Modern
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Intelligence for Wholesale Distribution Professionals

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Chasing Profitability

Sales growth not enough to sustain profitability

After following a yo-yo pattern in the wake of the Great Recession, distributor performance appears to have leveled off. The following analysis by Al Bates, director of research for Profit Planning Group and principal of the Distribution Performance Project, examines key profit drivers in wholesale distribution across 31 lines of trade. This article includes historical data from the past five years and trends in 2014, the latest year for which full data is available.

By Al Bates

During 2014 – the latest year for which complete information is available – distributors, as a group, experienced solid sales growth, enough to offset the impact of inflation. But gross margin growth didn't keep pace with the sales growth, which translates into lower profitability.

The up-and-down pattern over the last several years suggests that real profit improvements are still somewhat illusory.

The following paragraphs review key findings from analysis of key profit drivers across 31 lines of trade. Distributors in all lines of trade share a collective group of problems. There is always price competition, employee productivity and so on. All distributors want to improve internal operations.

Despite this common set of concerns, the underlying economics of distribution vary widely by line of trade. Gross margin across the lines of trade included in this report, for example, range from 6.4 percent of sales to 45.7 percent. Similarly, inventory turnover levels range from 2.4 times to 20.9 times.

Such differences make it difficult, but not impossible, to compare performance across lines of trade. The analysis can't simply look at how one industry's gross margin compares to other industries. Some adjustments must be made to allow for direct comparisons (for details on the adjustments, see the methodology section).

Ultimately, factors such as gross margin, operating expenses and inventory turnover come together to determine overall profitability.

This analysis looks at how six components trended in 2014 across three broad distribution industry segments:

- **Industrial** includes firms selling largely to the factory floor.
- **Construction** represents firms selling a wide range of building materials and supplies.
- **Consumer** firms are those selling consumer products or products utilized by retailers of all types.

Return on Assets

The best measure of financial performance is return on assets (ROA). This is calculated by taking pre-tax profits and dividing by total assets. The least-profitable industry in this report produced an ROA of 4.3 percent in 2014; the highest-ROA industry comes in at 19.2 percent. These are fundamental differences in performance.

The ROA differences between industries are almost entirely structural, or due to factors such as the barriers to entry, the degree of commoditization and the underlying growth rate for the products being distributed.

Structural factors tend to be locked in place. An industry plagued by a lack of barriers to entry is unlikely to become a competitively isolated one any time soon. As a result, some industries will be more profitable than others, probably into perpetuity. The role of management is to utilize the critical profit variables (CPVs) – such as gross margin or inventory turnover – to produce the highest possible ROA within the constraints of the industry.

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INSIDE

PERSPECTIVE ■ Commentary by Thomas P. Gale

Lessons from Lyft & GM: Adapt

General Motors last week invested half a billion dollars into a car service. Imagine that. But GM's deal with ridesharing service Lyft involves more than money, and there are a few timely lessons that distributors can take from this.

Rethink business model – every year, at least. Who would have thought five years ago we'd be hearing the president of GM talking about personal mobility? It's a significant shift away from product-centric thinking to new ways of creating value for customers.

Some distributors adapted their models long ago and built stronger customer relationships with specific service offerings beyond product. Instead of just selling a few o-rings for pennies, they preassembled kits to lower customer labor costs and increase productivity; the result was much higher profitability and lifetime customer value as they were embedded in the production workflow.

Companies like Uber and Lyft are fundamentally changing the equation of car ownership in metro areas. Many stores, including Staples, are changing retail by significantly reducing store square footage to match fast-changing consumer behavior. Look at Grainger's strategic branch reduction – as reported in our pages last year – as customers shift to more online sourcing or delivery.

The rate of change is increasing even in more traditional industries and companies. If you aren't challenging your team to find new ways to provide value to customers or vendors, you may feel like you lost at musical chairs to competitors that thought bigger or outside the UPS box.

Rethink supply chain. There is a lot of hype around disruption and sexy Silicon Valley startups. But through repeated cycles of change and consolidation, distributors have proven their value in highly fragmented markets to their suppliers and the customers they serve. Innovation is not new. Berlin Packaging is a great example, as we have also reported on in the past.

When you look at how markets for distributors are changing in 2016, it's not around being better at e-commerce than Amazon; it's about crafting a unique value set of product portfolio, services and expertise. And just as importantly, it's in the execution where the real long-term value is created. A good example is how the very healthy niche of integrated supply has evolved.

Rethink partnership. There are increasing examples of ways that distributors are combining specific strengths with other providers to build value. Look at the Air Liquide-Airgas deal or even Sonepar's acquisition of IDG to think how strategic value can be defined. We'll continue to see that in the M&A deals this year and beyond.

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Profitability
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Figure 1 shows the differences in ROA between different lines of trade. Since ROA is ROA, regardless of the industry, direct comparisons can be made.

At the lower-profit end of the graph, the typical firm generated an ROA below or near 5 percent. For most analysts, 5 percent is the minimum return required to ensure the long-term prosperity of the distributors in the industry. At the other extreme, a number of industries had typical firms with ROA in excess of 10 percent. For distribution, 10 percent as an industry median level of profitability is very strong.

Ignoring economic extremes, the majority of lines of trade tend to produce an ROA between 5 percent and 10 percent. To a certain extent this has become a comfort zone. The problem is that the comfort zone eventually becomes the calcification zone, with most firms content to stay there rather than look for significant improvement.

Even though there is usually stability in ROA over time, there are occasions when performance changes appreciably. Most often such changes are tied to economic conditions which impact one industry segment more than others.

Figure 2 outlines the ROA performance for the 31 lines of trade for 2010 through 2014. The overall pattern reflects a modest drop in ROA for 2011 followed by sustained increases for the next two years and a plateau for 2014. The pattern is fairly typical for years following an economic downturn.

ROA performance by segment varied only slightly in 2014, as shown in **Figure 3**. All three segments fell into the 5 percent to 10 percent comfort zone.

While the variations are slight, they tend to produce a large cumulative impact over time as higher profit provides greater funds for reinvestment in growing the business. In every segment, some firms produced an outstanding ROA while others suffered low returns or operated at a loss during the year.

Sales Growth

The ability to increase sales systematically is one of the key drivers of profit. But exceptional rates of growth are not required. What is needed is enough growth to allow the firm to offset the impact of inflation on expenses with some relative ease.

In today's moderate inflation environment, growth of about 5 percent is sufficient to beat the inflation rate. Any cushion beyond

Figure 1: ROA by Line of Trade

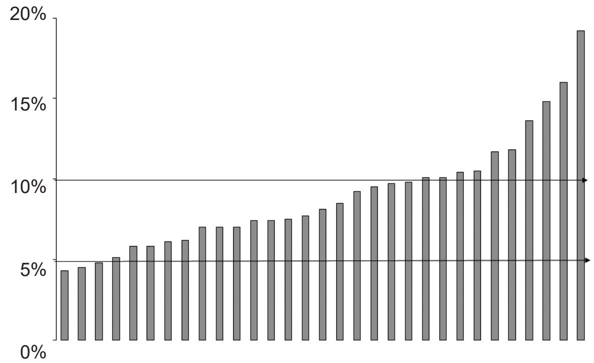


Figure 2: ROA by Year

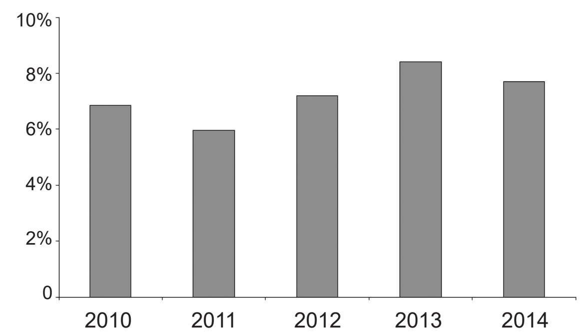


Figure 3: ROA by Distribution Segment (2014)

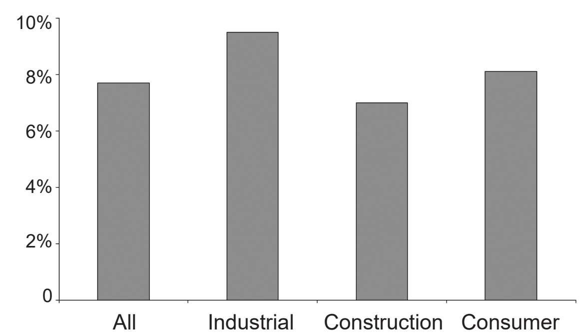
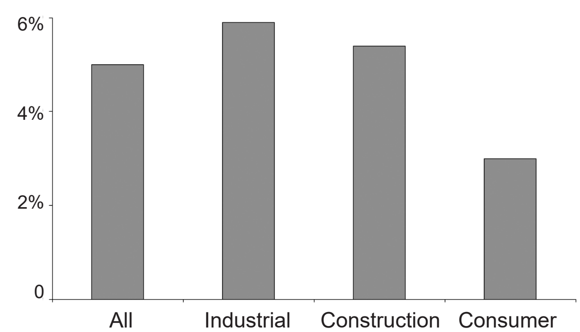


Figure 4: Sales Growth by Distribution Segment (2014)



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that would be beneficial. However, when sales growth moves north of 15 percent, the rapid sales growth often creates as many problems as it solves. Supporting the increased sales often necessitates an expanded employee base, new operating systems and even enlarged facilities.

Sales growth for the 31 lines of trade in 2014 was exactly 5 percent, as shown in **Figure 4** on the previous page. Both the industrial and construction segments were above 5 percent while the consumer segment lagged significantly.

Gross Margin

Overall gross margin fell in 2014 (**Figure 5**), with reductions in the industrial and consumer segments but a modest increase in construction.

In 2014, the gross margin percentage for all lines of trade was 26.7 percent of sales, compared to 26.9 percent in 2013. The gross margin difference, which appears small, is critical. The ratio reflects the change in the gross margin dollars that the typical firm would have experienced if sales had remained constant.

The overall performance for all 31 segments is a decline of 0.7 percent, meaning if sales had remained constant, the gross margin dollars generated would have declined by 0.7 percent. Because sales increased by 5 percent, total gross margin dollars actually increased – but only by 4.2 percent. The decline in the gross margin percentage eroded a portion of the sales gain.

Operating Expense

In aggregate, expenses as a percent of sales fell by 0.5 percent (**Figure 6**). Recent research indicates that the ability to control expenses is the single most important driver of profitability for distributors, even more important than the ability to maintain adequate sales growth. Given that, the expense improvements, while modest, are noteworthy.

However, this improvement was more than offset by the reduction in the gross margin percentage.

Inventory Turnover

Despite popular mythology, neither inventory turnover nor days sales outstanding have a very large impact on profitability for distributors. They do, however, have a large impact on cash flow. Both ratios have to be viewed in that particular context.

Inventory turnover levels deteriorated across the board in 2014 (**Figure 7**), although none of the declines were large. Construction-oriented distributors experienced no change.

Figure 5: % Change in Gross Margin Percentage (2014)

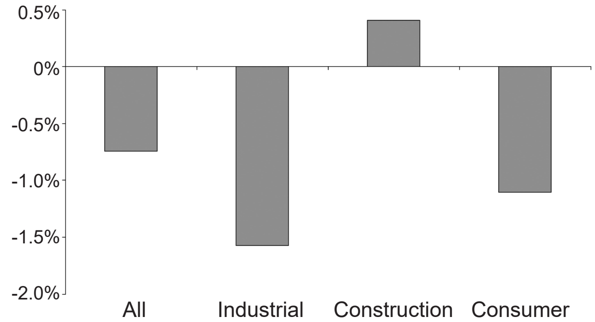


Figure 6: % Change in Operating Expense Percentage (2014)

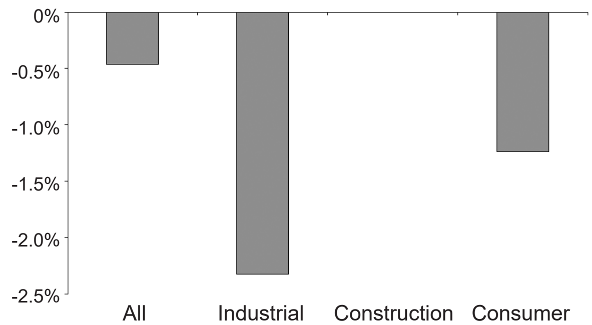


Figure 7: % Change in Inventory Turnover (2014)

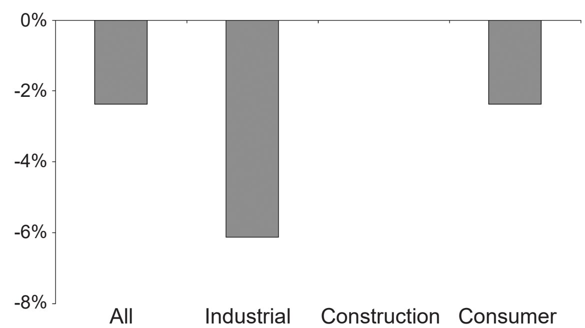
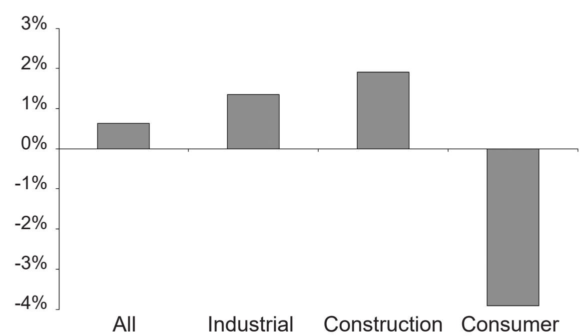


Figure 8: % Change in Days Sales Outstanding (2014)



When combined with the increases in sales and the decline in the gross margin percentage (an increase in the cost of goods sold percentage), the decline necessitated a jump in inventory investment.

For a typical firm, the changes are large enough to be concerning when combined with the sales growth. The increase in cost of goods sold is 5.6 percent because of the decline in the gross margin. The increase in inventory is 8.2 percent due to slower turns. The inventory increase has significant implications for any firm's cash position.

Days Sales Outstanding

In aggregate, distributors experienced an increase in their days sales outstanding of 0.7 percent (**Figure 8)**. This reflects the percentage increase in accounts receivable balances that the firm would require if sales remained constant. Most of the changes in performance reflect a necessity to invest more which causes a decline in the cash position of the firm.

Methodology

This report focuses on two issues. First, how well did individual lines of trade do on key performance metrics in 2014? Second, to what extent did those metrics change by line of trade between 2013 and 2014?

It is not possible to put high-gross margin industries together with low-gross margin ones and come to a conclusion. Some statistics must be converted to a common denominator to make conclusions possible.

The procedure used here involves converting absolute metrics into percentage change metrics. The percentage change figures measure how much better or worse a specific industry performed. For example, if an industry with an average inventory turnover of 2 times experienced a 0.5 turn improvement, the percentage improvement in turnover was 25 percent (0.5/2 = 25 percent). An industry with 5 turns per year as a starting point with the same 0.5 turnover improvement would see a 10 percent improvement.

■ *2015 State of Distribution Inside Sales*

Strive to be Proactive with Inside Sales

Too many distributors' inside sales teams remain reactive

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A joint MDM-Real Results Marketing survey revealed that inside sales teams struggle in balancing proactive and reactive sales activities. This article examines how distributors can streamline those activities to make their inside sales teams more effective and increase revenue.

By Debbie Paul

Distributors struggle to balance their sales teams' reactive and proactive sales activities, often relying more heavily on the reactive, according to the results of a joint MDM-Real Results Marketing survey. This results in very little outbound calling or lead generation activities for blended inside sales teams.

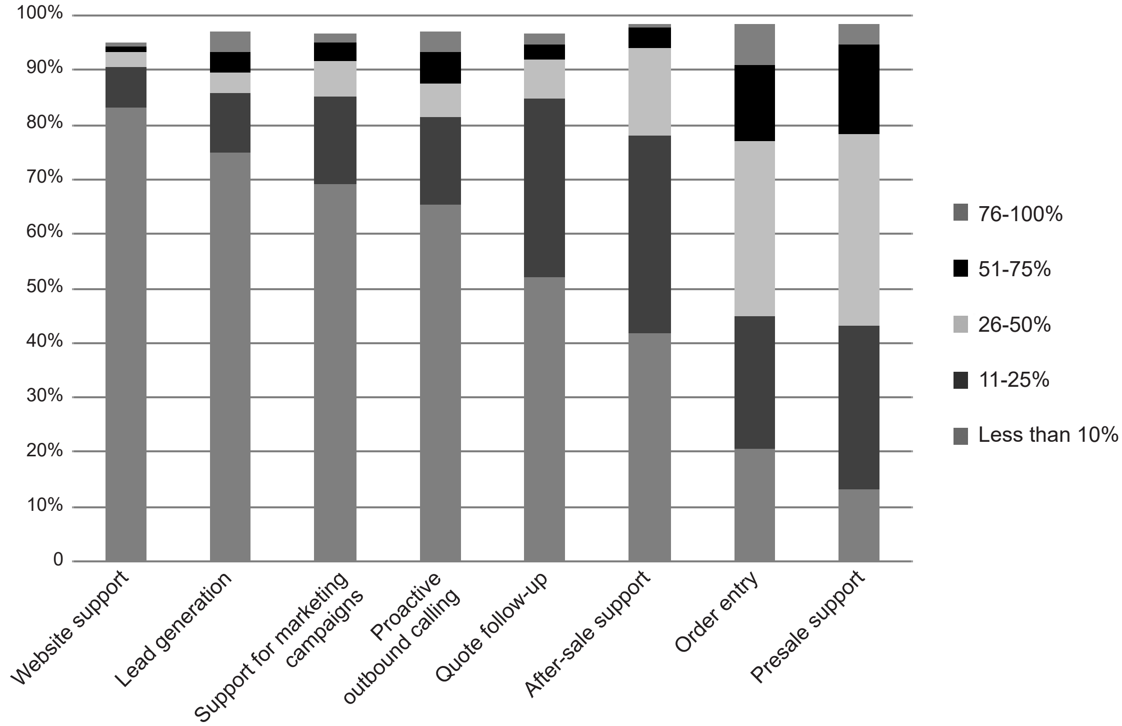
As in the 2014 survey, the challenge of getting reactive individuals to become proactive is difficult to overcome, primarily because the skill sets of these two groups are entirely different.

The term "inside sales" can encompass a variety of activities. Based on the survey results and the activities performed, the majority of respondents' inside sales teams perform various presale activities, including quoting and order entry, as well as after-sale support activities, all of which are primarily reactive functions.

As shows in **Figure 1** on the next page, 35 percent of respondents said that their inside sales teams were spending 26-50 percent of their time doing presales support activities. Proactive functions such as lead generation, quote follow-up and proactive outbound calling were not identified as key activities for inside sales. In fact, when respondents were asked to describe their inside sales teams as mostly proactive or mostly reactive, 75 percent described their teams as mostly reactive.

Inside sales teams were organized in two key ways: centralized or decentralized, with 56 percent of teams centralized at either the headquarters or a branch and 41 percent decentralized among various locations. The preference for centralization was to enable consistent

Figure 1: What percent of time do your inside salespeople spend on the following activities?



training, coaching and team support, while the pluses for decentralization included the ability to tap into local sales talent and better geographic team support. Some of the challenges with decentralization included lack of consistent training and processes utilization.

Respondents ranked the importance of various functions that related to profitability and other inside sales activities, as show in **Figure 2**. The top response, at 53 percent, was providing an excellent level of service, which aligns with the reactive activities and skill set profiles cited by the respondents of the survey. The second most important activity was to grow sales and profit (36 percent).

While an excellent customer experience may sustain wallet share, it won't always help to grow incremental sales. This typically requires a more proactive approach.

When asked about how their inside sales teams were measured, respondents' answers varied (**Figure 3**). Measuring gross profit dollars along with specific order entry quality and quantity measurements were most cited, while 17 percent of respondents didn't have any measurement at all.

Measurement is key to inside sales because this group is in constant contact with customers, and even a twice-monthly session can ensure a quality experience. It is important to balance the reactive measurements with the proactive measurements, which is a challenge, if the inside team is primarily reactive.

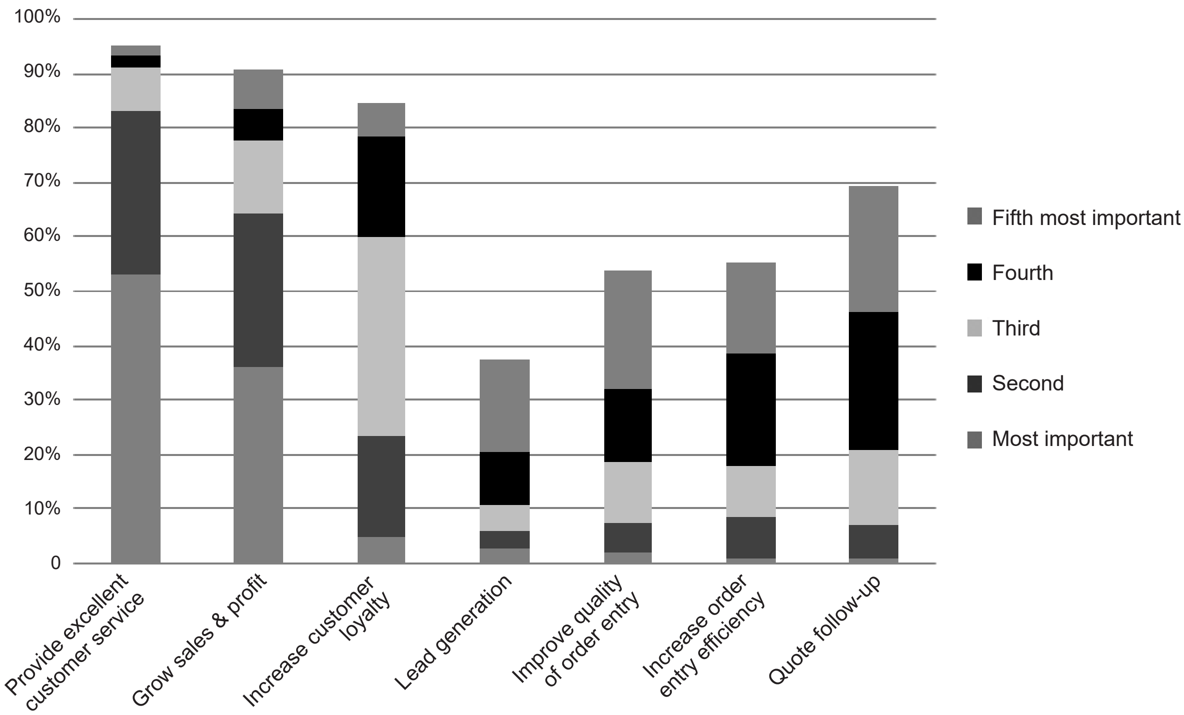
When asked about what additional training respondents wanted to see for their inside sales teams, 73 percent wanted their teams to have more sales training. The challenge with achieving this goal, however, is the majority of the activities currently performed by inside sales teams are reactive – primarily customer service related. Proactive sales may be in direct conflict with the skill set of a reactive individual, who is not likely to excel in sales activities.

Meanwhile, 58 percent of respondents wanted training on handling difficult situations and 55 percent wanted to see additional technical training.

When asked about the effectiveness of their inside sales teams, 62 percent of respondents felt their teams were very effective or effective, 36 percent felt their teams were somewhat effective and 3 percent felt their team was not effective at all. This is a reflection of the general desire of respondents to have their teams be more sales oriented. When asked what the biggest challenge for the inside sales team was, more than 50 percent of respondents cited lack of proactivity and a lack of time to perform sales activities.

The most effective avenues for inside sales training were informal coaching sessions (57 percent), team members doing on-the-job training (56 percent) and formal training sessions with a manager (56 percent). Online training was not as popular at 26 percent.

Figure 2: Rank the importance of the Top 5 Inside Sales Activities

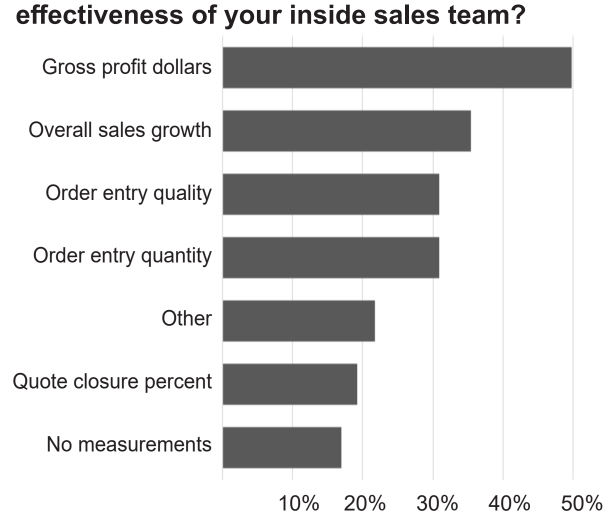


Dichotomies exist throughout the survey. While the desire to be reactive and provide an excellent customer experience was combined with the desire to be more sales oriented, the skill sets of an individual who is capable of providing an excellent reactive customer experience is the polar opposite of the individual who excels in selling.

Managers can't expect a reactive inside customer service person to be an excellent salesperson. It is realistic, however, to train inside sales people to exploit inbound transactions through cross-selling. One of the main complaints that distributors have is that customers don't know the breadth of their product lines. Customers think about distributors in a very narrow way, but once they understand the additional product lines their distributor carries, additional sales opportunities arise. The inside sales rep, through their relationships and contact with customers, can be a key avenue to get customers to understand product breadth.

If companies want to increase sales in a more proactive way, they should consider creating a separate group of individuals (or even just one person) who is responsible for growing customer sales and generating leads on a strictly proactive basis.

Figure 3: How do you measure the effectiveness of your inside sales team?



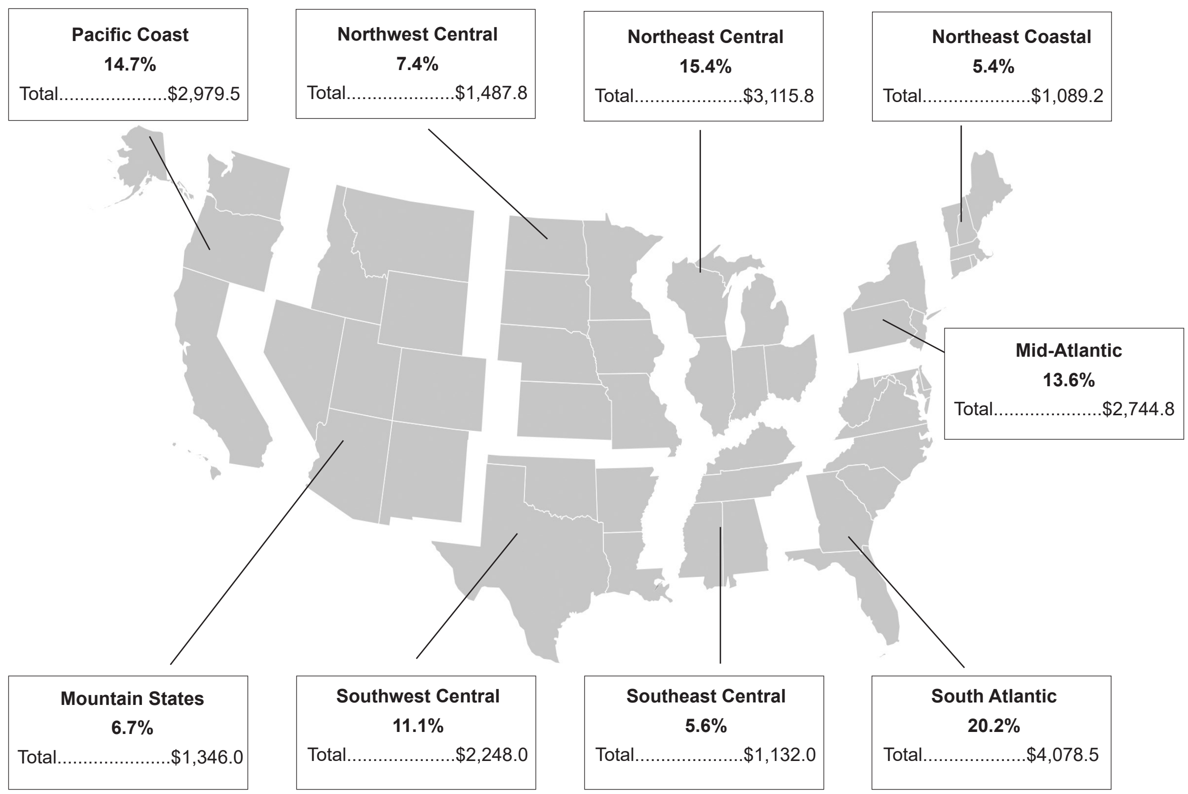
About This Survey

This research was conducted by Modern Distribution Management and Real Results Marketing. It included an online survey taken by 337 participants across a variety of distribution and manufacturing sectors. The majority of respondents to the survey were distributors (69 percent) vs. manufacturers (21 percent). More than half of the respondents have 10 or fewer branches, nearly a third have 10 to 100 branches and 13 percent have more than 100 branches.

MARKET ANALYSIS: Janitorial Supplies Consumption in the United States

Consumption of Janitorial Supplies in the U.S. was $20.2 billion in 2015, according to data from MDM Analytics. All estimates are 2015 end user demand, in U.S. dollars, including distributor margin.

■ U.S. End-User consumption of Janitorial Supplies by region, in millions of $ (2015 estimates)



U.S. Total 100%: $20,221.5 million

■ U.S. End-User Consumption of Janitorial Supplies: Top 10 End-Markets

Top 10 end-markets in $ volume, by NAICS code, consuming Janitorial Supplies (2015 estimates)

End User		Estimated Consumption
622110	General Medical and Surgical Hospitals	$1,883.2 million
611110	Elementary and Secondary Schools	$1,017.8 million
722511	Full-Service Restaurants	$554.7 million
721110	Hotels (except Casino Hotels) and Motels	$522.1 million
722513	Limited-Service Restaurants	$521.8 million
561720	Janitorial Services	$503.5 million
623110	Nursing Care Facilities (Skilled Nursing Facilities)	$498.5 million
621111	Offices of Physicians (except Mental Health Specialists)	$395.4 million
611310	Colleges, Universities, and Professional Schools	$373.6 million
445110	Supermarkets and Other Grocery (except Convenience) Stores	$350.2 million

This market size estimate was compiled by MDM Analytics, Lafayette, CO.
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Industrial & Construction Markets Update

VOL. 46, NO. 1 | JANUARY 10, 2016

Praxair Distribution Southeast Merges with nexAir

Praxair Distribution Inc., a subsidiary of industrial gases company Praxair Inc., Danbury, CT, has merged its two joint venture companies operating in the southeastern U.S. – Praxair Distribution Southeast LLC and nexAir LLC. Terms were not disclosed.

Praxair Distribution Southeast LLC, operating in Florida and southeast Georgia, will merge into Memphis, TN-based nexAir LLC, with locations in Alabama, Arkansas, Georgia, Louisiana, Mississippi and Tennessee.

With the merger, nexAir will have annual sales of $200 million and 67 locations, adding coverage throughout Florida. Its existing senior management team will continue to lead the combined business.

"Both the PDSE and nexAir businesses have been very successful partnerships for PDI in the southeast and it makes sense to now combine them," said Scott Kaltrider, president Praxair Distribution Inc. "It will allow us to streamline and simplify our management processes and improve customer focus and clarity around PDI's channel strategy. Together we will provide a stronger network of services and capabilities throughout the region."

The transaction strengthens nexAir's footprint and offer customers in Florida and Georgia access to the company's industrial and specialty gases, welding equipment and supplies, as well as its dedicated sales team.

"PDSE and its predecessors have a long tradition of strong operations, solid customer relationships, and an outstanding group of dedicated employees in Florida and southern Georgia," said nexAir CEO Kevin McEniry. "The PDSE and two PDI branches in Georgia, are perfect fits for our growth strategy in the southeast. We look forward to making these PDI and PDSE team members and customers part of our family."

Distributor News

Beacon Roofing Supply Inc., Herndon, VA, has acquired **Statewide Wholesale**, Denver, CO, a distributor of residential and commercial roofing and related products.

Beacon Roofing Supply Inc. has acquired **Roofing & Insulation Supply**, Dallas, TX.

Allied Motion Technologies Inc., Amherst, NY, has agreed to acquire **Heidrive GmbH**, Kelheim, Germany, for €20 million (US$22 million).

Applied Industrial Technologies, Cleveland, OH, has acquired **HUB Industrial Supply**, a distributor of consumable industrial products.

US LBM Holdings LLC, Green Bay, WI, has acquired five companies under the common ownership of **NexGen**, Britton, SD. The acquired companies – **Truss Pro's Inc.**, **Precision Wall Systems**, **Minnesota Building Pros**, **Britton Home Center** and **Webster Home Center** – have locations in South Dakota and Minnesota.

Royal Adhesives & Sealants LLC, South Bend, IN, a portfolio company of **American Securities LLC**, has acquired **Adhesive Systems Inc.**, Frankfort, IL.

Interline Brands Inc., Jacksonville, FL, CEO Michael Grebe is retiring from the company, according to the Jacksonville Business Journal.

Avnet Electronics Marketing, an operating group of technology distributor **Avnet Inc.**, Phoenix, AZ, has appointed Ed Smith to a new role as senior vice president of Avnet embedded solutions globally.

Wolter Power Systems, a member of **Wolter Group LLC,** parent company of **Illinois Material Handling**, named Joe Rubens as vice president of sales.

Economic News

The Chicago Fed National Activity Index moved down to -0.30 in November from -0.17 in October. Two of the four broad categories of indicators that make up the index decreased from October, and three of the four categories made negative contributions to the index in November.

Real gross domestic product for the U.S. increased at an annual rate of 2 percent in the third quarter, according to the "third" estimate released by the Bureau of Economic Analysis. In the second quarter, real GDP increased 3.9 percent.

New orders for manufactured durable goods in November were flat at $238.8 billion, according to the U.S. Census Bureau. This slight increase, up two consecutive months, followed a 2.9 percent October increase. Excluding transportation, new orders decreased 0.1 percent. Excluding defense, new orders decreased 1.5 percent.

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MARKETS UPDATE SUPPLEMENT P. 2

News Digest
Continued from p. 1 of this section

November **construction spending** was estimated at a seasonally adjusted annual rate of $1,122.5 billion, 0.4 percent below the revised October estimate of $1,127 billion, according to the U.S. Census Bureau of the Department of Commerce. The November figure is 10.5 percent above the November 2014 estimate.

Canadian investment in new housing construction increased 4.3 percent to C$4.7 billion (US$3.4 billion) in October compared with the same month in 2014, according to Statistics Canada.

The **Canadian Industrial Product Price Index** declined 0.2 percent in November, mainly as a result of lower prices for primary non-ferrous metal products, according to Statistics Canada. The **Raw Materials Price Index** fell 4 percent, led by lower prices for crude energy products.

Canadian wholesale sales declined 0.6 percent to $54.7 billion in October, according to Statistics Canada. Declines were recorded in four subsectors, led by lower sales in the food, beverage and tobacco and the motor vehicle and parts subsectors. In volume terms, wholesale sales decreased 0.6 percent in October.

Growth slowed for distributors and manufacturers during the month of November, according to the December **Economic Indicator Report from the Industrial Supply Association**. The ISA Distributor Index decreased from 62.5 in October to 54.2 in November, while the Manufacturer Index decreased from 66.8 to 54.5.

Heating, Air-conditioning and Refrigeration Distributors International reported a 4.6 percent sales increase for November. The annualized growth through November slipped further to 5.5 percent.

Manufacturer News

Atlas Copco, Stockholm, Sweden, has agreed to acquire **Capitol Research Equipment Inc.**, Chantilly, VA, commonly known as **Capitol Vacuum Parts**.

Weiler Corp., Cresco, PA, has acquired European bonded abrasives manufacturer **SWATY-COMET**, Maribor, Slovenia.

Boise Cascade Co., Boise, ID, has agreed to buy the engineered lumber business of **Georgia-Pacific**, Atlanta, GA, for $215 million.

The Manitowoc Company Inc. has named Barry Pennypacker as president and CEO of **Manitowoc Cranes**.

MAPI: European Recovery Accelerating

Domestic demand has emerged as the decisive driver of economic activity in Europe and prospects for growth in 2016 are on the horizon, according to a report from the MAPI Foundation, the research affiliate of the Manufacturers Alliance for Productivity and Innovation.

The semiannual European Industrial Outlook provides analysis and forecasts for 12 major countries – Austria, Belgium, Czech Republic, France, Germany, Hungary, Italy, Netherlands, Poland, Spain, Sweden and the United Kingdom.

"The European economic recovery is on solid ground, with domestic demand growing robustly in virtually all countries," said Kris Bledowski, director of economic studies. "Manufacturing is expanding more quickly in Europe than in the U.S., driven increasingly by pent-up consumer demand and a growing appetite for investment goods. We forecast a marked acceleration in spending on business equipment and a moderate uptick in construction outlays in 2016 and 2017. Although manufacturing activity is growing at a slower pace than services, business indices point toward a much faster pace of industrial production growth and should end 2016 about 2 percent higher."

The core Central European Big Three of the Czech Republic, Hungary and Poland are expected to be the manufacturing growth leaders in 2016. Poland is forecast to advance by 5.1 percent, Hungary is expected to grow by 4.9 percent, and the Czech Republic is anticipated to increase by 4.4 percent.

All 12 countries in the report are expected to see industrial production growth in 2016, led by Poland at the high end and the United Kingdom at the low end with 1.5 percent growth.

"Looser lending standards, combined with a promise of low interest rates for months to come, offer a strong incentive for companies to invest," Bledowski said.

JLL Industrial Outlook: More Ships, More Investment

When the Panama Canal expansion finally debuts in spring of 2016, it will open to a thriving market that remains hungry for new and efficient distribution center space in nearly every major U.S. market. Retailers and e-commerce companies are already investing in new and larger distribution and fulfillment centers as the U.S. supply chain evolves to meet changing consumer demand and service requirements; especially near key ports, transshipment points and large population centers.

"In 2015, rents and sale prices in many U.S. industrial property markets exceeded historical peak values last seen in 2007 and 2008," says Craig Meyer, president, industrial brokerage, JLL Americas. "Market conditions will remain strong, and we see no sign of a change in the coming months. Instead, all indicators point to demand again outpacing supply in 2016 with a continuing drop in vacancy rates to new all-time lows."

Many industrial developments are preleased before ground is even broken and speculative construction is being leased up. These large buildings leased to credit tenants on long-term leases are highly attractive to global investors that are interested in safe and stable property investments.

Global investors – sovereign wealth funds, institutional advisers and insurance companies – have taken billion dollar positions in U.S. industrial portfolios over the last two years and continue to have appetite for investment grade properties. Increasing demand across the U.S. is pushing lease rates and building values higher.

Once unable to allocate enough funds into individual industrial real estate, global investors are now competing for the best industrial deals across the country, as sizeable portfolios that have been built or aggregated over the last five years have traded hands. Offshore capital has been the biggest participant in 2015's race for U.S. industrial property investment, accounting for more than $11.5 billion in total investment at the end of the third quarter, according to JLL research.

Ownership of industrial real estate is being consolidated in the hands of increasingly fewer buyers, many of them now from outside the U.S. Continued acceleration in foreign direct investment into the industrial segment is expected as equity partners are sought to recapitalize the enormous portfolios acquired in 2015.

"We see this trend set to continue well in to 2016, as the occupiers of much of these portfolios are high-credit, national or multi-national corporations that provide stability and secure returns over long investment hold periods," Meyer said.

Anticipation of the long-awaited Panama Canal expansion is expected to continue to influence long-term changes in global supply chain dynamics. Many ports have already invested heavily in their infrastructure, with ports in the Eastern U.S. expected to benefit most from Panama Canal expansion over the next decade, especially in seaport markets with the best connectivity to major metropolitan population hubs throughout the country.

"Logistics companies will favor ports with intermodal options to meet flexibility, cost and service requirements to bring products in by ship and transfer to rail or truck to their final destinations," Meyer said.

In the third quarter of 2015, more than 170 million square feet of industrial space was under construction, up almost 20 percent from the same time last year. Many large occupiers are driven into new development for lack of quality, existing space options. JLL's third quarter 2015 U.S. Industrial Outlook report shows that current and projected demand is approximately double that of speculative construction now under way. The report anticipates that net absorption will surpass new completions for the sixth consecutive year in 2016.

"The major industrial hubs throughout the United States, like Chicago, Central Pennsylvania, the Inland Empire, Dallas and Atlanta, have seen a significant increase in industrial development," Meyer said. "As e-commerce volume is expected to more than double, companies will need to build new efficient warehouses and expand their industrial footprint deeper into urban locations in order to support customer demand for one-day or same-day deliveries."

MARKETS UPDATE SUPPLEMENT P. 3

Manufacturing Sector Contracts in December

MARKETS UPDATE SUPPLEMENT P. 4

The manufacturing sector contracted in December, while the overall economy grew, according to supply executives in the latest Manufacturing ISM Report on Business. The December PMI was 48.2 percent, a decrease of 0.4 percentage point from the November reading.

The New Orders Index registered 49.2 percent, an increase of 0.3 percentage point from the reading of 48.9 percent in November. The Production Index registered 49.8 percent, 0.6 percentage point higher than the November reading of 49.2 percent. The Employment Index registered 48.1 percent, 3.2 percentage points below the November reading of 51.3 percent.

A reading above 50 percent indicates that the manufacturing economy is generally expanding; below 50 percent indicates that it is generally contracting.

"With the dividing line between growth and decline at 50 percent, the December report indicates that manufacturing activity is declining," said Daniel Meckstroth, chief economist for the MAPI Foundation, the research affiliate of the Manufacturers Alliance for Productivity and Innovation.

"Only 15 percent of the time in the last 25 years has the PMI been at or less than 48.2 percent, so activity is abnormally weak but not at recession levels (about 43 percent). The only good news in the report is that exports are growing."

Of the 18 manufacturing industries, six are reporting growth in December in the following order: Printing & Related Support Activities; Textile Mills; Paper Products; Miscellaneous Manufacturing; Chemical Products; and Food, Beverage & Tobacco Products.

The 10 industries reporting contraction in December – listed in order – are: Apparel, Leather & Allied Products; Plastics & Rubber Products; Machinery; Primary Metals; Fabricated Metal Products; Transportation Equipment; Electrical Equipment, Appliances & Components; Computer & Electronic Products; Wood Products; and Nonmetallic Mineral Products.

The reaction from respondents to the Manufacturing ISM Report on Business survey was mixed, especially regarding the oil & gas. One executive in the petroleum & coal products sector said, "Low oil prices are negatively impacting oil and gas exploration activities (but) low oil prices are generally positive for the petrochemical industry." An executive in plastics & rubber products said, "Business is going well. Low fuel prices keep full-size SUV and truck sales at high volumes."

"The December ISM report confirms that manufacturing production is going through an inventory adjustment that has dragged production down. The good news is that inventory swings are always temporary and this swing has probably already run its course," Meckstroth said.

"The overall economy is being driven by solid job growth and accompanying income and consumption growth. Having a solid base of moderate overall growth allows the manufacturing sector to weather this temporary soft patch. This year will not see the dollar appreciate nearly as much than last (2015), commodity prices will not collapse again, it is unlikely that there will be another severe winter, and the West Coast port strike is over. Without these shocks, manufacturing production will accelerate in early 2016."

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