# MODERN DISTRIBUTION MANAGEMENT

*The Newsletter for the Wholesale Distribution Channel*

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# Are Reverse Auctions Evolving?

*Technology now helps buyers consider more than just price*

*Reverse auctions have left many distributors with a bad taste in their mouths. But new and cheaper technology is addressing some of the issues that turned off many distributors from this e-sourcing tool. Some buyers have learned from their mistakes and are spending more time to find better qualified suppliers in the pre-auction phase to avoid problems on the back end.*

**By Lindsay Young**

Could reverse auctions be coming into their own? Some industry watchers think so.

While many distributors have learned through bad experiences to avoid them, reverse auctions could be transitioning onto more neutral ground as technology advances and becomes more affordable, and the unsustainability of price-focused auctions is exposed.

"Online sourcing is just now moving from its adolescent phase into young adulthood," says Tim Minahan, senior vice president for marketing at Procuri Inc., which develops and provides e-procurement software. Minahan was the head of the Aberdeen Group's supply chain research practice for eight years before joining Procuri in March.

Price-focused tactics are unsustainable because only so much can be removed from a supplier's profit margins before endangering the health of that supplier. This, of course, is not news to distributors. But backlash from suppliers is one of the reasons some buyers have reconsidered their methods.

Minahan points out one other factor in play: "Unlike in the mid- to late-90s when online reverse auctions first burst on the scene, it is no longer a buyer's market." Global economic uncertainty, rising energy costs, inflation and tightening supply markets are driving buyers to use more collaborative and total-cost-based negotiations.

### A Few Key Changes

Multi-attribute auctions are becoming more common. In addition to using price, buyers are considering such factors as ability to meet equipment specifications, delivery areas and timeframe, service options, and experience. And they are looking at these considerations more closely before an auction begins.

Kevin Ehrie, senior principal at e-sourcing software provider Perfect Commerce, says more buyers are using a Total Cost of Ownership analysis. As part of this, buyers are looking harder at services their suppliers provide. Previous experience becomes a larger part of the pre-auction rankings. The ability to do a total-cost analysis has been around for years, Minahan says, but use of this capability has taken off more recently.

Buyers are learning to better incorporate online sourcing tools into their overall sourcing and supply management strategies. As they gain e-sourcing experience, buyers are focusing more on advanced negotiation capabilities to evaluate multiple parameters and total costs. In addition, technology has advanced to a point where e-sourcing is becoming easier and cheaper to implement.

"Over the years, e-sourcing providers have dramatically enhanced the usability and accessibility of these features by adding templates and configuration wizards," Minahan says. So, for example, a sourcing manager today can consider what-if scenarios using a series of pull-down menus and configuration wizards and templates.

Flexible subscription and usage-based pricing models are also making advanced online sourcing more accessible and practical for more companies. Karen Watson, manager for Capgemini's supply-chain buy practice, says some of her clients

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## INSIDE



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are starting to hire internally and buy their own software to manage their own auctions, rather than outsourcing the job. "The marketplace has become a lot more sophisticated," she says.

### Pre-Auction Preparation

If done right, a reverse auction can mimic a sealed-bid process, Ehrie says. More and more, reverse auctions are becoming part of an e-sourcing "suite" with project management tools at the front end and contracting tools at the back.

ITT, a $7.8 billion company, manufactures equipment for water and wastewater treatment and industrial processes, defense electronics and services, electronic components such as connectors and switches, and a wide range of industrial products. ITT started using Procuri to do reverse auctions as a way to maximize cost savings back in 2001. Lance Eruysal, director of global supply chain for Industrial and Biopharm Group at ITT, says at first, the company, like many others, jumped right into reverse auctions without fully thinking through the consequences. "A lot of the buying community got caught up in that," he says. As a result, reverse auctions gained a stigma that lingers today.

ITT quickly learned that when reverse auctions are not done right, they can damage supplier relationships. "It became clear to us that reverse auctions are a powerful and potentially risky tool that needs to be used properly," Eruysal says.

So buyers are spending more time in the supplier qualification stage before an auction. Eruysal says "conditions have to be right" to hold a reverse auction. ITT spends time analyzing the market, as well as the service and quality they are currently receiving from an incumbent supplier at a set price. It's important at this stage to ensure the company is comparing apples to apples, Eruysal says. ITT also considers how much it would cost to switch suppliers. "If the switching costs are too high, it could erode the savings (gained from a reverse auction)," he says.

If ITT determines that an incumbent supplier is charging more than the market demands, the company approaches that supplier and tries to work with it to improve its competitiveness. If the company and the supplier are unable to come to an agreement, ITT may decide to move the work or go to a reverse auction and invite all suppliers who are qualified, including the incumbent supplier. But this step is only after careful review with the incumbent supplier and exhausting all possible methods to reduce costs in the current supply chain.

If a reverse auction is done, Eruysal says it is key to communicate with the incumbent and invite the incumbent to participate. Sometimes, the incumbent is still able to offer the best package. ITT's work before the auction is crucial, Eruysal says. Communication and integrity in the process are especially important, he says. And companies need to follow through on reverse auctions. If a company's reverse auction fails, "it's not a failure of the tool, it's a failure of your preparation," Eruysal believes.

**MODERN DISTRIBUTION MANAGEMENT**

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### Still Hesitant

Still, Eruysal concedes there are many buyers out there who have not yet moved to a more comprehensive strategy when it comes to reverse auctions.

Indeed, many of the distributors reached for this article said they don't participate in reverse auctions. Most cited bad experiences or that the focus of reverse auctions is typically on price, not service or quality.

"We see very few reverse auctions," says Mike Baker, president of industrial distributor Quality Mill Supply Company, Franklin, IN. "They used to have them item by item but what we learned was that the buyer would select the best price only to find out after it was shipped it was not accepted because of brand preference or quality and was returned. One large customer indicated that the cost of returns and down time, wrong delivery and brand issues cost way more than the perceived savings."

Baker described an experience with a large manufacturer who decided to have a reverse auction on grinding wheels: "This company actually started orders from the lowest bidder, got the wrong specifications, wrong sizes, terrible delivery and it impacted their production at the plant level. While the buyer may have looked good to someone up the chain, the poor production manager at the local plant was forced to buy the right wheels using a credit card so he could keep the plant running. I think this experience was common in the past."

Baker advises that distributors participate in reverse auctions only if they need to. Even so, "you're better off spending time with a customer that understands the value of productivity savings, a long-term relationship and working together to reduce manufacturing and labor costs."

Adam Fein, president of Pembroke Consulting, says it's a golden time for wholesale distribution. End demand is strong, and price inflation is boosting bottom lines. "Many distributors are not feeling the pinch from reverse auctions," he says. "They are more willing to walk away from bad accounts."

### Flexible E-sourcing Techniques

Other e-sourcing techniques exist beyond reverse auctions, some of which are complementary. Some of the more common include the basic electronic request for quotes, electronic request for proposals and electronic requests for information.

Project management software is also providing another level of control for buyers looking to implement reverse auctions as a sourcing tool. As the software grows more sophisticated, Watson says it may improve how reverse auctions are run. The software walks buyers through every aspect of a reverse auction.

It helps buyers find qualified suppliers, set up the auction itself, communicate with suppliers on a consistent basis, monitor and manage project milestones, and interact with members of the sourcing team. Project management software also helps manage project information such as requirements, supply market dynamics, supplier evaluations and negotiation approaches.

Software providers have also started to offer what could be a more welcome approach to e-sourcing. Expressive bidding, also called flexible bidding, gives distributors more power by allowing them to make offers that make the most sense for their business. This means suppliers can offer bids based on alternatives to what the buyer puts up for auction: alternative bundles or offers that differentiate them on price and non-price attributes, including product specifications, location or delivery options, conditional offers, tiered pricing, and rebates.

### When Should You Participate?

- Use reverse auctions strategically, Watson advises. When you are invited to participate, really give it some thought. Do you need to protect your business? Or do you want to grow and win new business? "I don't think it's a bad thing to walk away from a particular auction, but you should communicate your reasons. Be forward," Watson says. This may help keep you in the loop.
- Watson advises distributors to find a niche. Participate in auctions where you know the product area well – an area that is your core competency so you have a broad understanding of market forces and prices in that particular market and what will be required to maintain a contract.
- Eruysal recommends distributors "get as much clarity as you can up front." This means asking: what the criteria for selecting a bidder will be, whether there will be ongoing negotiation after the event, whether a contract is already ready for the winning bidder – "Ask to see what you will be signing." Also, incumbents should not be afraid to ask whether their customers have considered switching costs.
- Distributors should also be sure they are comfortable with the interface being used in the reverse auction. If not, they should

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participate in practice auctions their customers offer.
- Fein recommends distributors identify one person in-house who will respond to reverse auctions. Distributors should have a plan as to how and when they will respond to and participate in reverse auctions.
- Reverse auctions may be an opportunity for distributors to open a new account using a loss leader – just make sure that is actually the case before jumping in, Fein says.
- Take advantage of reverse auctions to see how you rank in the field. No company sees another company's information or bid, but you will see how you measure up. Also, you don't have to be active in a reverse auction. If you are satisfied with your bid, sit back and watch, Ehrie says.

### Resources

Access links to the following archived MDM stories on reverse auctions online at www.mdm.com: *Online Auctions Are Here to Stay*, by Adam Fein, and *Rethink Reverse Auctions*, by Joe Salimando.

# Synchronize Your Sales Process

## *Be responsive to the timing of the customer's decision cycle*

*Distribution sales representatives have to understand sales processes and cycles in today's markets. This article offers a framework for analyzing your internal sales process against a customer's decision process. This type of analysis helps sales management focus resources where they will yield the most return. Your sales people will be more flexible and tuned to the customer's decisionmaking cycle.*

**By Todd Youngblood**

Timing is everything. Editors tell authors to never *ever* start an article with a cliché. Despite appearances, I always follow that advice, and here's why the above – when applied to selling – is not a violation of that rule. Competition is intense. Depending on luck to win is therefore foolhardy. It doesn't matter how fervently you *hope* your timing is right. As a sales rep, you must *make* your timing right.

To ensure that the clock is in your favor, synchronization of your sales process with the customer's decision process is essential. To illustrate the point, we'll first briefly define the two processes and then graph them to deliver some insights.

### The Funnel

All sales pros are familiar with the funnel or pipeline concept. Although your definition of stages may be slightly different, what follows is a good generalized model:

- **Identify Opportunities** – Figure out who might, maybe someday buy something from me.
- **Gain Attention** – Schedule a face-to-face appointment with the decision maker.
- **Establish Interest** – Get the decision maker's commitment to deploy time and resources to investigate and evaluate my offerings.
- **Conduct Discovery** – Find out everything I need to know about the prospect's business to write a compelling proposal.
- **Present/Propose** – Write a compelling proposal and if possible, present it.
- **Close** – No definition necessary.

### The Decision Model

Surprisingly few in sales have spent a lot of time thinking about the customer decision process. (Isn't it a bit embarrassing for so many of us to have ignored something so obviously important?) Here's a more detailed outline of a good generalized decision model:

- **Develop Strategic Plan** – Based on the organization's vision and mission, top executives examine their strengths, weaknesses, opportunities and threats. They then lay out strategies for each of their major functional areas along with an organizational structure and means to measure and control operations.
- **Design, Implement and Execute Business Processes** – In great detail, functional and operational managers determine exactly how each employee, tool and asset will be deployed to efficiently execute strategy and achieve desired results. In addition, they develop and track performance against budgets that ultimately get rolled up into Income Statements and Balance Sheets.
- **Respond to Problems** – Murphy's Law is still in force. Quality of strategy, plan and

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tactics notwithstanding, stuff happens. It must all be addressed …NOW!

- **Define Needs** – Operational level managers figure out what they need to carry out the "C-level" plans, execute the VP-level business process designs and react to everything that Murphy throws at them; keeping everything within budget.
- **Identify Alternatives** – Those same managers apply their personal knowledge, skills and contacts, and that of their subordinates, to research what is available to help them fulfill all those needs.
- **Evaluate Alternatives** – *Everybody* (at least it usually seems like everybody…) gets involved in tweaking, asking, changing, criticizing, measuring, judging and gagging at the price of all aspects of all alternatives.
- **Decide** - No definition necessary.

### Interaction

With the basic definitions in place, let's take a look at how all the pieces interact. Note how the vertical axis in the diagram below shows the sales process from bottom to top and the horizontal axis shows the decision process from left to right.

Assume that a sales rep is currently in the "Identify" sales stage for a given opportunity at a given account. If the customer is at the "Plan" or "Execute" decision stage, the rep's timing is great, and thus those two squares are green. If the rep is at "Identify" and the customer is at "Decide," the rep is very, very late to the game and has little or no chance to win. That square is red. He has a chance (i.e., a yellow square) if the customer is still figuring out exactly what is needed, but he better get cracking! If the customer defines needs without the rep's involvement, the rep is stuck with being in react mode and is headed toward a price war.

Along the top row of the diagram, the rep who is trying to close a deal while the customer is still defining needs will at best be viewed as too pushy and at worst really annoying. It would be much better to start closing while my customer is still looking around for alternatives. That means I'm out ahead of my straggling competitors and have already had the opportunity to frame the decision criteria in my favor.

Take the time to think through the situation for every one of the boxes in the diagram. Then think through each of your current opportunities. How good is your timing? What actions do you need to take to get back in sync with your customer?

In particular, think through the implications

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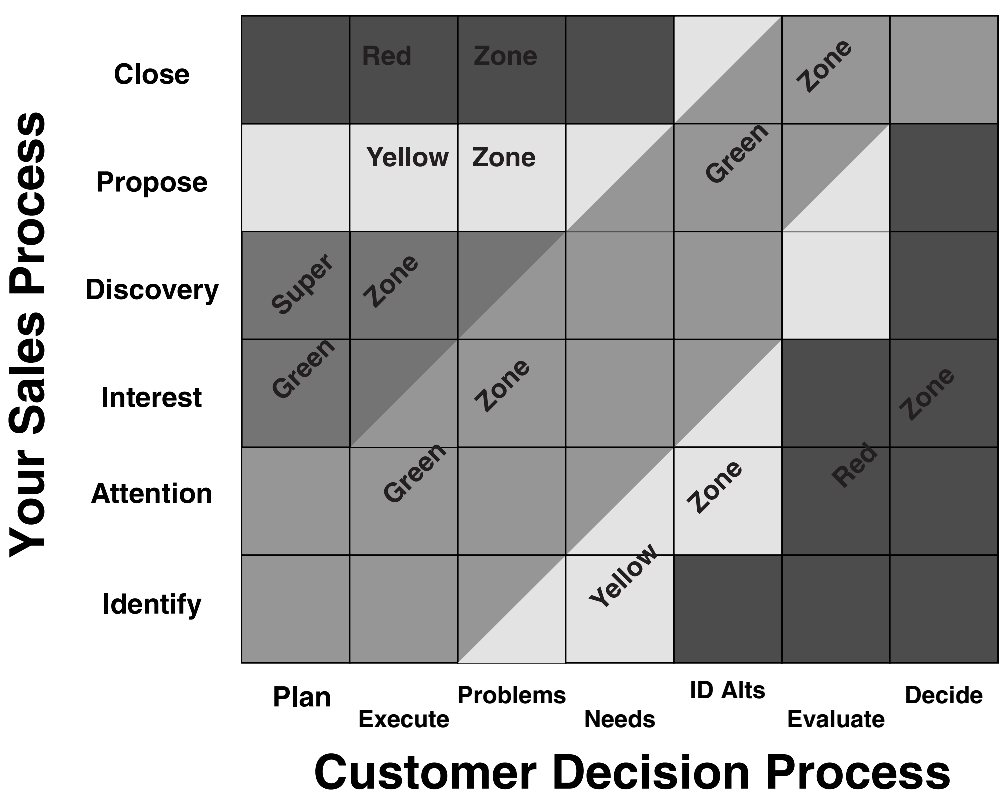
## Synchronizing Sales & Decision Processes



of finding yourself in the single most commonly occupied spot – right on the border of "Attention/ Interest" while the customer is at "Evaluate Alternatives." Sales managers see this over and over. The customer has already figured out what is needed and is already familiar with multiple sources of supply and is now evaluating alternatives. Out go the phone calls to the suppliers. In come the reps trying to establish the customer's interest in helping them gather facts and study the situation.

Well, the customer has already gone beyond your Discovery phase and already "knows" what you should propose. The customer wants a proposal now. And the customer wants your best and final price, NOW.

It is highly unlikely the customer will have the patience to endure your Discovery phase at this point so you can gain a thorough understanding of their strategic plans, business processes and problems. From the customer's perspective, that is just wasting time this far into their decision cycle.

Key point: The customer has forced you to skip over several critical steps of your sales process. The customer has made one of your green squares red. You are hopelessly caught in react mode. You can either compete on price or walk away from the deal.

A rep must get engaged much earlier in the decision process to stay inside the green, proactive zone. More specifically, if the customer has a crisp answer to the question, "What do you need?," the customer is into identifying and more likely evaluating alternatives, and you had better be delivering your proposal.

Based on research conducted by The YPS Group, most industrial sales reps live in the red and yellow zones at the bottom and right of the diagram. The key indicator of this is the percentage of potential deals where price is one of, if not *the* key decision criteria. At the risk of becoming repetitious, if you are constantly getting beaten up on price, you are entering the game too late in the decision cycle. Customers are forcing you to omit the phases of your sales process that enable you to shine and to clearly demonstrate your "value-add."

### The Eagles

Perhaps not surprisingly, the best performing sales reps (i.e., those closing the biggest deals with high margins and total territory sales exceeding $3 million) spend the bulk of their time in the "super green" zone at the center-left of the diagram. Their focus is on cross-departmental communication regarding the thought behind, the nuances and the implications of the customer's strategic plan, business processes and problems.

Eagle reps are providing a service that is extremely valuable to the top customer executives. It is a service that has literally and absolutely nothing to do with the products and services provided by that eagle rep's company. It's all about *cross-departmental communication* within that customer.

Customer executives know that internal and inter-departmental communication is crucial. Look at all the executive management books written on the subject! But do they really have the time to communicate well? Do financial or production or procurement executives have anywhere near the communication skills of a polished sales professional? Isn't it obvious who could be really effective leading the charge for better internal communication?

Eagle reps understand customer strategic plans, processes and problems so thoroughly, and communicate them so well, that they enable customers to leap-frog over significant pieces of their decision process. Eagle reps use their knowledge about customers to define their problems, what they cost, their root cause and how to address them before they even realize they have a problem.

How could a top executive not be impressed with a sales rep who consistently proposes money-saving and money-making solutions to problems nobody even knew existed? Why bother with identifying and evaluating alternatives? The eagle makes those steps superfluous.

### Not Easy Being Green

I'm not suggesting that implementing any of this will be easy. The effort it takes to get to the "super green" zone for even one account is significant. It's also a different kind of effort that requires broad, general management knowledge.

On the other hand, differentiating your products is getting harder and harder every day. It makes sense to focus more selling and research time on those early stages of the customer decision process. By doing so, reps can not only enhance their personal value and shorten the sell cycle, but also deliver greater ROI and shorten the customer decision cycle.

*Copyright 2006 The YPS Group, Inc. All rights reserved.* *Todd Youngblood is managing partner and CEO of The YPS Group Inc., a sales process engineering and sales training firm. The YPS partners are all obsessed with the sales productivity of their clients. He can be reached at 770- 514-1189, todd@ypsgroup.com or at www.ypsgroup.com.*

# MSC to Buy Kennametal's J&L Unit for $349 Million

*MSC Industrial Direct Co., Inc., Melville, NY, will pay $349.5 million in cash, or 11.3X EBITDA, for Kennametal's J&L Industrial Supply business. The deal completes Kennametal's planned exit from owned distribution businesses, which had created consistent channel management issues for the increasingly diversified cutting tool manufacturer.*

MSC Industrial Direct Co. Inc., Melville, NY, has announced it will pay $349.5 million in cash, or 11.3X EBITDA, for Kennametal's J&L Industrial Supply business. J&L reported sales of $265 million in 2005, with 74,000 customers and more than 140 salespeople.

The deal completes Kennametal's planned exit from owned distribution businesses, which had created consistent channel management issues for the increasingly diversified cutting tool manufacturer. "We're not competing with our own distributors anymore; that is good for us," Kennametal spokeswoman Joy Chandler told MDM.

The transaction is expected to be completed in the second quarter of 2006.

### Access to Kennametal Brand

For MSC, J&L offers a well-established specialty metalworking customer segment built through strong Kennametal technical support channels; metalworking also has been a traditionally strong segment for MSC, but it has effectively diversified its product offerings and markets in recent years.

"MSC will gain access to the exclusive relationship at the national level with Kennametal brand carbide cutting tools. …We will feature Kennametal in our catalogs and brochures as a lead brand," CEO and President David Sandler said in an MSC conference call. "We expect to add significant new business from the Kennametal brand, as we will sell it across the entire country."

Kennametal's Chandler said that MSC will be able to distribute Kennametal and Hertel lines of carbide cutting tools in the U.S. and UK, pursuant to a five-year renewable distribution agreement. Kennametal will maintain a network of local and regional distributors. The relationship with MSC expands Kennametal's coverage in that MSC has the capabilities to serve areas not currently being serviced by other distributors, she said.

"MSC is a great match and will be able to fully leverage J&L's capabilities. In turn, J&L will remain a major distributor of Kennametal products and an important strategic channel partner," said Kennametal CEO and President Carlos M. Cardoso. "MSC will have access to the Kennametal portfolio of brands, and the Kennametal brand will be marketed through MSC and J&L as the premier brand of indexable cutting tool products."

"All suppliers enjoy the rewards from that increased market share," Sandler said in response to a question regarding the effect the relationship with Kennametal will have on MSC's other supplier relationships.

Kennametal said the J&L divestiture will allow it to grow existing distributor relationships and build new ones. Chandler said Kennametal is still on track to double the number of its independent distributors. The divestiture of J&L also presents an opportunity for Kennametal to improve customer options by delivering its full range of products to customers through the strongest distribution partners, according to the company.

### Expanded Geographic Reach

The acquisition expands MSC's geographic reach in the central U.S., which Sandler said was the most concentrated region for metalworking products in the U.S. J&L has two distribution centers: one in Detroit and the other in Chicago.

Bob Cuthbertson, president of Machinery Tooling and Supply, a strong Sandvik Coromant distributor in Chicago, IL, says MSC is increasing its force in a "very competitive" and fragmented market. Beyond that, Cuthbertson noted, MSC is gaining a stronger presence in the backyard of its primary national catalog competitors. W.W. Grainger Inc. and McMaster Carr Supply Company both have headquarters in Chicago.

"(The acquisition) is certainly going to give MSC a much stronger presence in the Midwest," Cuthbertson says. Machinery Tooling and Supply's coverage includes Chicago, its western suburbs, Northern Illinois and the state of Wisconsin.

With the purchase, MSC also gains a foothold in the UK. About 10 percent of J&L's sales are generated in the UK. Sandler said MSC will eventually look to add onto J&L's operations there and throughout Europe. "We now have a

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cost-effective leg to produce growth over time," Sandler said.

### J&L History

Kennametal purchased J&L Industrial Supply, a mail-order company, in 1989 and also purchased Garrett Industrial Supply, Los Angeles, CA, that same year. Combined sales of the Garrett and J&L subsidiaries when acquired in 1989 were about $115 million. Kennametal continued to acquire distribution companies through the 1990s as part of a long-range strategy for developing a larger U.S. distribution chain.

That included L.R. Christiansen Co., Moline, IL, with revenues of $8 million at the time of its acquisition in 1991. But by 1993 Kennametal consolidated its distribution branches and cut back to a core group of product lines in abrasives, cutting tools, tooling and measuring devices focused on mid-sized production accounts.

Kennametal also entered national agreements with several vendors in the early 1990s to offer customers a single source for a broader selection of products. That included partnerships with Norton Company, Regal-Beloit, Precision Twist Drill, The L.S. Starrett Company and Carr Lane Manufacturing Company.

Kennametal made another strong push at expansion in the late 1990s. It spun off its distribution businesses in 1997 with the creation of JLK Direct Distribution Inc., which it then took public, selling roughly 20 percent of its shares in an initial public offering.

The JLK subsidiary included J&L as well as its Full Service Supply program, which focused on integrated supply agreements with large customers. In its fiscal year ended Jun. 30, 1999, JLK reported net sales of $531.6 million. That included $400.3 million in J&L's branch and catalog sales, a 35 percent increase over the prior year, primarily due to acquisitions, which generated $117.9 million in sales.

Its Full Service Supply business reported external sales of $131.3 million for fiscal 1999, an increase of 1.2 percent. J&L acquired six metalworking distributors in 1998, including Strong Tool Company, Cleveland, OH. Kennametal then took JLK private in 2000 by repurchasing the roughly 17 percent of shares held publicly.

J&L subsequently sold the Strong Tool operation in 2002 as part of its strategy to return to a focus on its core competencies in catalog sales distribution. In 2005, Kennametal sold its Full Service Supply division, with 2004 annual revenues of $138.4 million, to Ferguson Enterprises.

### Details

The sale remains subject to customary regulatory approval and negotiated conditions of closing. Goldman, Sachs & Co. is serving as financial advisor to Kennametal in this transaction.

The acquisition is not expected to have a material impact on MSC's fiscal 2006 results, and is expected to be neutral to the company's earnings per share through fiscal 2007, becoming accretive toward the end of fiscal 2007.

As a part of the transaction, Kennametal will recognize an estimated $228.6 million pre-tax gain in the quarter ending June 30, 2006, including transaction-related expenses, resulting in an earnings-per-share impact of about $3.25. The company expects to redeploy this capital in the next 12-24 months with strategic initiatives. Kennametal immediately plans to accelerate its manufacturing rationalization opportunities. This investment is expected to have a cost impact of approximately $0.55 to $0.70 per share and a payback of less than three years.

MSC Industrial Direct is a distributor of MRO supplies to industrial customers throughout the U.S. MSC distributes more than 500,000 industrial products from about 2,100 suppliers to roughly 342,000 customers. The company had $1.1 billion in sales in fiscal year 2005.

Kennametal Inc. is a global supplier of tooling, engineered components and advanced materials consumed in production processes. Customers buy more than $2.3 billion annually of Kennametal products and services delivered by 14,000 employees in over 60 countries with almost half of these revenues coming from outside the U.S.

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MODERN DISTRIBUTION MANAGEMENT VOL. 36, NO. 06
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# Industrial & Construction Markets Update

## PERSPECTIVE

How do you get a distributor agitated? Bring up the subject of reverse auctions. There are few topics in distribution that generate such a negative response. Nearly everyone who has participated or been displaced by one has a horror story of the resulting breakdown in contract performance. Some were ironed out and distributors lost business to the price battle; some displaced distributors came to the rescue months later and had the opportunity to say, "I told you so."

Satisfying as that may be on occasion, reverse auctions quickly became a lightning rod in the late 1990s for short-circuiting channel relationships. Distributors got squeezed in the middle of a price negotiation where their added-value capabilities were stripped out of the equation. For some it was a frightening wake-up call about how much of their added-value was bundled into the product costs. Customers took certain services for granted, and rejected outright the value of others that did not impact the bottom line.

Those negatives were compounded by suppliers that suddenly were faced with yet another channel management issue. In one case for the ages, we heard about a distributor into the production facilities of a primary supplier facing the Catch-22 of trying to get special discounts for a reverse auction being conducted by that supplier. Confused? So were all the participants in that one.

In spite of the strong negatives, including some expensive and painful learning curves, we found that a segment of customers, typically large ones, continue to develop reverse auctions as a tool instead of a weapon. Distributors may not like it, and as we found, many are electing not to participate today. But customers clearly are achieving some goals with them, whether used as weapon or tool. Worth watching.

**MSC Industrial Direct Co. Inc.**, Melville, NY, has announced it will pay $349.5 million in cash, or 11.3X EBITDA, for **Kennametal's J&L Industrial Supply** business. J&L reported sales of $265 million in 2005, with 74,000 customers and more than 140 salespeople. The deal completes Kennametal's planned exit from owned distribution businesses, which had created consistent channel management issues for the increasingly diversified cutting tool manufacturer. See story on pg. 7.

**Castrol Industrial North America** Inc., Naperville, IL, plans to realign its distribution channels to focus on its strengths. The company plans to reduce the number of distributors and the industries it serves. See story on pg. 3 of this section.

**W.W. Grainger Inc.**, Chicago, IL, $5.5 billion distributor of facilities maintenance supplies, is adding more than 39,000 products to its new 2006 catalog launching April 3, 2006. The expansion brings the number of products offered through its catalog from 82,000 to more than 115,000. The expanded offering consists of some 30,000 different fasteners such as screws, bolts and nuts, and an additional 10,000 products spread across diverse product categories including electrical, cleaning, material handling, plumbing and ventilation.

**Airgas Inc.**, Radnor, PA, has agreed to acquire the assets and operations of **Airtec Inc.**, an industrial gas and welding supply distributor with six locations in Wisconsin and one in Minneapolis, MN. The acquisition is expected to close by April 1, 2006, subject to customary closing conditions. The Altoona, WI-based business, which generated around $13 million in annual sales in 2005 and employs about 60 people, will be integrated into Airgas North Central, one of Airgas' 13 regional companies.

**Wolseley plc**, London, group revenues increased more than 26 percent to $11.85 billion with profit up nearly 22 percent to $677.5 million. Wolseley saw organic growth of 12.2 percent. Wolseley's North American companies had reported revenues up more than 40 percent and profit up 39 percent. Wolseley's U.S. plumbing and heating business, **Ferguson**, had overall sales growth of 37.8 percent to $4,530.5 million and organic growth of 27 percent. Profit growth was 29.5 percent. **Stock Building Supply** reported revenues up 27.2 percent to $2.5 billion with profit up 51.5 percent to $157.3 million. Organic revenue growth was 7.9 percent, reflecting some commodity price deflation in lumber and structural panels.

**Activant Solutions Inc.**, Austin, TX, (purchased Prophet 21 in September 2005) has signed a definitive agreement to be acquired by private equity investment firms **Hellman & Friedman LLC** and **Thoma Cressey Equity Partners**. The firms will acquire Activant Solutions Holdings Inc and all its subsidiaries from investment funds affiliated with HM Capital Partners LLC, which has approved the transaction. Activant serves small- and medium-sized retail and wholesale distribution businesses. See article on p. 3 of this section.

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Hardlines distributor **Orgill Inc**., Memphis, TN, will acquire **Wright & Wilhelmy**, a 131-year-old wholesale hardware distributor based in Omaha, NE. The addition of the Wright & Wilhelmy sales force and customer base will increase Orgill's penetration into Nebraska, Kansas, Iowa, North Dakota and South Dakota. The existing Wright & Wilhelmy distribution center will operate as an Orgill redistribution branch supplied by Orgill's Memphis distribution center.

**Hampshire Equity Partners,** New York, NY, has acquired **Impact Products LLC**, Toledo, OH. Hampshire reported it would explore strategic acquisitions that would expand the company's product offering. Impact's management retains an equity interest in the company. Impact Products is a supplier of branded and private-label non-chemical commercial cleaning, maintenance and related products. The company offers janitorial products, including floorcare products, waste receptacles, washroom products and safety products. Impact's products are used in the janitorial/sanitation, industrial and foodservice markets. Impact has 4,000 customers and a product offering of 3,700 commercial cleaning and safety products. Hampshire Equity Partners invests in lower middle-market companies (EBITDA between $3 million and $15 million).

**January U.S. machine tool consumption**, down 32 percent from December, totaled $225.94 million, according to the American Machine Tool Distributors' Association and the Association For Manufacturing Technology. This total, as reported by companies participating in the USMTC program, was down 31.9 percent from December but up 11.3 percent from the total of $202.94 million reported for January 2005.

Metals service center **Ryerson Inc.**, Chicago, IL, sales increased 75.1 percent to $5.8 billion for fiscal year 2005 on a 24 percent increase in tons shipped and a 41.2 percent increase in the average selling price per ton. Sales were up 44.4 percent to $1.3 billion in the fourth quarter due to the acquisition of metals service center **Integris Metals** ($2 billion in 2004 sales).

**Barnes Group Inc.**, Bristol, CN, has agreed to acquire **Heinz Hanggi AG, Stanztechnik** of Bettlach, Switzerland, a developer and manufacturer of high-precision punched and fine-blanked components, for a combination of cash and Barnes Group Inc. common stock. The acquisition is expected to close in the second quarter of this year and will add about $30 million in annual sales to Barnes Group's Associated Spring unit.

**Grainger** announced its **Lab Safety Supply** subsidiary has acquired **Rand Materials Handling Equipment Co.**, Pawtucket, RI. Rand is a national catalog distributor of warehouse, storage and packaging supplies, part of the $80 billion material handling market. Rand had $16 million in sales in 2005.

**Emerson**, St. Louis, MO, has acquired **Bristol Babcock** from **FKI plc** of Loughborough, England, for $121 million. To be renamed Bristol, the company becomes part of Emerson Process Management and adds measurement and control products, technologies and services for oil, gas, power, water and wastewater industries. Bristol Babcock is headquartered in Watertown, CT, and has annual revenues of $80 million. It has manufacturing facilities and offices in the U.S., UK, and Canada as well as Mexico, the Middle East, Australia and China.

Diversified industrial manufacturer **Eaton Corp.** ($11.1 billion in 2005 sales) will acquire the **Synflex** business unit of **Saint-Gobain Performance Plastics Corp.** The transaction is expected to close by the end of March. Synflex had 2005 sales of about $120 million and makes thermoplastic hoses and tubing for a range of industries, including transportation, beverage dispensing, fluid power and specialty applications.

**ADI International**, The Netherlands, a low voltage and security distributor, announced its parent, **Honeywell**, will acquire **Gardiner Groupe Europe** ($260 million in annual sales) from Electra Partners Europe, a private equity firm. The acquisition is meant to strengthen ADI's scope in security distribution throughout Europe. Gardiner Groupe Europe, Paris, distributes CCTV systems, fire alarm, intrusion alarm, access control, public address and integrated systems. It has 75 locations in 10 countries.

Increased traffic at ports, especially on the West Coast, is causing **increased demand for warehouse and distribution facilities**. New industrial construction should rise 20 percent this year to accommodate specific distribution requirements and to replace structures that are now obsolete, according to a commercial real estate report by the National Association of Realtors. **Industrial vacancy rates are likely to fall** to an average of 8 percent in the fourth quarter of 2006 from 9.6 percent in the last quarter of 2005. **Industrial rents are expected to grow** 3.8 percent this year.

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**INDUSTRIAL MARKETS UPDATE SUPPLEMENT P. 3**

## Private Equity Firms to Buy Activant Solutions

Activant Solutions Inc., Austin, TX, (purchased Prophet 21 in September 2005) has signed a definitive agreement to be acquired by private equity investment firms Hellman & Friedman LLC and Thoma Cressey Equity Partners. The firms will acquire Activant Solutions Holdings Inc and all its subsidiaries from investment funds affiliated with HM Capital Partners LLC, which have approved the transaction.

Activant serves small- and medium-sized retail and wholesale distribution businesses. Activant provides customers with software, professional services, content, supply chain connectivity and analytics. More than 30,000 customer locations use an Activant solution to manage their day-to-day operations.

"Over the past year, Activant has been on a steady and fast-paced climb in the market through organic growth and acquisitions," said Larry Jones, CEO of Activant Solutions. "While we have looked at a number of strategic options to best position the company for the future, we believe we have found the right partners in Hellman & Friedman and Thoma Cressey to continue the company's success."

David Tunnell, managing director of Hellman & Friedman, said, "We are very impressed with Activant's market leading position, vertical market expertise and strong management team."

The transaction is expected to close during Activant's third fiscal quarter ending June 30, 2006.

Activant bought Canada-based Speedware Corporation Inc., which provides software for lumber merchants, in March 2005, and in September bought Prophet 21 Inc., which provides software for wholesale distribution companies. It had considered an IPO last year before but abandoned the plan before buying Prophet 21, according to news reports.

Interestingly, Thoma Cressey with LLR Partners Inc., Philadelphia, PA, originally took Prophet 21 private in November 2002. Prophet 21 (now under Activant's umbrella) is back in Thoma Cressey's hands.

Hellman & Friedman LLC is a San Francisco-based private equity investment firm with additional offices in New York and London. Since its founding in 1984, the firm has raised and through its affiliated funds managed over $8 billion of committed capital.

Thoma Cressey Equity Partners is a private equity investment firm that has been providing equity and strategic support to experienced management teams building growing companies for more than 25 years. In the software industry, Thoma Cressey has amassed a portfolio of software earnings in excess of $150 million. Thoma Cressey currently manages approximately $2 billion of equity capital.

## Castrol to Realign Distribution Channels

Castrol Industrial North America Inc., Naperville, IL, plans to realign its distribution channels to focus on its strengths. The company plans to reduce the number of its suppliers and the industries it serves.

Castrol Industrial North America Inc. is part of BP, one of the world's largest energy companies, and is focused on the manufacturing and marketing of fuels, lubricants and petrochemicals.

"We are reshaping our distribution channels in order to better serve our customers by creating clear space for both direct and distribution channels to operate freely while complementing each other," said Vasu Kulkarni, marketing manager for Castrol Industrial North America. "We believe these actions will deliver improved customer focus, reduced complexity and provide Castrol with a sustainable growth platform."

Castrol currently has more than 85 distributors in North America. The company will determine over the next two to three months by how much it will reduce that number.

Castrol has acquired about 10 companies over the past 15 years and maintained the channels it inherited. But according to the company, not all the current distributors are equipped to sell the full Castrol line of products and services. Some sell only metalworking fluids, while others sell Castrol's range of lubricants.

The reorganized distribution channel will be able to sell and service the full range of Castrol offerings. Whether Castrol will go direct or through a distributor will be determined by multiple factors, the company said, including the customer's market segment, requirements, preferences and locations.

Castrol Industrial will further its direct sales' focus on certain industries – automotive, metals and machinery manufacture and aerospace. It also plans to grow its severe lubrication application business in the mining, cement and engineered wood industries.

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**INDUSTRIAL MARKETS UPDATE SUPPLEMENT P. 4**

"We currently are significant players with sufficient business in these industries," Kulkarni said. "What we are doing is focusing on those industries and markets where we have an inherent advantage in terms of our product portfolio, service offering and delivery management."

## Survey Gauges Manufacturer Outlook and Key Challenges

Forty-four percent of U.S. manufacturers expect manufacturing to trail the overall economy in 2006, according to the 2006 National Manufacturing Week survey of manufacturers.

On the brighter side, National Association of Manufacturers President John Engler said that more than half of the respondents expect to increase capital spending in 2006 and to increase employment, and that almost three-fourths of them now report they are exporting to other countries. "These are all positive signs," he said.

Engler said the biggest challenges are rising external costs associated with health care, materials and energy, which manufacturers are unable to transfer to product pricing. "External cost burdens are having the biggest impact on manufacturers — lowering their profitability and tying up more funds that would otherwise be spent on investment, research and development, and new product lines. These costs are a significant and long-term problem for our nation's manufacturers and our economy."

Tony Raimondo, chairman and CEO of Behlen Manufacturing Company in Columbus, NE, and a member of the NAM Board of Directors, said that energy was looming ever larger as a serious cost factor in his industry. "The government encourages us to rely more and more on natural gas for energy, and then makes it virtually impossible to access more supplies of natural gas. The result is the highest natural gas prices in the world."

"We have also got to get a handle on health care costs," Raimondo said. "We're looking at double-digit cost increases every year on what is already a major cost item. This survey shows that the cost of 'non-wage compensation' is having the greatest negative impact on manufacturers today, and by far the biggest item in that category is health care."

Engler noted that as the manufacturing sector continues to expand, manufacturers are more reliant on a high-performance workforce, and that qualified workers are getting harder to find. "We began seeing this issue a few years ago and it is becoming more pronounced in subsequent surveys," Engler said.

"Half of the respondents currently have unfilled positions because they cannot find qualified workers, and 70 percent of the new jobs that survey respondents anticipate creating will be for either skilled production workers or highly educated professionals. The need for highly-educated professionals specifically has nearly doubled from 2005 and we anticipate it will continue to grow in the future.

"If the U.S. is to preserve its position as a major economic power in the 21st century it must stay out in front of the innovation curve, and it will need a much better-prepared workforce to do so," Engler continued. "Like every modern nation, the United States is deeply involved in globalization. Technology and competition will only increase America's need to have access to highly skilled professionals. But our schools and training programs just aren't doing the job."

Ronald D. Bullock, CEO of Bison Gear & Engineering Corporation in St. Charles, IL, underscored Engler's comments with a personal comment on his quest for qualified manufacturing employees. "I recently filled an engineer's position that had been open for 18 months," Bullock said. "Right now, I have at least five empty slots, some of which have been empty for months. I need more people to keep up with demand, but I can't just hire anyone off the street. This is complicated work. We need people with strong backgrounds in math, science and computers."

Engler noted that one way manufacturers are competing more effectively with the rest of the globe is by increasing their exports, with an "astounding 73 percent" selling abroad. More information at www.nam.org.

**MODERN DISTRIBUTION MANAGEMENT**

*Founded in 1967 by J. Van Ness Philip*

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