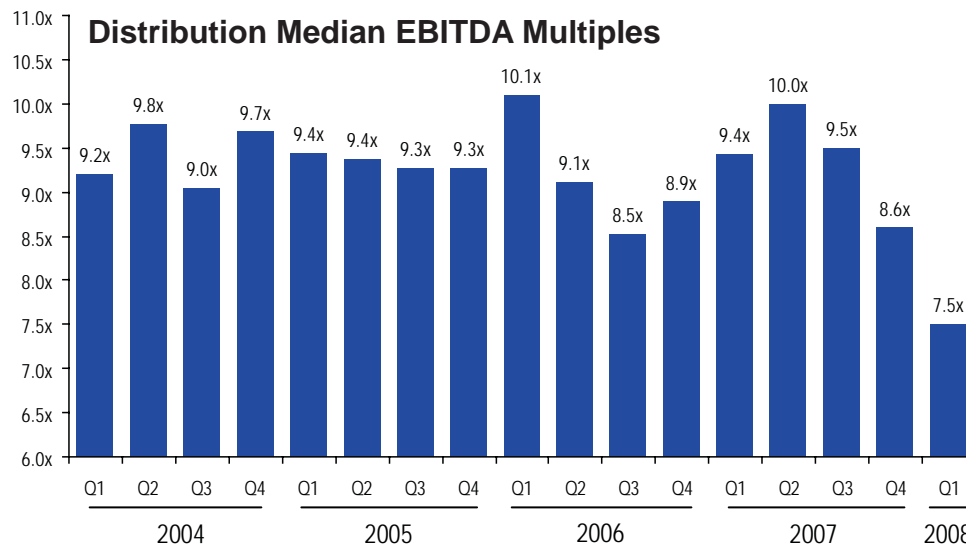
(\$ in millions)

Company	Ticker	Enterprise Value	LTM				EV to LTM Sales	EV to LTM EBITDA	ROIC	Working Capital/Sales	
			Sales	Sales Growth	Gross Margin	EBITDA Margin					
Airgas Inc. *	ARG	\$5,301	\$3,784	22.1%	51.8%	\$626	16.5%	1.4 x	8.5 x	9.3%	4.6%
AM Castle & Co.	CAS	660	1,420	20.6%	17.5%	111	7.8%	0.5	6.0	12.6%	15.2%
Anixter International Inc. *	AXE	3,254	5,853	18.5%	24.1%	473	8.1%	0.6	6.9	13.9%	25.3%
Applied Industrial Technologies Inc.	AIT	1,220	2,079	5.7%	27.1%	164	7.9%	0.6	7.5	22.6%	14.8%
Barnes Group Inc. *	B	1,657	1,440	14.3%	38.0%	210	14.6%	1.2	7.9	11.9%	14.3%
Beacon Roofing Supply Inc. *	BECN	843	1,664	8.0%	22.5%	99	6.0%	0.5	8.5	5.3%	15.2%
BlueLinx Holdings Inc.	BXC	662	3,834	(21.7%)	10.2%	36	0.9%	0.2	N/M	1.5%	12.3%
Builders FirstSource, Inc. *	BLDR	443	1,592	(28.9%)	24.5%	39	2.4%	0.3	11.4	2.2%	9.0%
Building Materials Holding Corp.	BLG	424	2,285	(28.7%)	19.4%	63	2.8%	0.2	6.7	1.6%	9.9%
Bunzl plc	BNZL	5,979	7,146	7.5%	24.5%	521	7.3%	0.8	11.5	13.0%	6.4%
DXP Enterprises Inc.	DXPE	350	445	58.9%	28.3%	37	8.3%	0.8	9.5	9.4%	20.6%
Fastenal Co. *	FAST	6,792	2,139	14.6%	51.2%	435	20.4%	3.2	15.6	25.5%	31.6%
Genuine Parts Co.	GPC	6,997	10,934	3.6%	29.7%	924	8.4%	0.6	7.6	17.3%	23.3%
Houston Wire & Cable Company *	HWCC	336	359	11.0%	25.9%	50	14.0%	0.9	6.7	28.3%	28.4%
Huttig Building Products Inc.	HBP	74	819	(21.5%)	19.1%	(1)	(0.1%)	0.1	N/M	N/M	11.9%
Interline Brands Inc. *	IBI	966	1,239	16.1%	38.2%	129	10.4%	0.8	7.5	9.4%	22.6%
Kaman Corp.	KAMN	651	1,086	9.5%	27.7%	72	6.6%	0.6	9.0	11.8%	21.8%
Lawson Products Inc.	LAWS	244	510	(0.3%)	59.1%	46	9.0%	0.5	5.3	11.9%	21.3%
MSC Industrial Direct Co. Inc. *	MSM	2,947	1,756	15.3%	46.3%	342	19.5%	1.7	8.6	21.1%	28.1%
Park-Ohio Holdings Corp.	PKOH	525	1,071	1.4%	14.6%	79	7.4%	0.5	6.7	7.7%	24.2%
Pool Corp *	POOL	1,238	1,928	1.0%	27.5%	148	7.7%	0.6	8.4	15.2%	15.9%
Reliance Steel & Aluminum Co.	RS	5,350	7,322	11.0%	25.4%	797	10.9%	0.7	6.7	14.2%	15.3%
Rexel SA	RXL	7,044	16,913	15.1%	24.4%	1,045	6.2%	0.4	6.7	7.0%	13.1%
Smith International Inc.	SII	14,856	8,764	19.5%	32.6%	1,563	17.8%	1.7	9.5	27.5%	28.9%
Watsco Inc. *	WSO	1,205	1,768	(0.9%)	25.4%	113	6.4%	0.7	10.7	11.4%	19.0%
WESCO International Inc. *	WCC	2,866	6,003	12.8%	20.4%	431	7.2%	0.5	6.6	15.0%	14.7%
Wolseley plc	WOS	13,350	32,680	7.1%	27.8%	2,171	6.6%	0.4	6.2	7.6%	14.5%
WW Grainger Inc. *	GWW	5,894	6,532	8.7%	42.5%	828	12.7%	0.9	7.1	19.3%	16.5%
Median		\$1,229	\$2,004	9.1%	26.5%	\$156	7.8%	0.6 x	7.5 x	11.9%	15.6%

* = 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

MSC Industrial

Continued from p. 1 of this section

lot of the additions were taken from elsewhere in our offerings to make it an easier shopping experience for our safety buyers." Customers are asking not only for safety products but also safety-related products, such as hand soap, in the same place, he said.

Customers are also "raising the bar" on expectations of their suppliers, he said. "Distributors need to do more than sell products. They need to help customers proactively address problems in the business."

For example, MSC created a "wellness kit" in response to customer demand for product that would help to prevent illness, and in turn cut down on employee absences due to sickness.

A kit may include products such as hand sanitizer or soap and safety masks with instructions on when to use the product provided and how to avoid getting sick. The focus there is on prevention and being proactive, rather than reactive.

Changing Demographics

MSC is also busy responding to other trends.

As more women enter a traditionally male work environment, Gershwind said MSC has had to shift its product mix.

The most apparent change is in the breadth of sizes the distributor offers for Personal Protective Equipment, including smaller sizes of gloves, shoes and goggles.

In addition, more workers – male and female – want more comfortable and stylish equipment. "Style has become a lot more important," he said. Gershwind said safety directors ask for the improvement in style and comfort because it increases the likelihood of compliance on the floor.

"We probably offer more glasses, for example, than you would think exist," he said.

"It's all based on personal preference. Some of the new glasses feel like you're just wearing a comfortable pair of sunglasses."

Green Products

MSC will soon launch a comprehensive green initiative. The initiative has a few key components, including providing a section on the Web site where customers can click an environmentally-friendly tab and see green products in seven categories.

Customers are demanding more energy-efficient products, Gershwind said. But they are also demanding eco-friendly cleaning products. "The demand is high enough that another component of our plan is the introduction of a (private-label) environmentally-friendly cleaning line called Nature's Solution.

"... We set the bar that we want the product to be as good or better than products that aren't considered green, and we want them to be cost-competitive."

Keeping Service Levels High

MSC is aware of the importance of training its sales people and other employees as it continues to add to its product mix. "It's something we think about all the time," Gershwind said. "We have a plan for it." The distributor is expanding its sales organization, and is careful about who it hires, he said. "We have an extensive training program that is a core part of our organization."

MDM News Digest

Continued from p. 2 of this section

Genuine Parts Company, Atlanta, GA, reported sales for the first quarter ended March 31, 2008, were \$2.74 billion, up 3 percent. Profit was \$123.5 million, up 2 percent. EIS, GPC's Electrical Group, sales were up 7 percent in the quarter, Motion Industries a 6 percent increase, and The Automotive Group a 4 percent jump.

Illinois Tool Works Inc., Glenview, IL, reported 11.4 percent growth to \$4.13 billion in the first quarter 2008. Organic growth was 0.4 percent, with international base revenues growing 4.6 percent and North American revenues falling 2.5 percent.