

Intelligence for Wholesale Distribution Professionals

## Find Savings in Leases

*Distributors prioritize and renegotiate real estate costs*

*This article looks at one way wholesaler-distributors of all sizes are saving money and boosting their bottom lines: by renegotiating leases. The author looks at why it's a good time to renegotiate, where to start when renegotiating lease terms, and what to offer in return for lower rates.*

**By Jenel Stelton-Holtmeier**

When the real estate market crumbled, the market price for leasing business space also took a hit. Yet most companies continued to pay the higher rates because they were locked into leases.

That was the case for KAR Industrial Inc., Toronto, Ontario. "Our lease rates were significantly higher than fair market value, higher by as much as 15 to 35 percent," said Ward Meek, KAR president and CEO.

Instead of just accepting that, KAR began approaching the landlords at four of its five facilities to see if they would be willing to negotiate. The move paid off. On one lease, the company got the landlord to agree to a 20 percent reduction in payments.

In these tough economic times, companies are looking for any way to cut costs. But many have overlooked opportunities for saving money by renegotiating existing leases.

"It's a tough time for landlords right now," says Andrew Mittler, a buyer and seller of corporate real estate based in California. "Where they used to have the upper hand on setting the prices, they're now showing more willingness to meet the needs of their tenants."

### When to Begin

When Wilkes-Barre, PA-based Benco Dental realized it was spending nearly as much on real estate for its 50 locations as the

profit it was making each year, the dental laboratory equipment distributor decided some changes needed to be made.

"The real estate expenses just kind of snuck up on us, in part because we had no one managing them," Benco President Chuck Cohen says. "And we just didn't notice because it wasn't a single line item. Instead, it was just an individual expense that showed up on the individual P&Ls for each region."

The company hired Kaare Birkeland, an independent real estate consultant with Birchland Development Co., Minnetonka, MN, to help bring those expenses under control. After an initial review, Cohen says the company expects to realize savings of up to 40 percent on their real estate portfolio over the next three to four years. While the total savings package also includes closing some locations and downsizing others, new lease terms will make up a significant portion.

"It's a great time to be looking at these types of negotiations, especially for leases that are nearing termination," Birkeland says. "With the market down, landlords realize they have to be looking longer term with their tenants."

Mittler agrees: "It's in the landlord's best interest, particularly in this economy, to keep a tenant. After all, the worst thing for a landlord is to lose a tenant and not have anyone to replace them. And right now, there just aren't any new tenants."

And Mittler doesn't see any improvement in demand for space in the next six months. "The reality is until jobs start to pick up, there's just not going to be any demand for more space," he says.

While any company can benefit from renegotiating its leases, in the current economic climate two types of companies

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**PERSPECTIVE** ■ *Commentary by Thomas P. Gale***November Will Be a Barometer for 2010**

Overall news is much more positive, as Adam Fein points out in his Oct. 20 blog at [www.distributiontrends.com](http://www.distributiontrends.com). Fein is raising his forecasts for industrial distribution with “slightly positive” year-over-year growth in the first quarter of 2010. The weakening dollar also is helping exports. All good. But few distributors expect a straight-line rebound like the good old days. There are too many important moving parts zig-zagging in different directions to have a smooth recovery this time around. While August was good news for many distributors, September was mixed. The coasts seem to be gaining more traction and that typically leads us both into and out of recessions.

I think the real payoff pitch will be the month of November, and many distributors are concerned about a fastball to the head. Here’s why I’m seeing that as a bellwether month in this final quarter.

November will give a better indication of how well manufacturing will offset expected weak consumer drivers outlined below. It will also be a decision time for delayed capital projects – from infrastructure to IT projects that are critical to supporting anticipated 2010 growth. Other factors:

**Consumer spending.** No one is bullish on consumer holiday spending. We are in late

October and consumer debt and confidence are still troubling. We have likely not seen the peak of unemployment. Fourth quarter retail won’t be driving the recovery. But there seems to be some beginning impacts of the huge government infusion finally having an impact on certain sectors – good for distributors in those areas.

**Gross margins, pricing pressures.** Every distributor is intensely focused on cost control. Most are stretching resources right now, from staff to credit access to inventory availability. At a time when sales are rebounding and your company is scrambling to meet spiking customer service demands, competitors are getting nasty (or nastier).

As an upcoming article in MDM will describe in more depth, many distributors are in dogfights for market share right now. Some larger distributors are strategically going after specific customer sets and getting aggressive on pricing. Not a surprise at this point in the business cycle but it is a profitability drag at a critical point in stabilizing your business.

For a timely and in-depth analysis on how these factors and more are shaping up for 2010, be sure to attend our 2010 Economic Forecast for Wholesale Distribution Webcast with Dr. Adam J. Fein on Nov. 19. More information on this event is at [www.mdm.com/events](http://www.mdm.com/events). ■

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## Find Savings in Leases

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could have an edge in the process, Mittler says: companies that are financially sound in spite of the economy and historically strong companies that have come upon rough times.

It's easy to understand why currently strong companies would have an edge: They aren't likely to abandon the space because they go out of business, Mittler says. But that same reasoning is why struggling companies should consider renegotiating the terms of their leases.

"If you say to the landlord, 'Help us or we're going to be out of business,' odds are he'll listen to you and consider the situation," he says. "A landlord understands that 70 percent of the current rate is far better than 100 percent of nothing."

But the process does require some research and planning on the part of the tenant.

### Where to Begin

"The situation is different for every company," Birkeland says. Size and location will play major roles in determining the best course of action.

The first step should always be determining the long-term plan for your company, Birkeland says. "It's not just about what works today, but what will work for you tomorrow."

Companies need to be careful about cutting themselves off from markets they will want to be in when things turn around, or limiting space for expansion when orders ramp up. At the same time, there is room for most companies to improve how they use the space they already have.

When Benco began looking at its 50 locations, it realized there were significant discrepancies in what each location had. "We have one location in an urban area that basically has a state-of-the-art conference center that may only get used four times a year," Cohen says. "Yes, it's the nicest showroom in the area but at \$150,000 per year, it may be a little excessive."

Applying a standard across a company regardless of location creates a consistent brand, easily recognized by clientele; at the same time, it can help a company better manage costs by providing a better understanding of needs across the company, Birkeland says.

Establishing the standard before implementing significant changes can also help sell the idea to managers who may have different ideas of what they "need" as well, Cohen says. "I'm expecting some pushback when I start telling them that we're changing things, but this approach

will help us explain that it's not just them."

The next step is research. If you're planning on telling your landlord you're paying more than market value, you need to know what the market value is, Mittler says.

"And the key is not to find out what landlords are asking," Mittler says. "What you want to know is what landlords are accepting."

Tenants should also work to understand the landlord's situation, as that will have an impact on his willingness to enter into negotiations. For example, if the building they are in is managed by a bank or receiver, it may be more difficult to negotiate with the property manager. "They don't care to. They don't need to," Mittler says. "All they want to do is sell the property as quickly as they can."

The approach a company takes when actually entering the negotiation phase will depend in large part on the complexity of the lease. Simple leases may not require outside help, but leases that are several pages long could have inexperienced negotiators bickering over small things, Birkeland says. Brokers and real estate consultants will know which small things to let go to keep moving forward.

In addition, the relationship the company has with the landlord could impact whether seeking outside counsel for the negotiations will be the most effective way approach.

"If you're on friendly terms with the lease holder, go ahead and approach them directly," Mittler says. "Explain your situation, but also be open to understanding their situation."

If you have a more distant relationship, you may want to consider hiring a broker to approach the property manager. Either way, don't start the negotiations from an adversarial position. "The last thing you want to do is start the process with a letter or phone call from your lawyer," Mittler says.

### What to Offer

Anytime you're working with legal contracts and agreements, there will be challenges, Mittler says. "You have to be prepared to offer something to the landlord in exchange for the benefits you're seeking."

This can be as simple as offering to enter into an agreement for more years at a lower rate, or offering a lump sum payment up front as an exchange for vacating some of the space. Or

continued on the next page

setting up an agreement to sublease part of the space for a period of time.

"Too many people are coming in and saying 'Just get me out of the lease,' and that's the wrong approach for the long-term," Birkeland says. Options exist as long as both parties are open to communicating about the situation.

"I don't think anyone in this business considers real estate to be a real competitive advantage. But what it is, is a real opportunity for cutting costs," Benco's Cohen says.

"But first you have to identify that there is a problem and that there is an opportunity to resolve that problem."

## Inflation by Commodity Group

### Pricing trends for the third quarter 2009

These select product groups provide a snapshot of inflation trends based on the Producer Price Index from the U.S. Bureau of Labor Statistics. Third quarter 2009 is compared with third quarter 2008, third quarter 2009 with second quarter 2009.

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Adhesives & Sealants

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Ball & Roller Bearings  
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Softwood Lumber  
Metal-Forming Machine Tools  
Metal-Cutting Machine Tools

#### Online Only ([www.mdm.com/databank](http://www.mdm.com/databank))

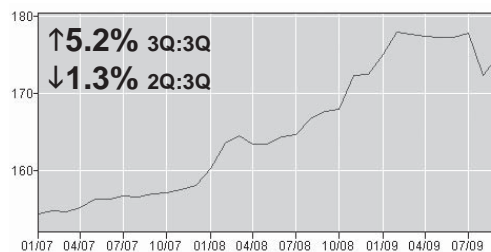
Electrical Machinery/Equipment  
Industrial Material Handling Equipment  
Hardboard, Particleboard, Fiberboard Products  
Hardwood Lumber  
General Millwork  
Plywood  
Construction Products from Plastics  
Gypsum Products  
Air Conditioning & Refrigeration Equipment  
Tools, Dies, Jigs, Fixtures, Industrial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

#### Key

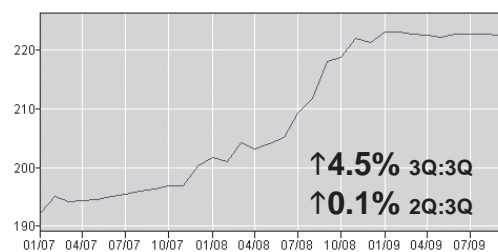
↑11.6% 2Q:2Q (3Q '08 with 3Q '09)

↑1.8% 1Q:2Q (2Q '09 with 3Q '09)

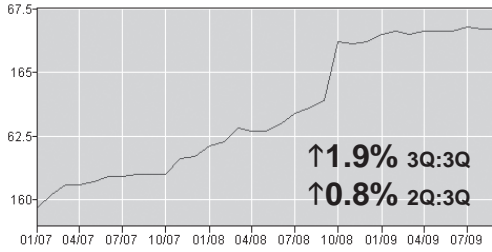
#### Abrasives



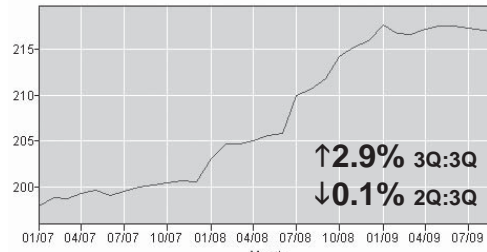
#### Adhesives & Sealants



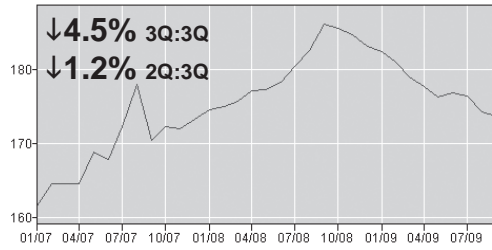
### Cutting Tools & Accessories



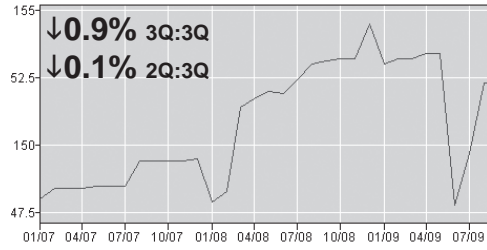
### Hand & Edge Tools



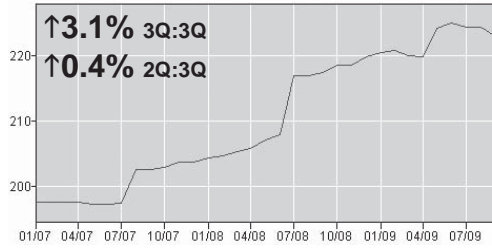
### Fasteners



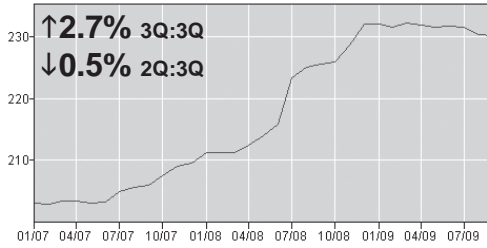
### Power-Driven Hand Tools



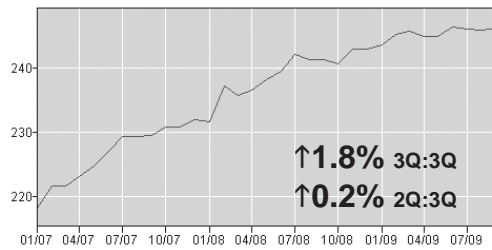
### Ball & Roller Bearings



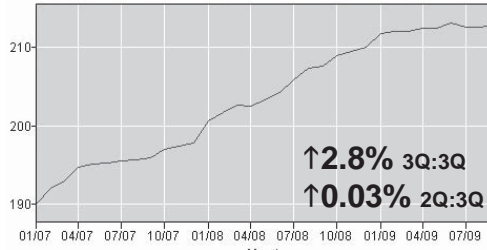
### Mech. Power Transmission Eqpt.



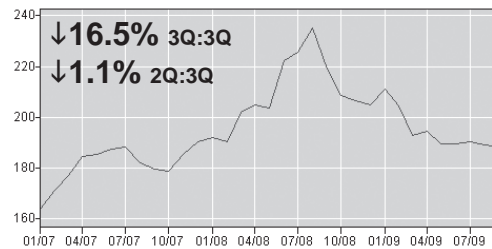
### Valves, Except Fluid Power



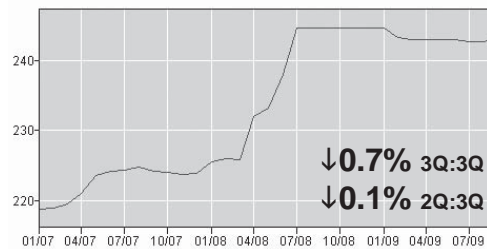
### Pumps, Compressors & Eqpt.



### Industrial Gases



### Welding Machinery/Equipment

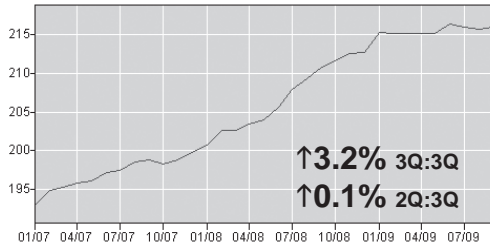


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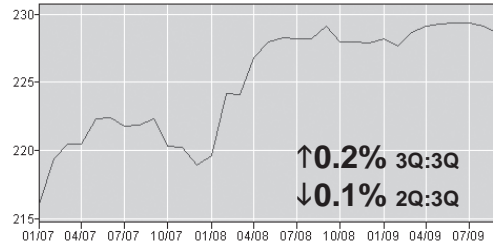
Go to *Inflation by Commodity Group in the Current Issue* at [www.mdm.com](http://www.mdm.com) to view the entire set of graphs.

**Inflation by Commodity Group from p. 5**

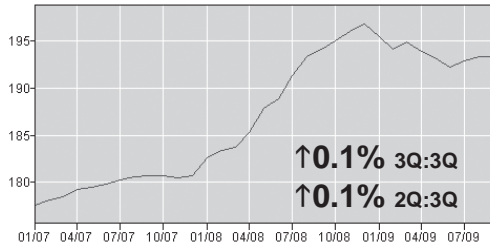
**Fluid Power Equipment**



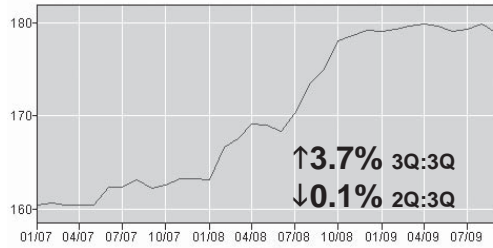
**Plumbing Fixtures & Fittings**



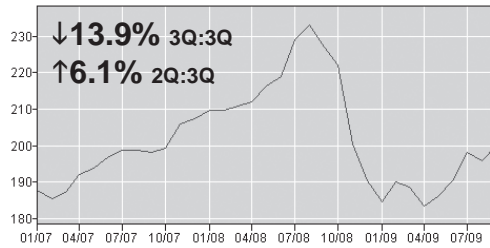
**Hardware**



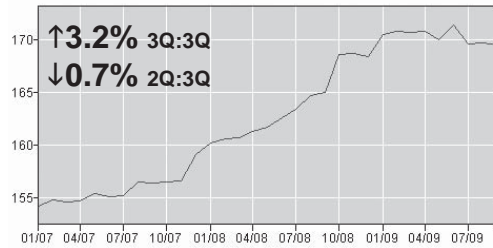
**Sanitary Paper Products**



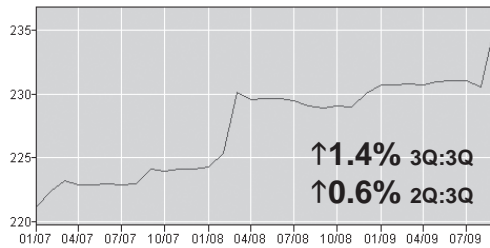
**Plastic Resins & Materials**



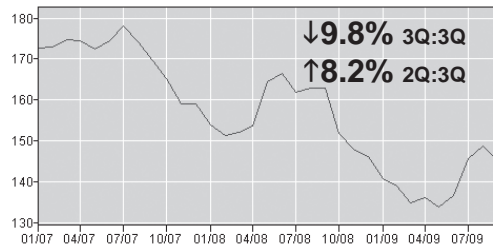
**Spec. Cleaning, Polish, San. Products**



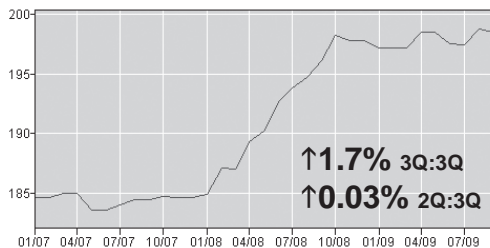
**Industrial Safety Equipment**



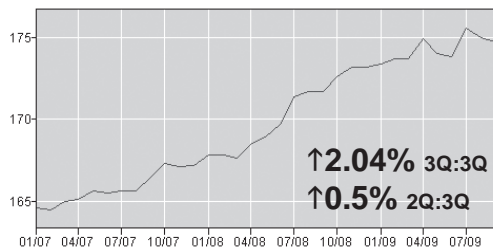
**Softwood Lumber**



**Metal-Forming Machine Tools**



**Metal-Cutting Machine Tools**

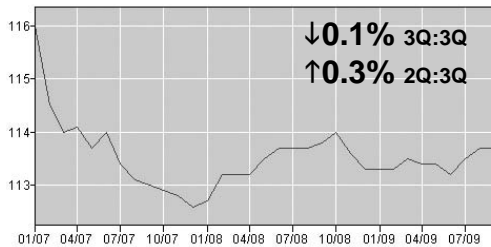


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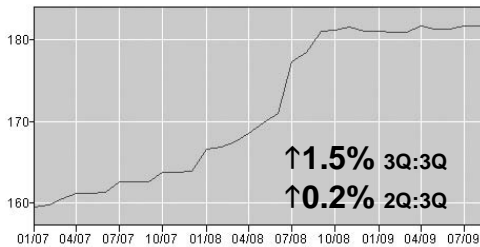
# MDM Inflation by Commodity Group cont.

Pricing trends for the third quarter 2009

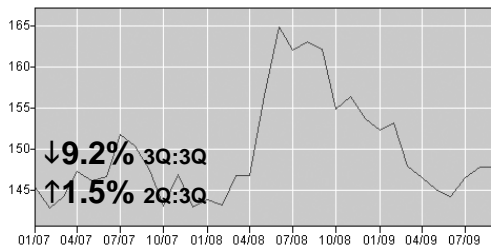
## Electrical Machinery/Equipment



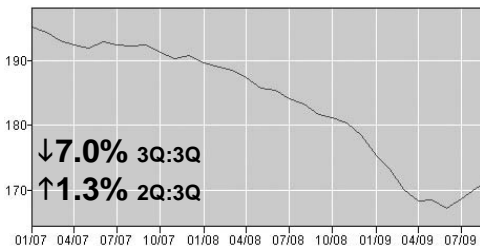
## Material Handling Eqpt. (Ind)



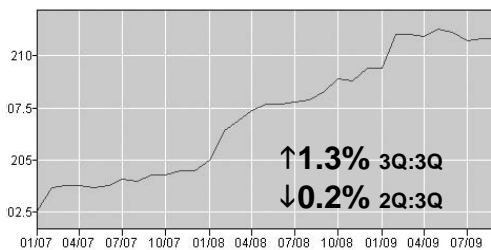
## Hardbd, Particlebd, Fiberbd Products



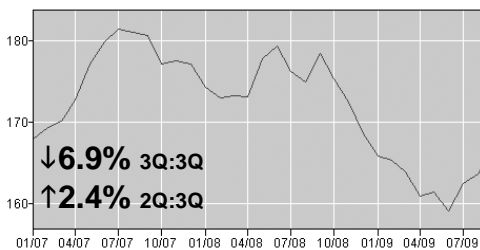
## Hardwood Lumber



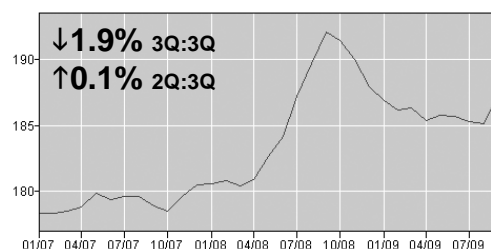
## General Millwork



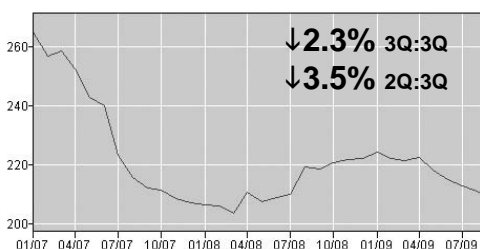
## Plywood



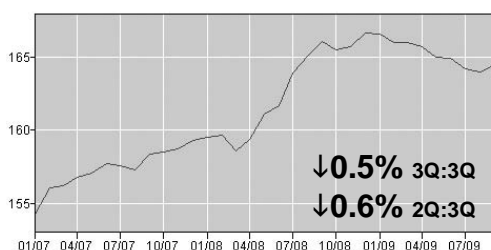
## Construction Products from Plastics



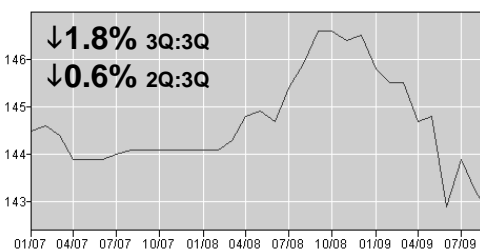
## Gypsum Products



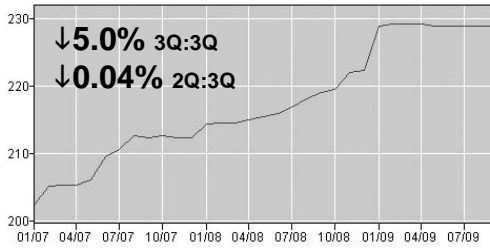
## Air Conditioning & Refrigeration Eqmt.



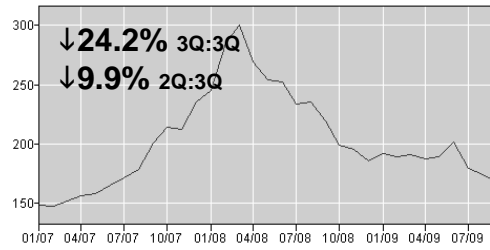
## Tools, Dies, Jigs, Fixtures, Ind. Molds



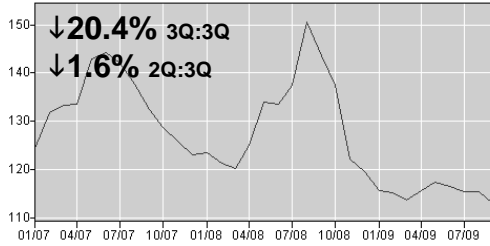
### Fluid Power Valves



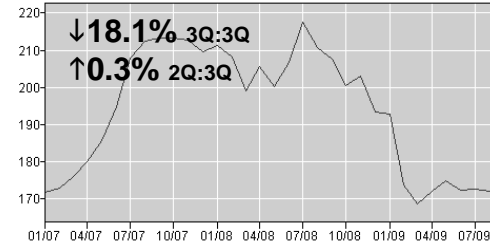
### Flour



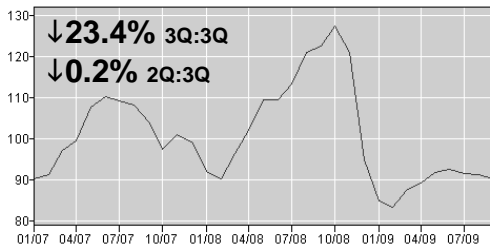
### Pork Products



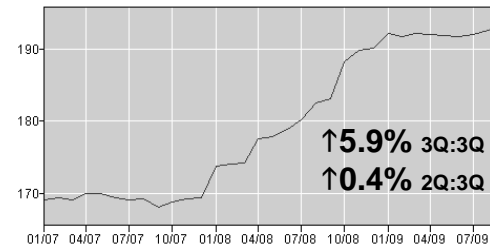
### Fluid Milk Products



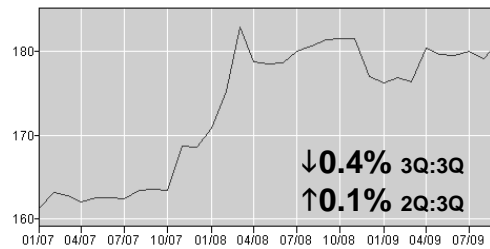
### Butter



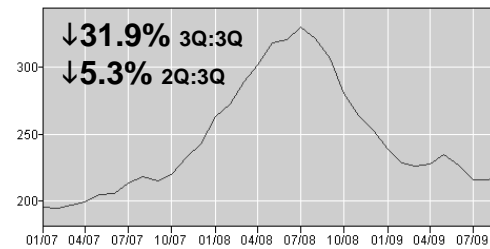
### Sugar & Confectionary



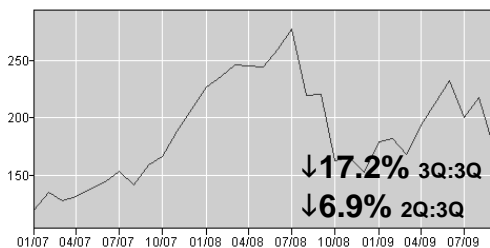
### Coffee



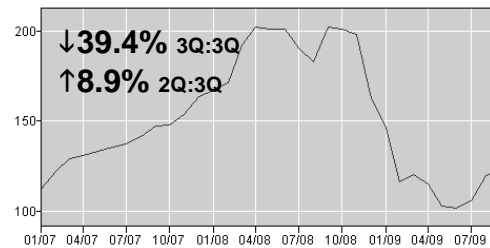
### Shortening & Cooking Oil



### Oilseeds

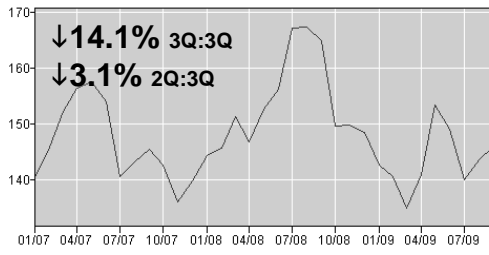


### Processed Eggs

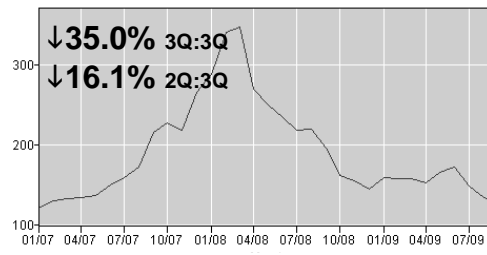




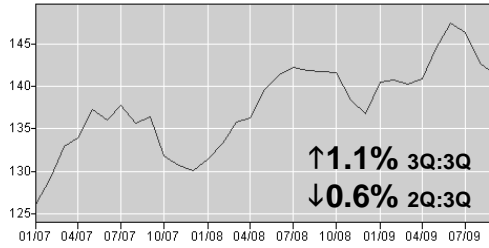
### Beef/Veal Products



### Wheat



### Processed Poultry



Source: U.S. Bureau of Labor Statistics, MDM Analysis  
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■ *Economic Update*

# Are Recent Signs Sustainable?

*Indicators are looking up, but a sustainable upward swing is not guaranteed*

**Industrial production** increased 0.7 percent in September, after a revised gain of 1.2 percent in August. Manufacturing production increased 0.9 percent.

While the sequential growth is a positive sign for a ragged economy, many factors will play a role in determining whether that growth is sustainable, says Thomas J. Duesterberg, president and CEO of Manufacturers Alliance/MAPI.

"The inventory cycle has further to run, and this should sustain growth in the fourth quarter," he says.

"But, capacity utilization remains well below historical level and final demand for finished goods and capital equipment remains subdued. We need support from consumers, from export markets, and from more robust investment in order to have confidence in stronger and more sustainable growth in 2010."

In August, the capacity utilization rate increased to 70.5 percent, 10.4 percentage points below its average for 1972 through 2008.

Here is a rundown of other key numbers released in the past month:

**U.S. housing starts** in September were at a seasonally adjusted annual rate of 590,000, 0.5 percent above August, but 28.2 percent below September 2008, according to the U.S. Census Bureau and the Department of Housing and Urban Development. Single-family starts were at a rate of 501,000, 3.9 percent above August.

In Canada, the **value of building permits** rose 7.2 percent in August to \$5.0 billion, according to Statistics Canada. The bulk of the increase was due to gains in Ontario and British Columbia. In the residential sector, the value of building permits increased 15.1 percent; in the nonresidential sector, the gain was 2.2 percent.

**Construction spending** in August increased slightly, up 0.8 percent from the revised July estimate to \$941.9 billion, according to figures released by the U.S. Department of Commerce. Residential construction spending was 4.7 percent above July. Nonresidential construction was 0.1 percent below July.

**Wholesale revenues** rose 1 percent in August to \$317.9 billion, the fourth consecutive increase. Sales are down 17.7 percent from a year

ago. The automotive (7.7 percent) and electrical (2.5 percent) categories posted the largest monthly gains for durable goods; petroleum and petroleum products (7.0 percent) led the nondurable goods. Inventories were down 1.3 percent from July.

**New orders for manufactured goods** decreased 0.8 percent to \$352.9 billion, the first decline in five months, according to the U.S. Census Bureau. Excluding transportation, new orders increased 0.4 percent.

The Institute for Supply Management's **New Orders Index** registered a 60.8 percent in September, lower than August's 64.9 percent but still representative of growth. This is the third consecutive month of growth on the New Orders Index.

ISM's September **Purchasing Managers Index** was 52.6 percent, slightly lower than the August PMI of 52.9 percent. Thirteen of the 18 manufacturing industries reported growth in August. Nearly a third of respondents to the **ISM Purchasing Managers' survey** expect their industries and companies to benefit from the American Recovery and Reinvestment Act. Thirty percent of industries and 27 percent of companies expect to derive "some benefit" from the stimulus program going forward.

Business Confidence Indexes were a mixed bag in September, representative of the continued discrepancy of recovery in different industries. The **AHMA's Home Improvement Industry Confidence Index** declined to 45.8 from 91.7 the previous month, while the **Electroindustry Business Confidence Index** rose 5.3 points to 58.6.

Builder confidence also slipped in October, according to the **National Association of Home Builders/Wells Fargo Housing Market Index**, falling one point to 18. Each of the index's components also posted declines for the month.

**Steel inventories**, in decline since early 2008, rose slightly in the U.S. and Canada in September, according to the latest report from the Metals Service Center Institute. Shipments of steel products remained down in a year-over-year comparison, but were higher than August levels.

**Aluminum inventories** continued to decline during the month.

## Monthly Wholesale Trade: Sales and Inventories for August 2009

August 2009 wholesale revenues were \$317.9 billion, up 1.0 percent from the revised July level, but down 17.7 percent from the August 2008 level. The July preliminary estimate was revised upward \$0.2 billion or 0.1 percent. August sales of durable goods were up 1.2 percent from last month and were down 18.8 percent from a year ago. Sales of motor vehicle and motor vehicle parts and supplies were up 7.7 percent from the previous month and sales of electrical and electronic goods were up 2.5 percent. Sales of nondurable goods were up 0.9 percent from last month, but were down 16.7 percent from last year. Sales of petroleum and petroleum products

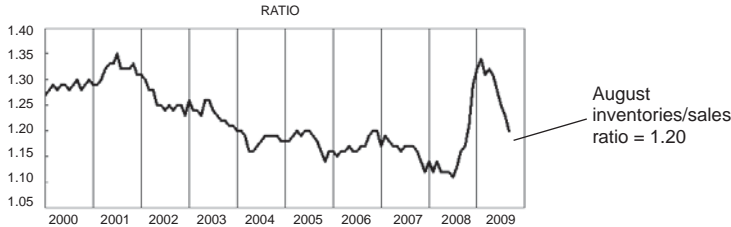
were up 7.0 percent from last month.

**Inventories.** Total inventories were \$381.2 billion at the end of August, down 1.3 percent from the revised July level and were down 14.7 percent from a year ago. End-of-month inventories of durable goods were down 1.6 percent from last month and were down 15.5 percent from last August. Inventories of metals and minerals, except petroleum were down 4.3 percent from last month and inventories of motor vehicle and motor vehicle parts and supplies were down 2.3 percent. End-of-month inventories of nondurable goods were down 0.9 percent from July, and were down 13.3 percent compared to last August. Inventories of paper and paper products were down 2.1 percent while inventories of drugs and druggists' sundries were down 1.9 percent.

**Inventory-Sales Ratio.** The August inventories/sales ratio was 1.20. The August 2008 ratio was 1.16.

Monthly Inventories/Sales Ratios  
of Merchant Wholesalers: 2000-2009

(Estimates adjusted for seasonal and trading-day differences, but not for price changes)



Source: U.S. Census Bureau

## Monthly wholesale trade: Sales and inventories August 2009

NAICS Code	Business Type	Sales \$ millions	Inventories \$ millions	Stock and Sales ratio	% Change in Sales 7/09-8/09	% Change in Sales 5808-8/09	% Change Inventory 7/09-8/09	% Change Inventory 8/08-8/09
42	U.S. Total	317,897	381,238	1.20	1.0	-17.7	-1.3	-14.7
423	Durable	141,168	233,410	1.65	1.2	-18.8	-1.6	-15.5
4231	Automotive	20,707	32,596	1.57	7.7	-12.9	-2.3	-24.2
4232	Furniture & Home Furnishings	4,321	6,451	1.49	-0.4	-15.8	-1.3	-19.7
4233	Lumber & Other Construction Materials	7,605	11,862	1.56	0.7	-21.4	-1.5	-21.1
4234	Prof. & Commercial Equip. & Supplies	27,982	28,145	1.01	-1.2	-7.6	-1.1	-15.0
42343	Computer Equipment & Software	14,244	9,129	0.64	-2.1	-6.2	-1.5	-19.5
4235	Metals & Minerals	8,037	18,495	2.30	0.5	-48.6	-4.3	-37.7
4236	Electrical Goods	24,788	29,591	1.19	2.5	-8.8	-0.6	-15.5
4237	Hardware, Plumbing, & Heating Equipment	5,873	12,996	2.21	-3.8	-13.6	-1.5	-11.0
4238	Machinery, Equipment & Supplies	24,579	68,177	2.77	-0.4	-20.4	-1.2	-2.7
4239	Miscellaneous Durable	17,276	25,097	1.45	0.7	-29.8	-1.1	-9.5
424	Nondurable Goods	176,729	147,828	0.84	0.9	-16.7	-0.9	-13.3
4241	Paper & Paper Products	7,300	6,497	0.89	1.9	-12.7	-2.1	-11.10
4242	Drugs	33,218	30,340	0.91	-0.1	1.3	-1.9	-9.1
4243	Apparel, Piece Goods & Notions	10,014	15,192	1.52	1.3	-5.9	-1.0	-8.3
4244	Groceries & Related Products	40,795	25,146	0.62	-0.9	-7.1	-2.1	-10.7
4245	Farm-product Raw Materials	15,755	16,237	1.03	-2.0	-24.7	-1.1	-34.0
4246	Chemicals & Allied Products	7,167	7,675	1.07	1.9	-21.8	-1.2	-24.6
4247	Petroleum & Petroleum Products	35,237	15,225	0.43	7.0	-38.4	3.6	-7.1
4248	Beer, Wine & Distilled Beverages	9,137	10,918	1.19	0.4	4.1	0.8	0.2
4249	Miscellaneous Nondurable Goods	18,106	20,598	1.14	-2.5	-11.0	-1.7	-10.9

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.

## Signs of Improvement in Manufacturing Index

Overall manufacturing activity is expected to contract over the next three to six months, but the composite index from the quarterly Manufacturers Alliance/MAPI Survey on the Business Outlook – September 2009 is showing signs of improvement. The September 2009 composite index rose to 38 from a near-historic low of 24 reported in the June 2009 report. It also represents the highest level since September 2008 when an index of 48 was recorded.

At 38, however, the index still indicates that overall manufacturing activity is expected to contract over the next three to six months, relative to the levels of one year ago when the economy was entering the severe recession.

The annual orders index, based on a comparison of expected orders for all of 2010 with orders in 2009, was a strong 66 percent.

The quarterly orders index, which compared new orders for the third quarter of 2009 with the same quarter one year ago, edged up to 11 percent from 6 percent in the previous survey.

The backlogs index, which compared the third quarter 2009 backlog of orders with the backlog of orders one year earlier, rose to 16 percent from 9 percent in the June survey. An accumulation of backlogs usually occurs when new orders exceed shipments.

The capacity utilization index, based on the percentage of firms operating above 85 percent of capacity, rose from 8.1 percent three months ago to 8.4 percent in the current survey. The profit margin index increased to 22 percent in September compared to 18 percent in the June report.

The inventory index dropped to a record low of 7 percent in September from 15 percent in June. This is a positive sign in that it indicates manufacturers will need to increase production for restocking purposes and new orders.

Chicago, IL-based **Grainger** reported third-quarter sales of \$1.6 billion, which were down 14 percent versus third quarter 2008. Profit for the quarter increased 3 percent to \$145 million versus \$140 million in 2008. The 2009 third quarter included a one-time \$47 million pre-tax gain from the step-up of its investment in MonotaRO Co. Ltd., after Grainger became a majority owner in September. For the nine months ended Sept. 30, 2009, sales of \$4.6 billion were down 13 percent, 12 percent on a daily basis, versus the nine months ended Sept. 30, 2008. Profit was down 9 percent to \$333 million from the prior-year period.

Grainger has acquired **Imperial Supplies, LLC**, Green Bay, WI. Imperial is a national distributor of maintenance products and aftermarket components for the vehicle and fleet industry with 2008 sales of \$67 million. Imperial Supplies serves the \$4 billion fleet maintenance industry.

**MSC Industrial Direct Co. Inc.**, Melville, NY, distributor of Metalworking and Maintenance, Repair and Operations supplies to industrial customers reported sales for its fiscal 2009 ended Aug. 29, 2009, were \$1.49 billion, down from \$1.78 billion the previous year - a 16.3 percent drop. Profit for the year was \$125.1 million, down from \$196.2 million in 2008. For the fiscal 2009 fourth quarter, sales were \$354.1 million, down 21.1 percent from the prior-year period. Profit was \$26 million, down from \$50.5 million in the prior-year period.

**MSC Industrial** announced two promotions: Douglas Jones has been tapped as Executive Vice President, Global Supply Chain Operations. In his role, Jones will be taking on responsibility for Product Management and Global Sourcing, in addition to his current responsibilities for Distribution Operations, Logistics, Engineering, Facilities, and Purchasing. Erik Gershwind has been promoted to the position of Executive Vice President and Chief Operating Officer. Gershwind previously served as MSC's Senior Vice President, Product Management and Marketing

Industrial and construction supplies distributor **The Fastenal Company**, Winona, MN, reported sales for the third quarter ended Sept. 30, 2009, were \$489.3 million, a decrease of 21.7 percent from the third quarter 2008. Profit was \$47.5 million, down 34.7 percent. Sales for the first nine months were \$1.45 billion, a decrease of 19 percent from the prior-year period. Profit fell 35.6 percent to \$139.8 million.

Atlanta, GA-based **Genuine Parts Company** reported sales for the third quarter ended Sept. 30, 2009, were down 10 percent to \$2.6 billion from the prior-year period. Profit for the quarter was \$107.6 million, a decrease of 18 percent. For the nine months ended Sept. 30, 2009, sales were \$7.6 billion, down 11 percent. Profit for the nine months was down 23 percent. Sales for **Motion Industries**, GPC's industrial unit, were down 22 percent for the quarter, and **EIS**, the Electrical Group, was down 30 percent. Sales for the **Automotive Group** were down 1 percent, and **S.P. Richards**, the Office Products Group, was down 5 percent.

**Applied Industrial Technologies**, Cleveland, OH, reported sales for the

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first quarter ended Sept. 30, 2009, were \$437.7 million, down 19.5 percent from the year-ago period. Profit declined 50.4 percent to \$11.2 million.

**Bunzl** plc reported sales in the third quarter have gone up 8 percent in the period ended June 30, 2009, from the prior-year period - primarily due to the effects of exchange. Organic sales were down 1 percent, slightly better than results in the first half of the year.

Swiss fasteners distributor **Bossard** reported third quarter sales of CHF 93.9 million (US\$92.4 million), down 32.8 percent from the prior year. Year-to-date, sales were CHF 299.8 million (US\$295 million), down 31.8 percent.

**Kennametal** Inc., Latrobe, PA, has launched the WIDIA Products Group. This launch completes the migration of all its current brands of metalcutting tools and tooling systems into two distinct portfolios: WIDIA Products Group and Kennametal Products Group.

**3M** plans to spend \$1 billion on acquisitions within the next 12 months, according to an article today by Bloomberg. The company plans to make 10 to 20 purchases in different industries, CEO George Buckley told Bloomberg. 3M will focus on acquiring brands that will help it to expand globally. 3M is a diversified manufacturer based in St. Paul, MN.

**Universal Forest Products** Inc., Grand Rapids, MI, reported sales of \$457.8 million for the third quarter 2009, down 25 percent from the prior-year period. Profit was \$10.1 million for the quarter

**Parker Hannifin Corp.**, Cleveland, OH, manufacturer of motion and control technologies, reported sales for the fiscal 2010 first quarter ended Sept. 30, 2009, were \$2.2 billion, a decline of 27 percent from a year ago. Profit fell 71 percent to \$73.5 million. Organic sales fell 28 percent. Acquisitions contributed 2 percent to sales.

Diversified electrical manufacturer **Eaton Corp.**, Cleveland, OH, reported third quarter sales of \$3.0 billion, down 26 percent from the third quarter 2008. Profit decreased 39 percent to \$193 million. Core sales were down 23 percent. Year-to-date, sales were \$8.7 billion, down 26 percent from the first nine months of 2008. Profit

decreased 81 percent to \$172 million.

**Carlisle Companies** Inc., Charlotte, NC, reported net sales from continuing operations of \$604.6 million for the quarter ended Sept. 30, 2009, a 27 percent decline from \$832.5 million in the third quarter of 2008. Sales were down across all segments, with organic sales decreasing by 26 percent from the third quarter of the prior year.

Swedish manufacturer **SKF** reported sales in its third quarter 2009 were down 13.4 percent in SEK; for the first nine months, sales fell 10 percent. Most of the decrease was due to volume. Profit was down by nearly half.

**Precision Castparts Corp.**, Portland, OR, reported sales for the second quarter of fiscal year 2010 were \$1.3 billion, down 27.8 percent from the prior year period. Profit decreased 23 percent to \$207.3 million. Year-to-date, sales were \$2.7 billion, down 25.7 percent from the first six months of fiscal year 2009. Profit declined 17.9 percent to \$447.7 million

Cleaning and maintenance supplies manufacturer **Zep** Inc., Atlanta, GA, reported sales for the fourth quarter of fiscal year 2009 were \$134.3 million, down 12.1 percent from the year ago period. Profit declined 20.4 percent to \$6.3 million. For fiscal year 2009, sales were \$501.0 million, down 12.8 percent from fiscal year 2008. Profit decreased 42.9 percent to \$9.3 million.

Diversified manufacturer **Illinois Tool Works** Inc., Glenview, IL, reported third-quarter operating revenues were \$3.6 billion, down 19.8 percent from a year ago but better than second quarter results. Base revenues were down 22.2 percent. Profit decreased by 33.3 percent to \$302.4 million.

Sweden-based **Alfa Laval**, a manufacturer in heat transfer, centrifugal separation and fluid handling, reported third quarter sales were SEK 5.8 billion (US\$847.2 million), a decrease of 12.3 percent from the prior year. Excluding the impact of foreign currency, sales were down 18 percent. Profit was down 30 percent to SEK 704 million (US\$102.8 million).

**Caterpillar** Inc., Peoria, IL, reported sales of \$7.3

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## Distribution Financial Metrics and Trading Multiples

(Data as of Sept. 30, 2009)

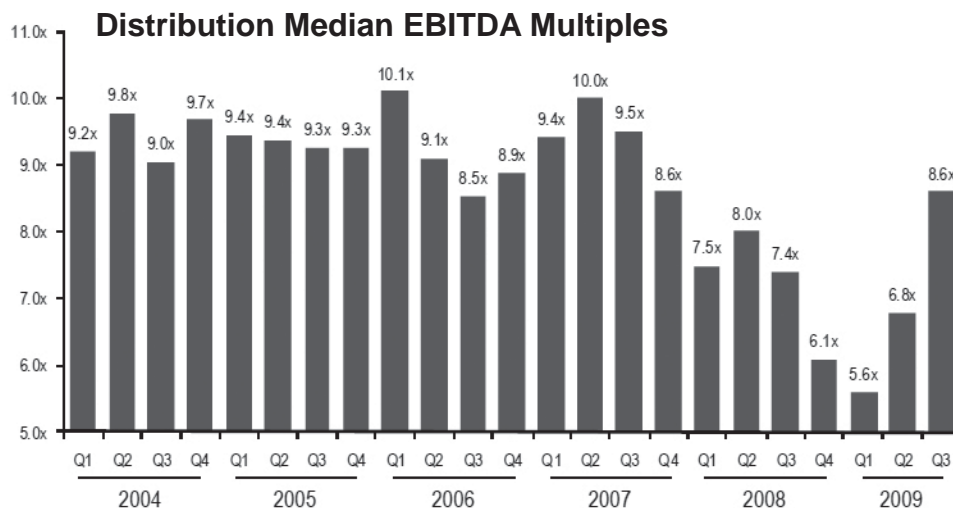
(\$ in millions)

Company	Ticker	Enterprise Value	LTM				EV to LTM Sales	EV to LTM EBITDA	ROIC	Working Capital/Sales	
			Sales	Sales Growth	Gross Margin	EBITDA					
Airgas Inc. *	ARG	\$5,630	\$4,212	(0.2%)	53.8%	\$722	17.1%	1.3 x	7.8 x	9.2%	6.3%
AM Caste & Co.	CAS	321	1,158	(20.9%)	14.0%	38	3.3%	0.3	8.4	2.3%	21.0%
Anixter International Inc. *	AXE	2,224	5,540	(9.2%)	23.1%	310	5.6%	0.4	7.2	1.7%	24.8%
Applied Industrial Technologies Inc.	AIT	958	1,923	(8.0%)	27.0%	131	6.8%	0.5	7.3	12.3%	18.0%
Barnes Group Inc. *	B	1,343	1,117	(23.6%)	36.4%	150	13.5%	1.2	8.9	7.3%	25.5%
Beacon Roofing Supply Inc. *	BECN	998	1,813	6.0%	24.1%	153	8.4%	0.6	6.5	10.7%	13.3%
BlueLinX Holdings Inc.	BXC	457	2,059	(38.5%)	11.0%	(12)	N/M	0.2	N/M	N/M	11.5%
Builders FirstSource, Inc. *	BLDR	344	836	(29.6%)	21.3%	(49)	N/M	0.4	N/M	N/M	7.8%
Bunzl plc	BNZL	4,578	7,415	(2.4%)	21.2%	437	5.9%	0.6	10.5	12.6%	5.5%
DXP Enterprises Inc.	DXPE	286	683	8.0%	28.8%	50	7.4%	0.4	5.7	8.3%	18.8%
Fastenal Co. *	FAST	5,574	2,134	(4.0%)	52.6%	406	19.0%	2.6	13.7	22.5%	32.2%
Genuine Parts Co.	GPC	6,341	10,382	(5.9%)	29.6%	792	7.6%	0.6	8.0	15.5%	21.8%
Houston Wire & Cable Company *	HWCC	214	302	(19.5%)	21.7%	23	7.6%	0.7	9.3	14.1%	29.7%
Hutig Building Products Inc.	HBPI	46	529	(31.8%)	17.3%	(31)	N/M	0.1	N/M	N/M	7.5%
Interline Brands Inc. *	IBI	819	1,122	(8.9%)	37.3%	93	8.3%	0.7	8.8	6.5%	21.3%
Kaman Corp.	KAMN	642	1,239	7.8%	26.3%	77	6.2%	0.5	8.3	10.8%	26.9%
Lawson Products Inc.	LAWS	137	427	(15.8%)	56.6%	12	2.8%	0.3	11.5	3.5%	17.9%
MSC Industrial Direct Co. Inc. *	MSM	2,726	1,584	(11.1%)	48.8%	268	16.9%	1.7	10.2	19.2%	23.0%
Park-Ohio Holdings Corp.	PKOH	460	860	(19.6%)	14.6%	49	5.8%	0.5	9.3	5.5%	28.8%
Pool Corp *	POOL	1,375	1,631	(12.3%)	29.2%	114	7.0%	0.8	12.1	10.5%	19.8%
Reliance Steel & Aluminum Co.	RS	4,217	7,517	(0.1%)	22.9%	564	7.5%	0.6	7.5	8.2%	14.6%
Rexel SA	RXL	7,664	17,493	(2.4%)	23.8%	722	4.1%	0.4	10.6	5.0%	11.3%
Smith International Inc.	SII	9,904	10,261	9.1%	29.8%	1,638	16.0%	1.0	6.0	12.6%	30.3%
Watco Inc. *	WSO	1,690	1,506	(16.6%)	25.8%	76	5.1%	1.1	22.1	8.0%	20.1%
WESCO International Inc. *	WCC	2,068	5,397	(11.4%)	19.7%	285	5.3%	0.4	7.3	11.2%	13.0%
Wolseley plc	WOS	6,732	24,082	(26.3%)	27.5%	375	1.6%	0.3	17.9	N/M	7.8%
WW Grainger Inc. *	GWW	6,698	6,431	(3.9%)	43.5%	846	13.2%	1.0	7.9	20.0%	17.0%
<b>Median</b>		<b>\$1,375</b>	<b>\$1,813</b>	<b>(9.2%)</b>	<b>26.3%</b>	<b>\$150</b>	<b>7.2%</b>	<b>0.6 x</b>	<b>8.6 x</b>	<b>10.5%</b>	<b>18.8%</b>

\* Companies covered by Baird Research.

The table above highlights key financial metrics and trading multiples for 27 publicly traded distributors in the industrial and building products industries.

The chart 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.

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billion for the third quarter, down 44 percent from sales in the third quarter of 2008. Profit decreased 53.5 percent to \$404 million. "We believe the third quarter marked the low point for Caterpillar sales and revenues in what has been the toughest recession since the 1930s. We are seeing encouraging signs that indicate a recovery may be underway," CEO Jim Owens said. "However, the world economy is still facing significant challenges. There is uncertainty about the timing and strength of recovery."

By region, **housing starts** in September fell 38.4 percent in the Northeast year-over-year; declined 22.5 percent in the Midwest; decreased 26.5 percent in the South; and fell 30.5 percent in the West.

**August U.S. manufacturing technology consumption** totaled \$129.16 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 14.8 percent from July and down 63.3 percent from the total of \$351.66 million reported for August 2008. With a year-to-date total of \$1,041.57 million, 2009 is down 67.7 percent compared with 2008.

**U.S. manufacturers of power transmission products** experienced an increase in sales while Canadian manufacturers had a drop in sales in August 2009, according to sales data released by the Power Transmission Distributors Association (PTDA). U.S. manufacturers' sales rose by 10.7 percent in August 2009 when compared to July 2009. Sales in August 2009 are down 30.6 percent compared to the same period last year. Canadian

manufacturers' sales fell 6.6 percent compared to July 2009.

**Wholesale prices** fell 0.6 percent in September, seasonally adjusted, according to the Bureau of Labor Statistics. The decrease follows a 1.7 percent rise in August, and a 0.9 percent decline in July.

**Canadian manufacturing sales** declined 2.1 percent to \$40.9 billion in August following a 5.2 percent gain in July. The aerospace product and parts and motor vehicle industries were the major contributors to the decline in sales. Sales have been relatively level since February, after declining 20.4 percent between October 2008 and January 2009. Constant dollar manufacturing sales fell 2.3 percent in August. Sales in 13 of 21 manufacturing industries decreased.

**Bailey Tools & Supply Inc.**, Louisville, KY, has acquired Indianapolis, IN-based **Capitol Drilling & Contractors Supply**. Bailey Tools reported that the purchase complements its current lines and adds new brands including STIHL and Honda Power Equipment

**Declines in home improvement spending** will moderate through the end of 2009 and first half of 2010 according to the Leading Indicator of Remodeling Activity (LIRA), released by the Remodeling Futures Program at the Joint Center for Housing Studies of Harvard University. The indicator suggests the remodeling industry is turning a corner. Annual spending levels should start to rise in the beginning of next year causing year over year declines to shrink to 8.9 percent by the second quarter of 2010.

The **AHMA Home Improvement Industry Confidence Index** in September found the "current situation" deteriorating even as "future expectations" improved to an all-time high. September's Current Situation Index declined to 45.8 from 91.7 the previous month. Meanwhile, the Future Expectations Index, made up of components projecting sales six and twelve months out, increased to 191.4 from 170.7 in August.

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