MODERN DISTRIBUTION MANAGEMENT

The Newsletter for the Wholesale Distribution Channel

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New Differentiators in Distribution

Four skills to navigate turbulent channels

Distributors have had plenty of practice managing change over the past decade, thanks to a constant barrage of multi-syllabic trends – commoditization, national accounts, integrated supply, consolidation, globalization, e-commerce, downsizing, offshoring, outsourcing and strategic sourcing. Cap it off with a deep recession with deflationary and inflationary threats thrown in. Beyond buzzwords, how do you sum up the key impact on traditional distribution channels? Customers today can buy anything, anywhere, at any time.

By Thomas P. Gale

The Next Big Things

Change is a cruel taskmaster. No matter how well you adapt, it's never enough. Customers continue to redefine the value of distribution in their quest to create frictionless (and sometimes profitless) supply chains. So now that distributors have proven their ability to weather storms, manage change and make a profit, what's the next essential skill needed to extend competitive advantage? Where will you discover market share and profitability as competition increases and margins inevitably tighten?

The winners will be those who are best at extracting the most from their relationships up, down and across the channel over the next few years. Sounds simple, but it goes far beyond improving manufacturer-distributor relationships or creating strategic partnerships.

Distributors have to start thinking differently to protect their turf and grow new revenue streams. Unique and specific skill sets valued by customers will clearly differentiate your company from competitors. You need to offer compelling reasons to customers *and* suppliers why you should be the partner of choice.

Here are four critical skill areas where distributors have to effectively differentiate from competitors:

- Visibility
- Leverage
- Service & Knowledge
- Process Discipline

In each of these four areas, evaluate your company's skills against local and national competitors. If you aren't brutally honest about your weaknesses or downplay the importance of applying resources to one of these areas, you may be vulnerable to competitors that already recognize these emerging areas of competitive advantage.

Visibility

Visibility is the new version of the question about how easy it is to do business with your company. It's measured in how well distributors can use technology tools to increase service capabilities with customers and suppliers. How fluent are your employees with email? Email offers capabilities for instant access and service that clearly differentiate the level of care and commitment.

Are you a seller or a resource to customers? Can customers check order and inventory status online in real time? Those are key indicators today, based on benchmarks established by Amazon.com, EBay, Grainger and other technology innovators. Do you have a virtual library of product and technical information that prospects and customers can access?

If your customers are not online today, watch and ask them often. If you are positioned to help as they become online savvy, there may be opportunities to lock in their loyalty. Better visibility will be critical to building deeper and stronger relationships with customers, and necessary to fight low-price providers and other

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alternate sourcing options a click or call away.

Better visibility with manufacturers will be mandatory sooner than most people think. Can you access product/technical literature online? Have your key suppliers established customer service tools online to cut down on costly and time-wasting telephone exchanges?

Are you actively working with manufacturers to standardize pricing update formats? The Product and Price Information Format, developed by the Power Transmission Distributors Association and Bearing Specialists Association, is a prime example of better visibility. PTDA member Bearing Belt Chain Co. Inc. is even using the PPIF as a factor in supplier evaluation.

An electrical marketing group (Imark) has established a three-year incentive program for its 180 members to get them to use more e-business tools. The starting level of a three-tier program includes high-speed Internet access at the workplace, email addresses for key people, and a basic level of e-commerce with the group's preferred suppliers. (This includes exchanging 810 and 850 transaction sets, transmitting flat files by email, or using supplier e-business portals.) The highest level includes use of EDI transaction sets with more suppliers.

Point of sale information, often a point of contention, has provided manufacturers with visibility into end-user buying and application behavior, spawning new products and shifts in marketing programs that have resulted in greater sales and profitability for all channel participants. Point of sale information is a key way manufacturers can leverage the unique visibility distributors have into end-user customers. As relationships up and down the supply chain get more complex and confusing, distributors and manufacturers need all the leverage they can get to stay competitive.

Leverage

Doing more with less has become standard operating procedure at all points in the distribution channel. Lean thinking is not only working its way into distributor operations as ways to cut internal costs, it has become an effective sales tool. Many distributor salespeople have shifted from pushing product to creating cost-saving solutions or production efficiencies. Regular cost-saving reports have become standard industry practice for power transmission distributors. All these activities are leading us to one of the new rules in the new distribution landscape – all relationships must be strategic. Transactional relationships are too expensive today.

Fewer distributors have explored how to leverage their customer relationships to find new revenue streams. But in the fight to get paid for services instead of bundling services into product cost, some distributors have partnered with innovative customers on pilot projects in the areas of repair, refurbish, inventory management, commodity purchasing, and other non-traditional distribution functions. These distributors found opportunities at innovative customers who were open to exploring the

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Founded in 1967
by J. Van Ness Philip

Publisher & Executive Editor
Thomas P. Gale
tom@mdm.com

Editor
Lindsay Young
lindsay@mdm.com

Contact Information
Questions, comments, article proposals, address changes or subscription service to:

Gale Media, Inc.
2737 Mapleton Avenue, #201, Boulder, CO 80304
Tel: 303-443-5060 Fax: 303-443-5059
Website: http://www.mdm.com

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benefits of a deeper relationship.

Safety supplies distributor Safety Today, Columbus, Oh., has been offering onsite inventory management to customers for ten years, and introduced vending machines three years ago, helping with customer efforts in lean practices. The systems the distributor has installed have yielded an average 35 percent in cost reduction for customers. Not only have these systems elevated the distributor's value at the account, but the increased data collection has helped the distributor reduce its costs as well.

Just as customers have reduced their vendor base, more distributors and manufacturers are reducing their supplier/partner base to reduce costs and leverage the specific benefits of fewer business relationships. These strategic partnerships leverage the specific skills and expertise to achieve the business goals of both partners. At another level, marketing and buying groups have effectively given many smaller distributors critical leverage in their purchasing and marketing power.

An emerging area for distributor leverage is the external talent they can tap into through peers, marketing groups, technology partners and other service providers. Distributors – competitive in some cases – are putting together deals where a customer opportunity has defined a clear value in a relationship. The most interesting examples emerging have been in complementary products, or even certain branded competing products, where master distribution relationships or second-tier supplier agreements have developed.

Service & Knowledge

Traditionally, distributors with expertise in specific production or process problems have always created effective barriers to entry. But as customers have gained more access to product information, how they value the nature and type of application knowledge has changed significantly. It's become a tougher battle to differentiate from low-price providers as more products have gone to commodity status and alternate sourcing has mushroomed.

Most distributors need to upgrade their knowledge and service systems to reflect the new ways customers want to do business. That means training employees in different skill areas, creating product and process champions in high-value areas, and elevating the value your company represents. It may require a new commitment and investment to train in select areas, rather than continue as a generalist in many areas. That decision means making some difficult choices about the core strengths where you can dominate your competitors.

Tooling distributor C.J. Smith Machinery, Fulton, Mo., saw its fee-based safety audits take off after a request five years ago from the safety director of one of its largest customers. The service has strengthened Smith's relationship with its customers and in some cases opened the door for sales to meet safety requirements uncovered during the audits.

Process Discipline

The last great differentiator has been at work for years. Many distributors are sales-driven, and continue to live month to month without much attention paid to strategic planning or shifting requirements of customers. But as the examples in this article illustrate, some distributors have perfectly positioned themselves to offer customers additional services and capabilities to grow their business. Do your employees have the skills they need to thrive in the future and make your company successful? What do those skills look like? Based on the current shifts in distribution channels, the answer is centered more on managing relationships than product lines.

Process discipline is critical to help your company train and transition from your current model to a more flexible one. Your employees need new skills that include online marketing and communications, selling process improvement capabilities, and other services that enhance productivity or reduce cost. You'll need more employees who can effectively sell the value your company offers outside the product boxes. Process discipline will in fact attract the best talent to flexible and innovative companies, which offer the best opportunities for employees to grow and succeed.

The Future Looks… Different

In spite of the challenges distributors have negotiated over the past decade, independent distribution channels have emerged relatively healthy and nimble. Most distribution sectors have enjoyed a few years of double-digit sales growth. This industry is still fragmented, entrepreneurial and, many would argue, crazy after all these years.

Many of the old rules are gone, replaced by new and sometimes confusing definitions of how the customer wants value delivered. And yet distributors who have invested in these four areas of differentiation have consistently outperformed competitors. They found profitable opportunities to deliver focused and flexible solutions to shifting customer needs.

Home Depot Supply First-half Sales Hit $5.4B

Home Depot Supply reported 325-percent sales growth in the second quarter compared to the same period last year, thanks to its rapidly expanding base of newly acquired wholesale businesses. Sales at HD Supply were $3.38 billion for the quarter or 13 percent of Home Depot's overall $26 billion in sales for the second quarter of fiscal 2006.

The Home Depot Supply reported $2.1 billion in first quarter 2006 sales, putting its year-to-date sales at about $5.4 billion.

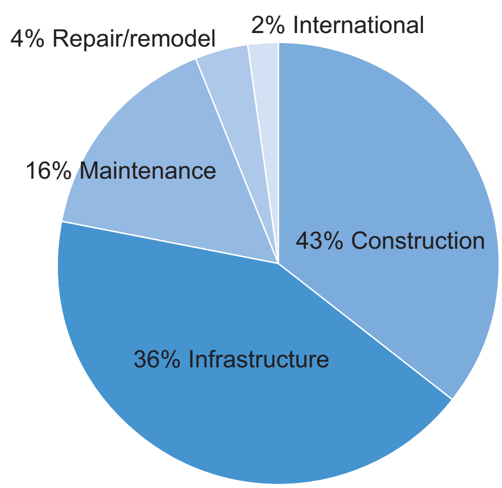
HD Supply's year-over-year organic growth was 12 percent. HD Supply chief Joe DeAngelo said in HD's second-quarter earnings call with investors that his division is focused on becoming an "organic growth machine." "If you don't have a great organic growth model, you don't earn the right to acquire," he said.

The division will continue on the acquisition trail. "We look at ten to fifteen for every one that we get," he says.

DeAngelo is not concerned about a possible slowdown in the economy. "When you look at Home Depot Supply, we have a very diverse portfolio now, which helps through any cycle," he explained. He broke out HD Supply's base: 36 percent infrastructure; 43 percent construction; 16 percent maintenance; 4 percent repair/remodel; and 2 percent international.

"No matter what is happening in the cycle, our philosophy is that we're going to be No. 1 in every one of those segments. When certain things go down, other things go up," DeAngelo said.

HD Supply's Sales Mix



SOURCE: Home Depot Supply, www.hdsupply.com

During the quarter, HD Supply acquired: Western Fasteners, distributor of construction fasteners, power tools and accessories with eight branches; Texas Contractors Supply, distributor of forming, concrete accessories, tilt-wall and power tools; Rice Planter Carpets, provider of flooring design, sales and installation services with two locations; and Forest Products Supply, supplier of lumber, doors, millwork, and windows with two locations.

Home Depot Supply also recently announced it would push further into electrical markets by agreeing to purchase Edson Electric Supply, an Arizona-based electrical distributor with 11 locations in the state. The acquisition extends HD Supply's electrical sector to key growth markets in the Southwest.

Edson serves residential and commercial contractors. Its products include wire, lighting, electrical supplies and switchgear. HD Supply's electrical business currently operates 59 branches in nine states. The company said in a press release it plans to become the "top global full-line supplier of electrical products and services."

The Home Depot, Atlanta, GA, reported a 16.7 percent increase in overall sales from the second quarter fiscal 2005. Net earnings were $1.86 billion, up 9.8 percent compared to the same period in fiscal 2005.

Year-to-date, The Home Depot reported sales of $47.48 billion, up 15 percent from the year before. Profit for the first six months was $3.34 billion, up 11 percent.

Total sales in the Retail segment grew 5.1 percent to $22.6 billion, reflecting new stores and comparable store sales of -0.2 percent.

The company saw growth in average ticket across most merchandise categories. In the second quarter of fiscal 2006, The Home Depot increased its average ticket by 4.2 percent to $59.98.

During the quarter, Home Depot opened 30 new stores, including two relocations, with two new stores in Canada and one new store in Mexico, bringing the total store count to 2,079. As of the end of the quarter, approximately 10 percent of the company's store base was in Canada and Mexico, as compared to 9 percent for the same period last year.

Find full coverage of Home Depot Supply at www.mdm.com.

Manufacturing Outpaces GDP in 2006

But activity may slow in 2007, MAPI report shows

The economy is showing the lagged effects of higher interest rates, skyrocketing energy prices and slower employment gains. Gross domestic product growth should experience below-trend growth over the next 18 months, and manufacturing activity in the U.S., which has been on a roll lately, will slow appreciably in 2007, according to a new report.

The Manufacturers Alliance/MAPI Quarterly Economic Forecast predicts inflation-adjusted GDP growth will be 3.3 percent in 2006 and 2.5 percent in 2007, nearly consistent with the May 2006 projections of 3.3 percent and 2.7 percent, respectively. Overall U.S. GDP growth in 2005 was 3.2 percent.

By supplying major assumptions for the economy and running simulations through the Global Insight Macroeconomic Model, the Alliance generates unique macroeconomic and industry forecasts.

"Spending can exceed income for only so long before consumer and business budgets are brought back into line," said Daniel J. Meckstroth, chief economist for the Manufacturers Alliance/MAPI. "Higher interest rates and slower income growth are slowing the housing market and putting an end to home equity financing of big ticket purchases. Slower consumer spending growth ripples through the rest of the economy."

Manufacturing production growth will significantly outpace the general economy in 2006 and equal it in 2007. The MAPI forecast envisions manufacturing industrial production to increase a robust 5.0 percent in 2006, before returning to a more modest 2.5 percent increase in 2007. Manufacturing activity increased 3.9 percent in 2005. Inflation-adjusted spending for computers and electronic products is forecast to rise 17.1 percent in 2006 and 12.1 percent in 2007. Production in non-high-tech industries will grow 4 percent this year and 1.5 percent in 2007.

"The hurricanes and commodity supply disruptions in 2005 set off a scramble for manufacturing inventory in 2006," Meckstroth said. "The manufacturing sector has also benefited from its high concentration in capital goods industries and electronics which have outperformed other sectors of the economy this year."

Real investment in equipment and software should increase 8 percent in 2006 and 6.1 percent in 2007, growing several times faster than the general economy. The largest percentage gains in spending will come in the high-tech sectors. Inflation-adjusted expenditures for information processing equipment are expected to rise 9.2 percent in 2006 and 8.4 percent in 2007.

Spending on non-residential structures is forecast to rise 8.3 percent this year and 9.4 percent in 2007. The forecast calls for industrial equipment expenditures to increase 8.4 percent and 4.7 percent, respectively. Spending for transportation equipment is likely to show 4 percent growth in 2006 and a 2.2 percent increase in 2007.

Exports should outpace imports by a fairly wide margin by the end of 2007. Inflation-adjusted exports should rise 8.6 percent this year and 8.5 percent in 2007, while imports are expected to increase 6.2 percent in 2006 before decelerating to 4.3 percent growth in 2007.

MAPI sees the unemployment rate at 4.7 percent in 2006 and 4.9 percent in 2007. Energy challenges will continue to loom for the U.S. economy. The refiners' acquisition price for imported crude oil is expected to average $65 per barrel in 2006 and $64.30 per barrel in 2007, a significant increase from the actual $48.90 per barrel price in 2005.

Return from Duty

Be aware of workplace rights for military service workers

Employers and employees need to be aware of their rights and responsibilities under the Uniformed Services Employment and Reemployment Rights Act (USERRA). This article appeared in the August 2006 issue of The Electrical Distributor *magazine, www.tedmag.com.*

By Denise Kelly

Since almost half of our national defense is dependent upon the guard and reserve, many businesses have been affected by the mobilization of men and women to fight the war on terror.

USERRA is the latest federal law to provide employment and reemployment rights to veterans since World War II. It was enacted following the first Gulf War to address the concerns raised by veterans returning from military service in that conflict. Final regulations, published in December 2005, became effective in January.

Under USERRA, it is unlawful for an employer to refuse an employee's military leave of absence or to discriminate in employment or reemployment based on military service. The law extends reemployment rights to members of the uniformed services. Specifics include:

Covered employers. USERRA applies to any employer that either pays an individual a salary or wages to perform work or controls an individual's employment opportunities. There is no "minimum number of employees" requirement, so USERRA applies to companies of all sizes—from the smallest, family-owned distributorship to the largest publicly held corporation.

USERRA notice requirement. While it is not required that an employer post the USERRA rules, employers are required to provide all persons entitled to rights and benefits under USERRA with a notice of the rights, benefits and obligations. Practically speaking, the most obvious way to meet the notice requirement is to post the model poster in the place where legally required workplace posters are customarily displayed. (The text of the required notice and the model poster are available on the Department of Labor's Web site, www.dol.gov.)

Nondiscrimination. It is unlawful to deny initial employment, reemployment, retention or promotion to a person in the uniformed services.

Reemployment rights and employment benefits. An employee is entitled to reemployment rights and maintenance of employment benefits provided the person meets five eligibility criteria:

1. Held a civilian job with the employer
2. Gave advance notice that he or she was leaving for service
3. The period of service did not exceed five years
4. Was released from service under honorable conditions
5. Reported back to the civilian job in a timely manner or submitted a timely application for reemployment

Returning employees' job rights. The job position to which a returning employee is entitled depends upon the length of military service. For service up to 90 days, employees are entitled to return to the positions in which they were employed if their employment had not been interrupted.

For service more than 90 days, employees are entitled to return to pre-leave positions or a position of "like seniority, status, and pay, the duties of which the person is qualified to perform." Employers are required to make reasonable efforts to train returning employees in order to qualify for reemployment. In addition, employers are required to reasonably accommodate returning employees who are disabled during military service.

"Escalator" principle. This requires that a returning employee is entitled to the same position and pay grade, or to the position and pay grade the employee would have held if employment had been uninterrupted. It may mean that the returning employee is entitled to the pre-service position, a better position, a worse position, or no position at all — based on his or her probable advancement had employment been uninterrupted.

For example, prior to deployment, an employee completed the training needed to advance from a counter sales position to inside sales when an inside sales position was available. Upon reemployment, the employee would qualify to return to counter sales and would once again be in line for promotion to inside sales. If an inside sales position had become available during the military leave, unless the employer's circumstances have changed sufficiently, the returning employee would be placed in the inside sales position.

Two notes: 1) This "changed circumstances" exception is narrowly interpreted and does not apply where a replacement worker has filled the position; and 2) reemployment rights do not apply to positions where there was no reasonable expectation that the employment would continue indefinitely for a significant period.

Health benefits and pension benefits. For leaves of fewer than 31 days, healthcare coverage shall be provided as if the employee had remained employed. Where service members are on duty for more than 30 days, they are entitled to continue employer-sponsored healthcare for themselves and their families for up to 24 months, similar to COBRA rights. Upon return from military service, health insurance coverage is reinstated without any waiting period or exclusion for pre-existing conditions. This rule does not apply to the coverage of any illness or injury incurred during the employee's performance of military duty.

For pension purposes, returning service members must be treated as though they have been continuously employed for purposes of participation, vesting, and accrual of benefits. A returning service member is given an extended period of time in which to pay employee contributions for the purposes of employer matching.

Termination protection. An individual cannot be discharged, except for cause, for one year after being reemployed if that employee served in the military for more than 180 days. A returning employee is protected from discharge without cause for 180 days if the period of service was for more than 30 days but less than one year.

State laws. USERRA does not preempt state laws providing greater rights, but does preempt state laws providing lesser rights. Employers are advised that many states have similar laws for "state" military duty or where a state governor calls up members of the National Guard.

Kelly is a human resources consultant with experience in distribution. Contact her at dkelly10@atlanticbb.net. This material is provided as general information and is not a substitute for legal or other professional advice. Additional information explaining an employer's obligations under USERRA is available at the U.S. Department of Labor's Web site at www.dol.gov.

Canada Distributor Sales Grew Slightly in 2Q

Canadian distributor sales fell for a second time in three months (-0.6 percent) in June, pulled down by lower sales in the automotive sector. Wholesalers sold $41.5 billion worth of goods and services.

Sales contracted in three of the seven sectors in June, accounting for approximately 49 percent of total sales. Decreases were registered in the automotive sector (-2.1 percent), the "other products" category (-2.3 percent) and the food, beverages and tobacco products sector (-0.8 percent). The sectors showing the largest gains were building materials (+0.6 percent) and farm products (+4.7 percent).

In constant dollars, wholesale sales declined 0.6 percent in June.

Sales for the quarter ending in June showed a lower growth rate than in the previous two quarters. In the second quarter, sales grew only 0.5 percent compared to increases of 2.9 percent and 2.5 percent in the previous two quarters. Substantial declines in sales of lumber (-8.1 percent), motor vehicles (-2.2 percent) and office and professional equipment (-3.0 percent) explain in part the low growth in the second quarter. These three groups all recorded strong growth in the first quarter.

Wholesalers in the automotive sector were unable to hold onto all the gains made in May (+2.7 percent), with sales falling 2.1 percent to $8.2 billion in June, the fourth decline in five months. Wholesale sales of motor vehicles fell 1.5 percent in June, a fourth decline in five months.

After rising 1.2 percent in May, sales of building materials advanced 0.6 percent in June. Two groups in this sector are responsible for the increase. Sales of metal products (+4.3 percent) posted a fourth consecutive increase in June.

Wholesale sales in the building materials group edged up 0.2 percent in June. This group has experienced a period of practically uninterrupted growth since the fall of 2003, as a result of the strong performance of the renovation and construction market in Canada.

Sales among lumber and millwork (-2.6 percent) wholesalers fell for the fourth time in five months. This downward movement is largely related to declining activity in the residential construction sector in the U.S. Canadian wholesalers are responsible for nearly 30 percent of lumber exports.

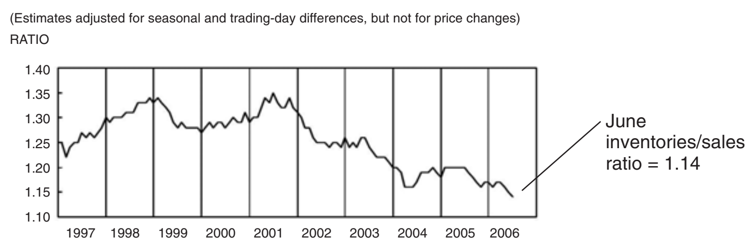
Monthly Wholesale Trade: Sales and Inventories for June 2006

June 2006 sales of merchant wholesalers, except manufacturers' sales branches and offices, after adjustment for seasonal variations and trading-day differences but not for price changes, were $331.1 billion, up 1.4 percent from the revised May level and were up 13.5 percent from the June 2005 level. The May preliminary estimate was revised upward $0.9 billion or 0.3 percent. June sales of durable goods increased 0.2 percent from last month and were up 10.8 percent from a year ago. June sales of nondurable goods increased 2.6 percent from last month and were up 16.1 percent from last year.

Inventories. Total inventories of merchant wholesalers, except manufacturers' sales branches and offices, after adjustment for seasonal variations but not for price changes, were $378.9 billion at the end of June, up 0.8 percent from last month and were up 8.1 percent from a year ago. The May preliminary estimate was revised upward $0.2 billion or 0.1 percent. End-of-month inventories of durable goods increased 0.5 percent from May and were up 8.4 percent from last June. End-of-month inventories of nondurable goods increased 1.1 percent from May and were up 7.4 percent compared to last June. Inventories of drugs and druggists' sundries grew 3.0 percent from last month and inventories of grocery and related products increased 2.6 percent.

Inventories/Sales Ratio. The June inventories/sales ratio for merchant wholesalers, except manufacturers' sales branches and offices, based on seasonally adjusted data, was 1.14. The June 2005 ratio was 1.20.

Monthly Inventories/Sales Ratios
of Merchant Wholesalers: 1996-2006



Source: U.S. Census Bureau

Monthly wholesale trade: Sales and inventories June 2006

NAICS Code	Business Type	Sales $ millions	Inventories $ millions	Stock and Sales ratio	% Change in Sales 5/06-6/06	% Change in Sales 6/05-6/06	% Change Inventory 5/06-6/06	% Change Inventory 6/05-6/06
42	U.S. Total	331,052	378,890	1.14	1.4	13.5	0.8	8.1
423	Durable	160,675	239,506	1.49	0.2	10.8	0.5	8.4
4231	Automotive	26,625	36,844	1.38	-0.9	10.4	-0.6	6.6
4232	Furniture & Home Furnishings	5,524	8,057	1.46	-0.4	7.5	0.8	7.6
4233	Lumber & Other Construction Materials	11,713	16,460	1.41	0.3	7.8	2.3	13.5
4234	Prof. & Commercial Equip. & Supplies	26,791	30,128	1.12	0.8	6.5	-1.3	4.4
42343	Computer Equipment & Software	13,598	10,446	0.77	2.4	5.1	-2.5	0.7
4235	Metals & Minerals	12,991	21,070	1.62	2.6	19.7	2.8	6.9
4236	Electrical Goods	23,631	29,368	1.24	0.0	7.9	-0.3	6.4
4237	Hardware, Plumbing, & Heating Equipment	7,785	14,472	1.86	-2.0	12.6	1.4	14.4
4238	Machinery, Equipment & Supplies	26,763	61,331	2.29	1.1	9.6	1.4	13.6
4239	Miscellaneous Durable	18,852	21,776	1.16	-0.4	21.0	-0.1	1.0
424	Nondurable Goods	170,377	139,384	0.82	2.6	16.1	1.1	7.4
4241	Paper & Paper Products	8,153	7,411	0.91	0.3	12.9	-0.1	1.8
4242	Drugs	31,268	30,845	0.99	0.6	14.9	3.0	5.6
4243	Apparel, Piece Goods & Notions	10,798	15,359	1.42	6.7	11.2	0.4	-2.3
4244	Groceries &Related Products	36,950	25,234	0.68	1.6	4.4	2.6	9.5
4245	Farm-product Raw Materials	10,159	12,115	1.19	0.3	14.5	2.1	7.1
4246	Chemicals &Allied Products	7,725	8,709	1.13	0.4	6.5	1.6	7.9
4247	Petroleum &Petroleum Products	38,193	10,883	0.28	6.1	44.5	-0.1	35.8
4248	Beer, Wine & Distilled Beverages	8,426	9,359	1.11	3.1	5.1	-1.4	8.4
4249	Miscellaneous Nondurable Goods	18,705	19,469	1.04	1.8	12.9	-1.5	5.7

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.

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Industrial & Construction Markets Update

PERSPECTIVE

Home Depot Supply's results for the second quarter are wagging some tongues (see p. 4). The company's wholesale distribution business is on pace to exceed $11 billion in sales in 2006. Its second-quarter sales were 13 percent of Home Depot's overall sales of $26 billion for the quarter. The company's goal is to reach $23 billion in wholesale sales by 2010.

These numbers are worth considering. For 2006, Home Depot is likely to post sales near $100 billion, with its wholesale distribution division contributing somewhere in the neighborhood of 15 percent. When you consider the vendor commonality between the retail and wholesale divisions, you start to redefine the meaning of leverage.

From a competitive standpoint, the scale and pace at which Home Depot is changing independent distribution channels is breathtaking. But we have to consider that as part of a global trend. Britain-based Wolseley, which owns Ferguson and Stock Building Supply in North America, doubled its sales since 2001 from $10.4 billion to $21 billion.

To put that in a little more perspective, for decades W.W. Grainger has been considered the dominant force, at least the largest in terms of revenues. Grainger's $4.6 billion in revenues in 2003 still topped most charts in comparing the various MRO sectors – industrial, construction, facilities maintenance and institutional.

How does all this change business for an independent distributor in 2007 and beyond? There will be fewer, bigger players, operating across oceans, and potentially more elbow room for those who offer unique value in the smaller niches of this world. Consolidation inevitably breeds service losses for some customers, and that in turn creates local opportunity. That won't change.

Home Depot Supply reported 325 percent sales growth in the second quarter, thanks to its rapidly expanding base of newly acquired wholesale businesses. Sales at HD Supply were $3.38 billion for the quarter or 13 percent of Home Depot's overall $26 billion in sales for the period. Home Depot Supply reported $2.1 billion in first quarter 2006 sales, putting its year-to-date sales at about $5.4 billion. Home Depot Supply also announced it agreed to acquire **Edson Electric Supply**, an Arizona-based electrical distributor operating 11 locations in the state, extending the reach of HD Supply's electrical business to key growth markets in the Southwest. HD Supply's electrical business now operates 59 branches in nine states – the company announced it plans to become the "top global full-line supplier of electrical products and services." See article on p. 3.

Stock Building Supply, Raleigh, NC, distributor of building materials to professionals in the U.S., has acquired **Martin Architectural Products**, in Cary, NC. Martin reported sales of $26.3 million in fiscal 2005. Martin is a fabricator, supplier, and installer of architectural products for commercial and institutional projects. Its product categories include hollow metal doors and frames, wood doors and frames, fire doors, electronic security entrance systems, and commercial hardware. The company operates from two locations.

Industrial gases distributor **Airgas, Inc**., Radnor, PA, has agreed to acquire Houston, TX-based **Aeriform Corp**., an independent distributor with 29 locations in Texas, Louisiana, Oklahoma and Kansas. Aeriform has 240 employees and annual sales of $65 million. About 58 percent of its revenue comes from gas and rent, with the balance from traditional welding hardgoods.

BlueLinx Holdings Inc., Atlanta, GA, a distributor of building products in North America, has acquired **Austin Hardwoods**, a privately held hardwood lumber distributor in Austin, TX, with four facilities and more than $22 million in sales for 2005. The acquisition expands BlueLinx's presence in the Southwest and is expected to enhance the company's ability to service industrial customers in certain local markets.

Interline Brands, Inc., Jacksonville, FL, reported sales for the second quarter of 2006 increased 15.6 percent over the comparable 2005 period to $235.4 million. Average organic daily sales growth for the second quarter was 11.8 percent. Interline recorded a net loss of $2.865 million compared with profit of $8.5 million last year.

July housing starts fell 2.5 percent from June, and 13.3 percent from July 2005. Building permits were 6.5 percent below June, and 20.8 percent below the July 2005 rate.

Applied Industrial Technologies, Cleveland, OH, reported sales for its fiscal year ended June 30, 2006, increased by 10.7 percent to $1.9 billion. Net income rose 30.6 percent to $72.3 million versus $55.3 million the

continued on next page

previous year. Sales for the fourth quarter increased 11.2 percent to $504 million from $453.3 million in the same period a year ago. Net income increased 26.2 percent to $20 million compared with $15.9 million last year.

Strategic Distribution, Inc., Bristol, PA, reported revenues of $37.2 million for the second quarter 2006, a 10 percent jump. The company reported a net loss of $1.1 million in the second quarter 2006. For the six months ended June 30, 2006, Strategic Distribution reported revenues of $74 million compared with $62.7 million for the same period last year. The company reported a net loss of $2.2 million for the first half of the year.

Kennametal Inc., Latrobe, PA, has opened its new Tianjin, China, manufacturing facility. Located in the Tianjin Economic Development Area, the facility, initially sized at 160,000 square feet, will employ 200 people in manufacturing and advanced engineering and design activities. The operation could grow to 450,000 square feet and employment could reach 400 people. The $31 million invested in this plant is in addition to the approximately $35 million that Kennametal has already invested in its China businesses in other locations.

Beacon Roofing Supply, Peabody, MA, announced sales for the third quarter ended June 30, 2006, were up 63.9 percent to $407.1 million, reflecting sales from companies acquired since last year's third quarter and internal growth of 5.4 percent. Net income for the third quarter was $17.1 million, an increase of 50.5 percent from last year. Year-to-date, sales increased 72.5 percent to $1.07 billion from $619.8 million in 2005, reflecting sales from companies acquired and internal growth of 13 percent. For the first nine months, net income was $34.7 million, an increase of 54.5 percent from the same period a year ago.

Diversified industrial manufacturer **Eaton Corporation**, Cleveland, OH, has agreed to acquire **Dover Resources' Ronningen-Petter** industrial fine filtration business. Dover Resources is a subsidiary of Dover Corporation. Dover Resources' Ronningen-Petter fine filtration business had 2005 sales of $30 million. It provides filters and components to customers in end markets that include the oil and gas, pulp and paper, and food and beverage industries. The business is based in Portage, MI, and has 110 employees.

Rexnord Corporation, Milwaukee, WI, reported sales grew 20.2 percent, excluding the acquisition of Falk, in first quarter fiscal 2007 over the prior-year quarter to $288.4 million. Approximately $25.2 million of this increase was due to the timing of the Falk acquisition in May 2005 as prior-year first quarter only included approximately 1.5 months of Falk sales.

Calculation of MDM Inflation Index for July 2006

		BLS Price Indices Jul. '06	BLS Price Indices Jun. '06	BLS Price Indices Jul. '05	% Sales Weight	Weighted Indices Jul. '06 (1)X(4)	% Change Jul. '06 Jun. '06	% Change Jul. '06 Jul. '05
1136	Abr. Prod.	453.0	451.8	431.3	19.1	86.52	0.26	5.02
1135	Cutting Tools	430.6	430.8	413.5	18.9	81.38	-0.06	4.13
1145	Power Trans.	614.2	610.8	590.5	15.4	94.59	0.56	4.02
1081	Fasteners	429.4	424.8	416.4	9.0	38.65	1.08	3.11
1149.01	Valves, etc.	735.6	726.6	683.9	7.6	55.91	1.25	7.57
1132	Power Tools	324.6	324.1	327.9	6.5	21.10	0.14	-1.01
1144	Mat. Handling	447.8	446.4	432.3	6.2	27.76	0.32	3.58
0713.03	Belting	535.6	536.3	517.0	6.1	32.67	-0.12	3.61
1042	Hand Tools	667.4	667.4	634.4	8.1	54.06	0.00	5.21
108	Misc. Metal	409.1	407.7	397.8	3.1	12.68	0.35	2.84
"New" July Index		264.0	July Inflation Index			505.32	0.38	4.34
"New" June Index		263.0	June Inflation Index			503.39		
			July 2005 Inflation Index			484.29		

New index reflects 1977=100 base. Other numbers=1967 base. To convert multiply by .52247

MARKETS UPDATE SUPPLEMENT P. 3

U.S. MARKET ANALYSIS: Industrial Controls-MRO

Industrial Controls-MRO represented a market in 2005 of $10.46 billion, according to estimates by Industrial Market Information, Minneapolis.

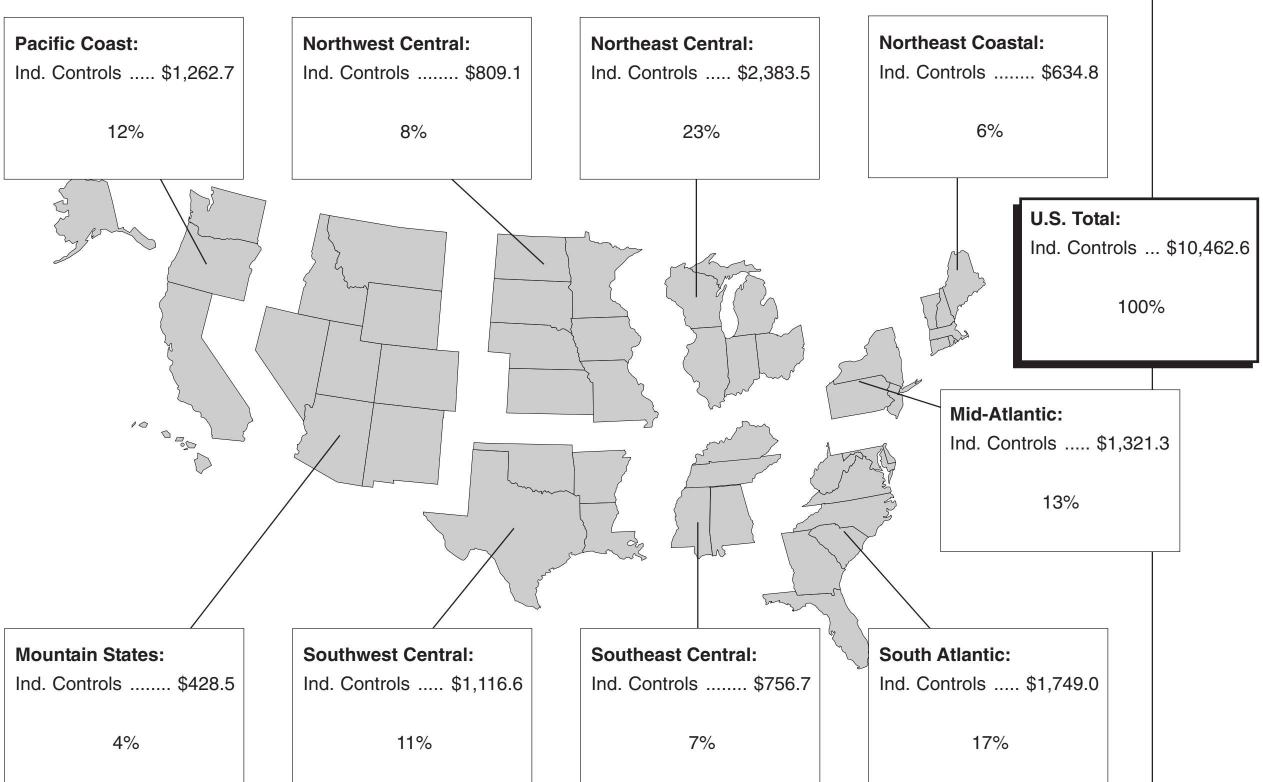
These charts show the top ten industries, by SIC code, consuming these products; and the 2005 end-user consumption of these groups sorted by the nine government market regions.

Top ten industries in $ volume, by SIC code consuming Industrial Controls

(2005 estimates)

SIC CODE	Company Count	Genl. Ind. Controls MRO (Total $)
2621 Paper Mills	2078	869,141,874
2631 Paperboard Mills	694	354,981,523
3089 Plastics Products	10815	259,087,444
2834 Pharmaceutical Preparations	3030	224,723,837
3714 Motor Vehicle Parts & Accessories	4874	203,366,535
3599 Industrial & Commercials Machinery & Equipment	30326	174,709,294
2611 Pulp Mills	509	167,247,993
3674 Semiconductor & Related Devices	2257	152,093,982
2821 Plastics Materials, Synthetic Resins & Nonvulcanizable Elastomers	1687	149,676,545
4911 Electric Services	7439	147,802,108

End-user consumption of Industrial Controls-MRO by region, millions of $ (2005 est.)



Source: INDUSTRIAL MARKET INFORMATION, INC. (763) 535-7432. Industrial Market Information has more than 200 industrial product profiles available at the county level. www.imidata.com

MARKETS UPDATE SUPPLEMENT P. 4

Machine Tool Consumption Up 24% in First Half of 2006

June U.S. manufacturing technology consumption totaled $322.68 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 0.4 percent from May but up 26.7 percent from the total of $254.74 million reported for June 2005.

With a year-to-date total of $1,774.48 million, 2006 was up 23.9 percent compared with 2005.

These numbers and all data in this report are based on totals of data reported by companies participating in the USMTC program.

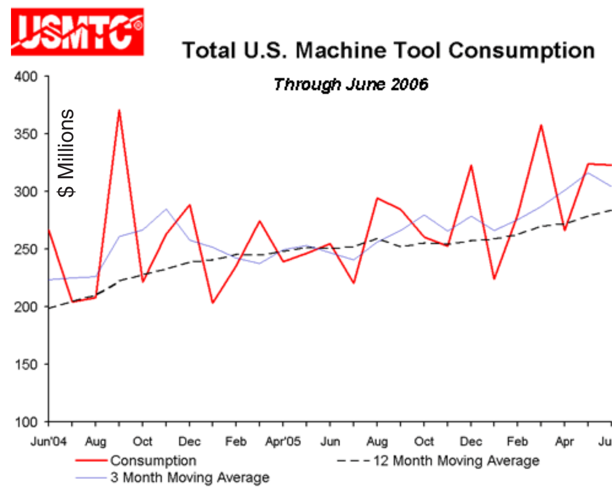
"Since the recovery began in November 2003, orders have grown steadily, punctuated by June's 27 percent increase over June 2005," said John B. Byrd III, AMT president. "Counter to concerns that the 32-month expansion is ready to turn, the market is still 35 percent lower than its 1997 peak. There is still a lot of room to grow."

The U.S. Machine Tool Consumption (USMTC) report, jointly compiled by the two trade associations representing the production and distribution of manufacturing technology, provides regional and national U.S. consumption data of domestic and imported machine tools and related equipment.

U.S. machine tool consumption is also reported on a regional basis for five geographic breakdowns of the United States.

Northeast Region

Northeast Region manufacturing technology consumption in June stood at $43.35 million, down 10.3 percent when compared with May's $48.34 million, but 20.9 percent higher than the total for June a year ago. The year-to-date total of $260.53 million was up 22.8 percent when compared with 2005 at the same time.



Source: USMTC Report

Southern Region

June manufacturing technology consumption in the Southern Region rose to $47.01 million, up 19.1 percent from May's $39.46 million and 47.7 percent higher than the June 2005 total. At $246.66 million, the year-to-date total was 4.0 percent higher than the comparable figure in 2005.

Midwestern Region

Totaling $97.91 million, June Midwestern Region manufacturing technology consumption was level with May's $97.85 million and up 9.7 percent from the previous June. Year-to-date 2006 consumption stood at $531.40 million, 7.4 percent higher than the figure for 2005.

Central Region

June manufacturing technology consumption in the Central Region rose to $88.08 million, up6.9 percent from May's $82.37 million and 51.5 percent higher than the June total in 2005. With a year-to-date total of $459.20 million, 2006 was running 56.3 percent ahead of 2005 at the same time.

Western Region

At $46.32 million, June manufacturing technology consumption in the Western Region was down 17.4 percent when compared with May's $56.10 million but 17.0 percent higher than the June 2005 total. Year-to-date 2006 consumption totaled of $276.69 million, 42.3 percent ahead of 2005 at the same time.

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