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Intelligence for Wholesale Distribution Professionals

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The Year in Distribution: 2008

The boom years are over; distributors grow more cautious

The economy has officially shifted into lower gear after a turbulent ride in the second half of 2008. This article is an overview of trends and events in the past year in the wholesale distribution sector.

By Lindsay Young

At the end of 2007, MDM published an article titled, "Preparing for Uncertainty in 2008." At the time, the economy was starting to show signs of weakening. Certain sectors – automotive and housing — had already taken a dive. And deal-making had started to ease.

But we could not have guessed the enormity of change that would take place this year – particularly in the second half. Financial markets collapsed and previously stalwart institutions went under.

Residential construction plummeted further. In November, unemployment rose to 6.7%; half a million jobs overall were lost. Job losses are expected to continue in 2009.

Commodity prices have dropped; so the inflation-driven growth of yesteryear has been tempered. Distributors that benefited from commodity prices increases in the past two years – if they haven't already – must focus on underlying growth.

As a result, wholesaler-distributors have grown more cautious. They've trimmed costs, and they along with their customers have put off capital plans until things start to turn around. No one knows when this will be, but some economists forecast that the weakest segments may hit bottom in the second half of the new year.

The industry has entered a period where some fundamental shifts have taken place. These shifts are due not only to the economic situation (though many have been sped up by it), but to general trends in IT, green, productivity gains and globalization.

Growing Impact

UK-based global building materials distributor Wolseley plc was the most prominent example of the struggles those who serve the construction markets continue to face.

In fact, Wolseley said in a recent conference call with analysts that it does not know when the residential construction market will rebound. Its North American building materials group Stock Building Supply has cut about 55 percent of its workforce since 2006.

It's no surprise that distributors that serve the construction industry are struggling. Some have closed their doors; others have shrunk the size of their distribution networks dramatically. Distributors serving the automotive industry directly or indirectly are seeing similar drops.

Now other industries are starting to feel the pain. Though still positive, growth in other sectors – including industrial – has slowed down considerably. Many distributors are recording single-digit organic growth toward the end of this year.

Fourth-quarter numbers are not in yet, but distributors and manufacturers in many sectors have revised their projections downward.

Credit Crunch

Credit markets are crimping growth even more. Even those banks that are willing to lend aren't seeing the demand – more distributors are focusing on cash flow and less on taking on extra debt and risk. Distributors are also concerned about Accounts Receivable; certain end markets have seen a slowdown in projects, and cash flow has followed suit. This has filtered through the entire chain.

Deal-making has also seen an impact from tight credit. While in years' past,

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PERSPECTIVE ■ *Commentary by Thomas P. Gale*

Five Things to Be Thankful For

When it rains, it pours. Sometimes it sleets and snows, as well. With weather before Christmas hurting retail traffic in an already slow year, bad news is flowing freely.

Many manufacturers and distributors are making tough decisions as the New Year approaches. But it's important to keep a healthy perspective, manage what you can control, and focus on the future. With that in mind, it seems appropriate to end this year with a few thoughts of what we have to look forward to in the many niche distribution markets that make this industry strong, flexible and resilient. Let us hope and work to grow in the next few quarters!

Demand will build. Even as we hear continued dismal monthly reports on housing starts and car sales, demand is in fact starting to develop. It won't look like it used to as buying habits and demographics change, but markets will rebound, and already there are new industry sectors rising out of the ashes, such as alternative energy and low-energy product manufacturing.

New markets are born. Manufacturing is returning to this continent after the offshore exodus ten years ago. Security, reliability of shorter supply chains, labor cost differentials, fuel costs – all these factors are combining to make manufacturing in North America more cost-competitive than even a few short years ago. (Government bailout of non-competitive manufacturing and labor agreements can only delay a return to competitiveness, but this column is determined to remain positive and won't go there.)

Adversity creates opportunity. Some dismiss this as a cliché. Others use it to grow their business. People and companies focus more on what is truly important in times of crisis and stress. It's a perfect time to evaluate how to streamline and improve internal operations, as well as how to increase your value with customers and suppliers.

Your rules are better. This is slightly different than the last point. Customers and suppliers are most open to trying new approaches when they are forced to. Product lines or accounts that seemed off-limits may be in play for those who can provide an innovative way to cut costs, increase productivity or grow market share. This is a time to sell why your company is better than the competition.

Finally, thank you for your business in 2008. With your support we have been able to broaden our coverage and educational offerings. In 2009, we plan to bring you even better analysis as we invest more in our research capabilities and reporting of critical issues facing wholesale distribution executives. ■

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we've seen many billion-dollar deals go down – HD Supply buying Hughes Supply, for example – those are now few and far between. The pendulum has swung to strategic buyers and smaller deals. HD Supply, a strong consolidator under The Home Depot, has slowed its acquisitive growth considerably since moving into private hands.

But some distributors continue to buy.

Before the credit crunch, Sonepar and Rexel completed their acquisition of Hagemeyer assets mid-year. Rexel started the process, buying the Dutch distributor in March in a $4.7 billion deal. Then it sold Hagemeyer's North America, Asian-Pacific and selected European businesses to Sonepar at the end of June. The deal shifted the balance in the electrical distribution industry.

Another who continues to grow by acquisition: Genuine Parts Company subsidiary Motion Industries, Birmingham, AL. The distributor recently told MDM that it was looking to continue its recent spate of acquisitions in industrial supplies – working to build out that part of its portfolio. Recently it bought Port Arthur, TX-based Drago Supply Company, whose focus is primarily on industrial supplies.

Airgas is another that has continued buying smaller distributors, albeit fewer than in years' past. Its acquisitions were weighted toward the first half of the year.

Manufacturer Parker Hannifin hasn't slowed in its acquisitive growth strategy; at least a half-dozen acquisitions were made in the past two quarters.

It's yet to be seen how the last quarter's tightening affected deals in progress or deals that might have been, but are now delayed or scrapped for good.

Focus on Profitability

Distributors have moved back to the mindset formed in 2001-2002. Many are tightening their belts and looking for ways to improve productivity and efficiencies even if they have not yet seen a drop in sales. Some are avoiding layoffs and instead trimming hours and cutting temporary workers out of the budget. Many are delaying planned expansions.

Lean distribution is moving into the mainstream. While in its earlier iterations it was a tool for manufacturers, distributors have found lean to be a way they too can improve productivity, efficiencies and in some cases the bottom line.

Pricing has also moved front and center for many distributors. In a time of economic uncertainty and volatile costs, distributors are looking for longer-lasting solutions to preserve and expand gross margin.

Some of the standard pricing methods – cost-plus or list-price-with-a-discount, or a combination of the two – are not necessarily the best ways to ensure continued profitability.

Smaller distributors are taking a piece-by-piece approach to the process, looking at small changes they can make that will improve gross margin on certain product lines. Large distributors are implementing complex pricing software packages to do the job.

Global

For part of the year, high fuel costs (which dropped to deep lows in the final quarter) shifted how businesses near and far viewed logistics in their overall strategies.

One example of this shift in viewpoint: Instead of expanding production in Eastern Europe or Asia, many North American manufacturers are eyeing Latin America, and particularly Mexico.

European companies are trading Asian expansion for Eastern Europe, and Asian companies are staying closer to home. These markets are still attractive, but manufacturers are rethinking their roles in the long-term. They are utilizing what is now called near-sourcing to cut transportation and labor costs.

Latin America is growing more attractive for manufacturers and their distributors. Brazil in particular is a hot local market – much like Eastern Europe and parts of Asia. Another trend we've seen over the past year is the growing number of acquisitions of Asian companies by North American distributors and manufacturers.

Distributors are also increasingly following their manufacturer customers overseas. We featured Anixter earlier this year as one of those distributors.

The distributor focuses mainly on multinational customers when moving into new countries.

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With the weak dollar, exports buoyed the U.S. economy in 2008; the dollar has strengthened in recent weeks, benefiting importers.

Green

Outside of the response to the economy, green products started moving into the mainstream this year. The significance: More than just distributors to the construction industry increased their focus on this area.

Hagemeyer released an all-green catalog; MSC Industrial announced it would be launching a new initiative centered on green. In the same vein, many distributors are working with customers on green as a value-added fee-based service.

Despite its woes, Wolseley plc opened a 6,800 square-foot sustainable building center in the UK. The center demonstrates the company's green offerings in action, including solar power, wind-generated ventilation and cooling. The idea is to help the construction business embrace sustainability.

Moving Forward

The only thing we know for sure is that by the end of 2009, much will have changed. As Paul Krugman wrote in the *New York Times* recently, the year will be a transition into a time with "no bubbles." With consumer spending in decline and the housing bubble popped, the U.S. economy is entering a new era.

So the year ahead for distributors is shaping up to be one of positioning and repositioning – focusing on cash flow and streamlining business expenses, looking for opportunities in new geographic or product markets, revising and building online marketing strategy and deepening existing relationships with good customers.

Tight credit and cash flow issues will also force some to sell. The continued turbulence makes it a good time to recruit talent let go either by other distributors or in other industries.

When the upturn happens, distributors focused on these strategies will have a strong platform for growth in place.

Forecast: Flat to Negative Growth in '09

Purchasing, supply executives expect capital spending will fall

The collapse of the financial markets, the drops in new residential construction, and the pronouncement that the U.S. is in a recession have all contributed to a general feeling of pessimism about the state of the economy.

The results of the Institute for Supply Management December 2008 Semiannual Economic Forecast show just how widespread that pessimism is.

Business investment, a major driver in the U.S. economy, is expected to decline as both sectors expect a combined 7.6 percent decline in capital spending. Sixty-five percent of survey respondents expect revenues to be the same or smaller in 2009 than in 2008. The panel of purchasing and supply executives expects a 1.1 percent net decrease in overall revenues for 2009, compared to a 2.2 percent decrease reported for 2008.

Manufacturing Summary

Manufacturing industries expecting improvement over 2008 — listed in order — are: Petroleum & Coal Products; Electrical Equipment, Appliances & Components; Printing & Related Support Activities; Miscellaneous Manufacturing; Food, Beverage & Tobacco Products; Apparel, Leather & Allied Products; and Chemical Products. Industries expecting a decline over 2008 — listed in order — are: Primary Metals; Nonmetallic Mineral Products; Fabricated Metal Products; Textile Mills; Computer & Electronic Products; Machinery; Paper Products; Furniture & Related Products; Transportation Equipment; and Plastics & Rubber Products.

In the manufacturing sector, respondents report operating at 75.2 percent of their normal capacity, down from 78.6 percent reported in April 2008. Purchasing and supply executives predict that capital expenditures will decrease by 6.7 percent in 2009, compared to a 5.9 percent increase reported for 2008.

Survey respondents also forecast that they will reduce inventories in an effort to decrease their purchased inventory-to-sales ratio in 2009. Manufacturers have an expectation that employment in the sector will decline by 2.7 percent, while labor and benefits costs are expected to increase an average of 1.9 percent in 2009.

Manufacturing purchasers are predicting

Manufacturing: Summary of Forecasts for 2009

- Production capacity increase by 2.1 percent
- Capital expenditures decrease 6.7 percent
- Overall 2009 prices paid decrease 2.6 percent
- Labor and benefit costs increase 1.9 percent
- Manufacturing employment decrease 2.7 percent
- Manufacturing revenues (nominal) down by 1.1 percent
- Overall attitude of manufacturing management: pessimistic, with 80 percent of respondents predicting 2009 will be the same or worse than 2008.

strength in exports but weakness in imports. They also expect the U.S. dollar to strengthen on average against the currencies of major trading partners.

The panel also predicts the prices they pay will decrease 2.3 percent during the first four months of 2009, and will decrease an additional 0.3 percent during the balance of 2009, with an overall decrease of 2.6 percent for 2009. Respondents' major concerns are: weak economy/recession; credit crisis; consumer spending; automobile industry; and housing.

Survey respondents expect to realize supply chain improvements through new or improved enterprise technology; cost reduction; supplier consolidation; improved inventory management; and improved supplier management practices.

Non-Manufacturing Summary

Thirty-six percent of non-manufacturing supply management executives expect their 2009 revenues to be greater than in 2008. They currently expect a 0.7 percent net increase in overall revenues for 2009 compared to a 2.6 percent decrease reported for 2008.

Non-manufacturing industries expecting revenue improvement in 2009 over 2008 — listed in order — are: Information; Accommodation & Food Services; Health Care & Social Assistance; Wholesale Trade; Other Services**; Retail Trade; Utilities; and Management of Companies & Support Services.

Industries expecting revenue decreases in 2009 — listed in order — are: Professional, Scientific & Technical Services; Arts, Entertainment & Recreation; Construction; Finance & Insurance; Agriculture, Forestry, Fishing & Hunting; Public Administration; Educational Services; Transportation & Warehousing; and Real Estate, Rental & Leasing.

Respondents in non-manufacturing industries expect that the prices they pay for materials and services will increase by 2.3 percent during 2009. They also forecast a 1.5 percent increase in their overall labor and benefit costs for 2009.

Survey respondents indicate they have achieved an average of 55.2 percent of potential benefits from application of technology to supply chains, and that the increased use of technology and analytical tools is the most frequently cited means of improving supply chains in 2009. Other improvement approaches include: product rationalization and value analysis; supplier consolidation; contract management strategies; and improved supply management processes.

Other Highlights from the Report: Production Capacity

Production capacity in manufacturing decreased 0.8 percent in 2008 as 36 percent of purchasing and supply executives reported an average capacity increase of 10.3 percent, 23 percent reported decreases averaging 20 percent, and 41 percent reported no change. This compares to a predicted increase of 2.5 percent for 2008 made in April 2008. Expectations for 2009 are for an increase of 2.1 percent.

The capacity to produce products or provide services in the non-manufacturing sector increased 0.3 percent during 2008. This is less than the 1.5 percent increase reported in December 2007 for 2007, and is less than the prediction in April 2008 of a 3.9 percent increase in 2008. For 2009, a larger increase (0.6 percent) is predicted.

Capital Expenditures – 2008 vs. 2009

Manufacturing purchasing and supply executives expect capital expenditures to decrease 6.7

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percent in 2009. The 13 percent of respondents who predict increased capital expenditures in 2009 indicate an average increase of 105.4 percent, while the 57 percent who said their capital spending would be reduced predict an average decrease of 35.8 percent; 30 percent said they expect to spend the same in 2009 as in 2008. Industries predicting increases in capital expenditures for 2009 — in order of percentage increase — are: Printing & Related Support Activities; and Food, Beverage & Tobacco Products.

Non-manufacturing purchasing and supply executives are expecting a decrease of 8.4 percent in capital expenditures from what they are reporting for 2008 (1.4 percent). The 20 percent of respondents expecting to spend more predict an average increase of 27.8 percent. An additional 50 percent anticipate a decrease averaging 27.5 percent. Wholesale trade is one industry expecting a decrease.

Prices Paid – predicted through April 2009

Twenty-seven percent of manufacturing purchasing and supply managers expect the prices they pay to increase in early 2009 by an average of 6.7 percent. At the same time, 47 percent anticipate decreases averaging 8.6 percent.

Non-manufacturing survey respondents predict that their purchases in the first four months of 2009 will cost an average of 1.4 percent more than at the end of 2008. This is less than the increase reported in the preceding section for all of 2008. Considering the prediction of price change for all of 2009 (2.3 percent), purchasing and supply executives apparently expect most of next year's price increase to occur in the first part of the year. Fifty percent of non-manufacturing respondents predict the prices they pay will increase an average of 6.7 percent in the first part of 2009.

Employment

ISM's Manufacturing Business Survey Committee members report that manufacturing employment decreased 4 percent since April 2008, and forecast that it will decrease 2.7 percent in 2009.

Twelve percent expect employment to be 9.5 percent higher, while 43 percent predict employment to be lower by 9 percent. Non-manufacturing employment has decreased 3.2 percent since April 2008. They forecast employment will decrease 1.3 percent by the end of 2009.

Imports and Exports

Purchasers for manufacturers expect a contraction in imports in the first half of 2009. Of the 85 percent of purchasers who reported they import, 30 percent predict an increase in their imports over the next half year, while 33 percent predict a decrease in imports of materials.

Non-manufacturers have lower expectations for use of imports for the first half of 2009 than they did in December 2007 for the first half of 2008. Of the 40 percent of non-manufacturing organizations who reported they import, 22 percent predict an increase in their imports during the first half of 2009. Twenty percent of the respondents predict a decrease in imports of materials and services.

The responses for this semiannual report indicate purchasers see increases in new export orders for the first half of 2009. This is inconsistent with the most recent ISM New Export Orders Index data in the monthly Manufacturing ISM Report On Business®, which has shown a contraction in new export orders in the last two months. Of the 79 percent of respondents who export, 36 percent predict an increase over the next half-year. Nineteen percent of respondents predict a decrease in their exports.

For the first half of 2009, non-manufacturing supply managers who report their organizations engage in exporting feel less optimistic than they did one year ago concerning their export business. Wholesale Trade was among the industries expecting an increase in export business.

Changes to Supply Chain Practices

A significant majority of manufacturing respondents (66 percent) indicated that they would be taking new steps in 2009 to improve their supply chain management practices. The changes include new or improved enterprise technology, cost reduction plans, supplier consolidation, improving inventory management, and improving supplier management practices.

Sixty-seven percent of non-manufacturing respondents stated they would be taking steps regarding supply chain improvements in 2009. The most frequently cited approaches include increased use of technology and analytical tools, product rationalization and value analysis, supplier consolidation, contract management strategies, and improving supply processes.

Outlook for the Next 12 Months

Supply management executives are pessimistic about conditions over the next year. More than half of respondents expect conditions to worsen. Only 20 percent of manufacturers and 16 percent of non-manufacturers indicated they had a better outlook for the coming months.

- Jenel Stelton-Holtmeier

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MDM 2008 Index

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Industrial & Construction Markets Update

VOL. 38, NO. 24 | DECEMBER 25, 2008

Distributors Alter Strategies to Offset Sector Weaknesses

According to a report released by RSM McGladrey, executives of U.S. wholesale-distributors have altered their growth and operational strategies to offset sector weaknesses and the rising costs of doing business, mainly associated with labor and energy.

RSM McGladrey's Distribution Industry Report was extracted from the results of the firm's 2008 Manufacturing and Wholesale Distribution National Survey conducted earlier this year. More than 960 industry executives, including 303 Distribution executives from 284 companies responded to the survey.

According to the survey, business conditions for many distribution companies have declined.

Thirty-eight percent of those surveyed described their companies as "thriving and growing," a decline of 21 percent from RSM McGladrey's 2006 survey. However, many executives retain some measure of optimism, as 45 percent reported their company as "holding their own."

Economic concerns have caused many distribution companies to alter their growth strategies for the upcoming year. Increasing brand recognition is the most popular growth tactic cited, increasing from 44 percent in 2007 to 49 percent this year. Strategies that saw a sharp decline – according to the survey – include vertical integration, creating private label products and growing with large retailers.

Mergers and acquisitions have also been a prominent growth strategy in the past, but executives that plan on engaging in such activity dropped from 48 percent in 2007 to just 18 percent in 2008. This is most likely due to the tightened credit markets in the U.S., as well as lower valuations.

Distribution companies, inherently dependent on logistics and billing, have increased their spending and reliance on

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HD Supply White Cap, an HD Supply company, has opened a 44,000 square foot distribution center and regional offices in Arlington, Texas. The facility will improve inventory availability throughout the South Central markets by consolidating all purchasing, receiving and distribution activities for more than 300 vendors.

Avnet, Inc. entered a joint venture agreement with **Sanko Holding Group** in Turkey. Avnet will acquire a 50.01 percent interest of the joint venture, which will include the operations of Akora Technology and Industry Corporation, a Sanko affiliate company, making the joint venture one of the largest IT distributors in Turkey.

The Bosch Group has acquired the power tool accessories business of the **Freud Group**, Milan, Italy. The Freud Group is a global supplier of circular-saw blades, router bits, and cutters for woodworkers, professional and industrial users, with sales of 100 million euros in 2007 (US$138.71 million).

Barnes Group Inc., Bristol, CT, international aerospace and industrial components manufacturer and logistical services company, has sold several of its units in the UK. The UK Motalink business, Corsham, England, was sold, as well as certain assets of its UK direct sales to car dealerships unit, and the systems and catalog unit. The Logistics and Manufacturing Services management team in Europe is also exiting the Corsham facility, eliminating the telesales and back office functions currently at the site.

Crane Co., Stamford, CT, a diversified manufacturer of highly engineered industrial products, acquired **Friedrich Krombach** GmbH & Company KG Armaturenwerke and **Krombach International** GmbH, both of Kreuztal, Germany. Krombach is a manufacturer of specialty valve flow products for the power, oil and gas, and chemical markets, employing 640 people globally.

84 Lumber has closed another five stores and two truss plants in the last week, according to Home Channel News. In addition, 28 positions at the corporate level were eliminated in the last three weeks. The Pennsylvania-based lumberyard chain closed 20 stores in October.

Actuant Corp., Milwaukee, WI, reported sales of $380 million for the first quarter ended Nov. 30, a decline of 8 percent over the same period a year ago. Excluding the impact of currency exchange rates and acquisitions, sales declined 11 percent. Profit dropped 58 percent to $11.6 million.

More manufacturers reported cost cuts, including **Gibraltar Industries** Inc., Buffalo, NY, and **Regal Beloit Corp**., Beloit, WI. Regal Beloit is a $1.8 billion manufacturer of mechanical and electrical motors and generators. Gibraltar Industries will close its Enterprise, MS, facility and consolidate its operations into two other existing facilities. Regal Beloit is closing a Leeson Electric plant. **Baldor Electric**, Fort Smith, AR, will cut an estimated 900 jobs by next June through attrition and retirement.

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MDM News Digest
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Titan Machinery Inc., Fargo, ND, has agreed to acquire **Western Plains Machinery** Co., and **WP Rentals** consisting of nine construction equipment locations in Montana and Wyoming. The acquisition will expand Titan's footprint into those two states.

Illinois Tool Works Inc., Glenview, IL, reported an operating revenue increase of 2.4 percent for the three months ended Nov. 30, 2008. Revenue growth was driven by contributions from acquisitions. Base revenues were negative for the three month period as North American and international end markets declined significantly in the month of November.

In a pre-close statement for the year ending Dec. 31, 2008, **Bunzl** plc reported group revenue was consistent with expectations. The group experienced growth in all geographic areas, led by acquisitions in most areas.

Avnet Technology Solutions, an operating group of Avnet, Inc., has launched its solutions distribution business in China, expanding its geographic footprint in the Asia Pacific region. Avnet Technology Solutions, China, builds on and extends Avnet's existing integration and components businesses in China.

Executives of U.S. wholesale-distributors have altered their **growth and operational strategies** to offset sector weaknesses and the rising costs of doing business, mainly associated with labor and energy, according to a report released by RSM McGladrey. Increasing brand recognition is the most popular growth tactic cited, increasing from 44 percent in 2007 to 49 percent this year. Strategies that saw a sharp decline – according to the survey – include vertical integration, creating private label products and growing with large retailers.

In constant dollars, **Canadian manufacturing sales** decreased 1.8 percent compared with September, bringing constant dollar sales to their lowest level since December 2001. In October, eight of 21 manufacturing industries, accounting for about 40 percent of total sales, posted decreases. The Canada/U.S. exchange rate, as well as a notable decrease in the price of petroleum and coal products, both affected October's manufacturing results.

U.S. industrial production decreased 0.6 percent in November with declines widespread across industries. Manufacturing production dropped 1.4 percent in November despite the resumption of activity in the commercial aircraft industry after the resolution of a strike early in the month. At 106.1 percent of its 2002 average, total industrial production in November was 5.5 percent below its level of a year earlier. The capacity utilization rate for total industry fell to 75.4 percent, a level 5.6 percentage points below its average level from 1972 to 2007.

Canadian industries operated at 77.4 percent of their capacity, down from 77.7 percent in the second quarter, according to Statistics Canada. This was the rate's lowest level since data were first kept in 1987. The rate in the third quarter of 2008 was 9.7 percentage points below its peak of 87.1 percent reached in the fourth quarter of 2000. In the transportation equipment manufacturing industry, almost two-thirds of which consists of automobile and parts manufacturers, capacity utilization fell for the fourth consecutive quarter to 71.1 percent, the lowest since the fourth quarter of 1992.

The **Producer Price Index for Finished Goods** fell 2.2 percent in November, seasonally adjusted, the Bureau of Labor Statistics of the U.S. Department of Labor reported. This decline followed decreases of 2.8 percent in October and 0.4 percent in September. At the earlier stages of processing, prices received by manufacturers of intermediate goods dropped 4.3 percent in November after falling 3.9 percent in the prior month, and the crude goods index declined 12.5 percent subsequent to an 18.6-percent decrease in October.

Privately-owned housing starts in November were at a seasonally adjusted annual rate of 625,000, 18.9 percent below the revised October estimate of 771,000 and is 47 percent below the revised November 2007 rate of 1,179,000. Single-family housing starts in November were at a rate of 441,000; this is 16.9 percent below the October figure of 531,000. The November rate for units in buildings with five units or more was 166,000.

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Manufacturers Alliance/MAPI Forecast: Canada on 'Shaky Ground'

MARKETS UPDATE SUPPLEMENT P. 3

The Canadian economy is on "shaky ground" and is headed for a short and relatively shallow recession, according to a new Manufacturers Alliance/MAPI report.

In Review of the Canadian Economy, 2008-2009, Jeremy A. Leonard, MAPI economic consultant, contends that formerly strong domestic consumption and investment have reversed course, the high commodities boom that once buoyed Canada's large natural resource sector has stalled, and the U.S. recession has put further downward pressure on demand for the nearly 25 percent of Canadian production that is sold in U.S. markets.

Real gross domestic product (GDP) growth slowed to 1.3 percent at an annualized rate in the third quarter of 2008.

The consensus forecast is for a 0.9 percentage point decline in real GDP in 2009, reflecting substantial declines in exports as well as a drastic slowdown in domestic demand.

The Canadian manufacturing sector, which has been in recession for most of the past two years, will be harder hit than the economy as a whole, with industrial production forecast to decline by a further 3.2 percent in 2009.

This decline, though, is expected to occur in the first half of the year, with growth returning to slightly positive territory by the third quarter of 2009, contingent on improvement in the U.S. economy.

The main pockets of weakness are concentrated in several large industries: transportation equipment, fabricated metals, and rubber products, which together account for 30 percent of total manufacturing production.

In a forecast of selected economic indicators for 2009, the report indicates that pre-tax corporate profits are expected to decline by 12.2 percent, exports to decline by 5.3 percent, and imports to decline by 2.2 percent.

Consumer spending is anticipated to grow by 1 percent, and real disposable income should increase by 0.9 percent.

The unemployment rate has edged up to 6.3 percent but is below the U.S. rate for the first time in over 30 years.

According to Leonard, most forecasters predict that it will gradually rise to about 7.5 percent by late 2009.

In spite of the seemingly gloomy outlook, Canada's economy remains on more solid footing that that of the United States for several reasons.

"First, Canadian consumers have more potential spending liquidity than their American counterparts due to strong income growth, and Canadian households have more savings to dip into to sustain consumption through this cyclical downturn," Leonard said.

"Second, there is virtually no sub-prime mortgage market in Canada, and as a result homeowners are in dwellings they can afford. Finally, the general health of financial institutions is much better, largely due to a more stringent regulatory environment.

"Despite the rather dismal outlook," he added, "the structural underpinnings of the Canadian economy are firmer than in the U.S."

Canada Wholesale Revenues Fall 1.8% in October

Wholesale sales fell 1.8 percent to $45.3 billion in current dollars in October, following a 1.1 percent increase in September, according to Statistics Canada. Declines in the recycled metals industry and the automotive sector were the main contributors.

In terms of the volume of sales, which take price fluctuations into account, wholesale sales were down 3.6 percent.

This was due in part to the impact of the depreciation of the Canadian dollar on import prices. In addition, export demand for Canadian goods, a significant part of which flows through wholesale markets, was down. Canadian wholesalers sell to both the domestic and international markets, and are active importers and exporters.

In October, four out of seven sectors reported lower sales. The largest decline (-8.0 percent) occurred in the "other products" sector, which registered its biggest monthly drop since March 2001. A significant fall in both demand and prices for recyclable metals was the main contributor to the decline in this sector.

After a partial recovery in September, sales of automotive products fell 5.4 percent in October to $6.9 billion. Almost all of the decrease was the result of a decline in the sales of motor vehicles, which fell 6.9 percent, erasing all of the gains made in September. Sales of motor vehicle parts and accessories were down 0.5 percent, after registering a large increase in September. The automotive sector continued to be the only

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Canada Wholesale Revenues

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sector with lower sales on a year-over-year basis.

Among all sectors, the food, beverages and tobacco sector showed the largest monthly increase, advancing 1.8 percent. Sales in the machinery and electronic equipment sector rose 0.4 percent in October, its eighth consecutive monthly increase.

By Province

Overall, seven provinces registered lower sales in October.

After posting increases in September, wholesalers in Ontario and Quebec reported lower sales in October. Sales were down 2.6 percent in Ontario and 1.7 percent in Quebec. Lower sales in the "other products" and automotive sectors were the major factors behind the decreases in both provinces in October.

Of the four western provinces, three reported lower sales in October. Manitoba recorded the biggest drop (-4.1 percent), its third decline in as many months, while sales in British Columbia were down 1.9 percent. Declines in both provinces were mainly due to the "other products" sector.

The only increase occurred in Alberta, where sales rose 1.5 percent on the strength of the building materials and machinery and electronic equipment sectors.

Within the Atlantic provinces, New Brunswick posted its first decline (-4.5 percent) in October after six consecutive months of growth.

Inventories Grow

In October, wholesale inventories rose for an eighth consecutive month, up 0.8 percent.

Distributors Alter Strategy

Continued from p. 1 of this section

information technology (IT). Eighty percent of distributors report that IT is increasingly critical to their business, while 75 percent plan on expanding the use and functionality of existing systems.

More than half of respondents indicated that their companies plan to align their IT strategy with their business plan (66 percent), implement new technologies (55 percent) and train employees to use their current systems more effectively (53 percent).

Despite the importance of IT to the distribution industry, the survey indicates that many companies have significant weaknesses pertaining to risk management.

Almost 25 percent of executives surveyed do not have effective disaster recovery systems, test their network security at least once a year or expect to increase their spending on information security.

Some of the ways that companies are combating changes in costs include looking at self-insurance, especially those in the $100 million to $500 million revenue size. While in the past larger companies have used self-insurance as a way to approach plan administration costs, smaller companies are now exploring self-insurance, as well.

Companies are also looking at wellness programs as a way to combat healthcare costs, according to the survey.

Over 60 percent of companies with more than $500 million in annual revenues report that they employ a wellness program, while only 18 percent of companies with less than $25 million in revenue implement such a strategy. Disease management programs are also utilized.

Many distribution companies are also embracing green initiatives. Almost half of the largest distributors, as well as many smaller companies are being asked by their customers to become more environmentally-friendly.

But many companies have also taken such steps on their own, with 38 percent of executives reporting a reduction in non-recyclable waste and 23 percent eliminating the use of certain chemicals.

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