MODERN DISTRIBUTION MANAGEMENT The Newsletter for the Wholesale Distribution Channel

VOL. 36, NO. 17
SEPTEMBER 10, 2006

Succession Planning: What's Next?

Make transition to next generation as seamless as possible

In the next decade, the distribution industry will come upon a huge generational shift. So why haven't many owner-managers planned for this change? This article outlines some key issues to address now to ensure a smooth transition in your company, whether you decide to sell or pass the torch to your son, daughter or a key employee.

By Lindsay Young

Rick Rogers' father served as a salesman for fluid power distributor BW Rogers Co, Akron, OH, until founder Bruce W. Rogers died abruptly in 1971. Rick's father was thrust into the top spot, with no management training and no previous view into the company's financials.

"My grandfather kept the cards close to his chest," Rogers says. "He left no information regarding his desires for the company or the financial condition of the business."

It took Rick's father many years to catch up. He learned from that experience, knowing Rick would eventually take over the nearly 80-year-old company. "He wanted to make sure he laid the groundwork for a seamless transition," Rick says.

Among other things, he had Rick work many different jobs in the company. Rick also started working with his father in the five years leading to his retirement. As a result of deliberate preparation, the company went through no operational or financial stress when, in 1998, Rick took over as CEO.

Seamless Transitions

Succession planning is about preparing for the inevitable departure of the owners and managers of your distributorship, and having all the right pieces in place when that happens. "Think about what is going to be when you're not there anymore," says Brent Grover, president of Evergreen Consulting.

As USESI Founder Richard Worthy pointed out in a recent interview with MDM, the next five to seven years will see quite a few owners in their 70s and 80s, many of whom will sell the business for estate reasons. But even if you're not in your 70s or 80s, it is still critical to plan for the unforeseeable such as illness or death that could leave the business on unstable ground. In addition, plan for what happens when you or other principals retire.

"The earlier you can start the process, the better," Rogers says.

Along with ensuring a clear roadmap after you leave, put a strategic plan in motion now that involves key managers in making decisions that affect the company in the near- and long-term.

Succession planning is about making a transition as seamless as possible for the next generation of owners and managers. "A company without a good succession plan could not only *not* have the management to preserve the continuity of the business, but won't have the money to do it," Grover says.

Barriers to Planning

Why haven't many distributors moved forward with succession planning? Sometimes owner-managers just don't know what is out there, or they can't make up their minds as to what they want. Keep the company or sell it? Are the children smart enough to run the business, and do they want to? Should they sell the company to employees, even if employees can't afford to pay as much as outside buyers?

Grover says owner-managers also sometimes have not invested in a succession plan or in building up a strong management infrastructure because they may

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have a feeling of immortality or invincibility, with the idea that no one else could do as good a job as they have.

On the other hand, some owner-managers just may not know where to start or what is available. They may not know that there are ways to minimize transfer taxes, or that there are ways to give non-owner executives a stake in the business so they won't be easily recruited away by competitors or start their own companies. Rogers has offered some of his top executives phantom stock plans to give them a stake in the future of BW Rogers, for example, which provides Rogers the option that one of them could take over the company when he retires.

Accountants and lawyers often will not bring the subject of succession planning up – though some will. Rogers recommends hiring a consultant who specializes in succession planning; accountants and lawyers should be used as well, but not exclusively.

Also, use resources provided by trade associations. Take advantage of executive education programs and local networking groups. And use other advisors, including insurance agents. A life insurance agent can often be better at getting owners to think about the future of the business than accountants and lawyers. "Life insurance is the only planning tool you can get at a reasonably affordable price to get cash to keep the business from going into another's hands when you die," Grover says. "Sometimes it's the best thing to do, and sometimes it's the only thing to do."

Planning for the Unplanned

In the early 1980s, three brothers were getting into their 60s and decided to sit down and talk about the future of their distributorship. They hired a lawyer to facilitate the discussion about when they would retire, how to pay for the stock, how that would be financed, what positions the kids would be put into and what would happen if someone died.

Not long after, one of the brothers had a heart attack and died, but because of the roadmap, the sons knew they would not be kicked out of the organization. They also knew how their father's stock would be handled. All of this had been objectively negotiated by people who were healthy. Not far down the road, a 38-year-old family member had a heart attack, but again the family was prepared.

"The plan kept the business and the family together," Grover says.

Worst-case scenario, without any planning, an owner-manager dies or becomes incapacitated, and the company is left with both management and ownership up in the air. Suppliers may lose confidence and may look to other distributors to serve their needs in that market. They also may get nervous about payment and cut credit.

Key employees may consider leaving for more stable work. "It's a vicious circle," Grover says. "You may then start losing customers."

Create a Timeline

To start thinking about succession, create a

MODERN DISTRIBUTION MANAGEMENT

Founded in 1967 by J. Van Ness Philip

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Subscriptions are available by online delivery and/or first-class mail. Three-year archives of MDM are available online to subscribers. Previous-year archives are available at a discounted rate to current subscribers.

Published twice monthly; $345/yr., $365 U.S. funds other countries; $169 each additional subscription to a company ($189 other countries). For group subscription rates and site licenses, please contact Tom Gale at 303-443-5060.

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ISSN 0544-6538

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timeline. Start with things that are known: ages of family members and business principals; likely family and business events such as graduations and marriages. Then look at where the business is likely to be at certain points in the future. Project the cash needs for the business based on growth needs. Project the value of the business and cash flow at certain points in the future.

Now, test different scenarios. What if someone died? What if you want to make an acquisition? Grover says this exercise helps owners get their hands around whether they would need to grow or sell based on their expected circumstances.

Finding a Successor

"Those who have family members in the business have to use extreme caution that any successor they choose wants the responsibility and is capable," Grover says. There is a difference between ownership succession and management continuity. "You can have people who like to be owners, but don't want to be part of the management."

When family is involved, things might get tricky, especially if you have some children involved in the business, and some who are not interested at all. "How do you equalize the value? … Those are tough choices. No two sets of parents are going to come up with the same answers. Some people feel their children should receive something equal and some people feel that those who have really sacrificed for the business should receive it or the lion's share."

Rogers, who has two brothers who weren't interested in running his father's business, says he has seen "unhealthy situations" where many family members were involved in businesses and did not work well together. He recommends assigning clear roles to all family members who are involved directly, or keeping the number of family in the business to a minimum.

Another point: Giving stock to non-working family members may not be fair to them or to the company. More than likely, the investment is not liquid, and they are not likely to receive any income from it unless other family members buy their stock, or if the company is sold. Grover recommends providing non-stock assets to non-working family members.

The Details

There are many steps an owner-manager can take to make any transition a little smoother.

Appraisal. One-quarter of Industrial Supply Association members surveyed by Grover said they had not had an appraisal of their business in the past five years. Most never have. But appraisals can help resolve issues that may arise later on, including buy-sell among owners, Grover says.

It's also useful to have stock valuation for the purposes of having a gift program. And in domestic disputes, the value of the company may become a factor. In the near future, if someone wanted to buy your company, you would need to know whether you are getting a good offer.

Board of Directors. Less than 30 percent in the ISA survey reported having a "real" board of directors. About one-third has a board made up of insiders, and for 40 percent the board is a legal formality. But Grover says more owner-managed distributors are moving to establish a board of experienced business people. This is important, he says, to hold leadership accountable, validate the company's strategy and track financial results. Boards also provide an outside perspective.

"I always come out of board meetings with fresh ideas," Rogers says. BW Rogers has a board of outside advisors, formed 20 years ago, which would take over the company if Rogers were to become disabled.

When it comes to the loss or incapacity of a CEO, a board can be a tool for the owner to implement a CEO's wishes after he is gone. The owner-manager can do this through a letter of wishes.

Letter of Wishes. The letter of wishes contains instructions to the board on what is to be done when the CEO is gone. (See example at this article online at www.mdm.com.) Include which management should be in charge, what the company is worth, how to dispose of the business, and which investment banker should handle a sale of the business if that's the chosen route, for a few examples.

In addition, provide details on family members, if you want them to play a part in the future of the business. The document is not legally binding, but should provide a guide for the board to follow. "These are the things that are sometimes thought of, rarely said, and almost never written down," Grover says.

The letter of wishes can be updated regularly and shared with the board, or sealed until a person's death. Just less than 20 percent of ISA members surveyed said they had a letter of wishes.

Transfer Taxes. Talk to your accountant and lawyer. They will be able to help you save

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money in this area. Plan as if all taxes currently in effect will continue to be, including estate taxes. "No one has a crystal ball," Grover says. In addition, discuss with your advisors the benefits and drawbacks to being S Corporations or C Corporations. If you are selling your company, an S Corporation may provide more flexibility and incur less taxation on gains.

This article is based on a presentation by Evergreen Consulting President Brent Grover at the Industrial Supply Association's 2006 annual meeting and follow-up conversations between Grover and MDM.

*Brent Grover's firm, **Evergreen Consulting, LLC**, advises owner/managers of closely-held distribution and manufacturing companies about the challenges of strategy and ownership succession. Brent, a former national firm CPA and business school accounting instructor, has published several articles about these topics. He was in the distribution industry for over 25 years, most recently as CEO of National Paper & Packaging Co. Brent can be reached through his Cleveland office at 216-360-4600 or brentgrover@evergreenconsultingllc.com.*

Industrial Outlook: Modest Acceleration in '06, Slowing in '07

Moderate acceleration in the manufacturing sector in 2006 will likely be followed by pronounced slowing in 2007, according to the Manufacturers Alliance/MAPI Quarterly Industrial Outlook-Second Quarter 2006, a report that analyzes 27 major industries.

In a sign of consistent strength in manufacturing, second quarter 2006 figures show that 19 of the 27 industries tracked in the report had inflation-adjusted new orders or production above the level of one year ago, thus indicating broad-based growth in the industrial sector.

Top industry performers in the second quarter, recording year-over-year double-digit growth, were mining and oil and gas field machinery (44 percent); communications equipment (34 percent); construction machinery (20 percent); oil and gas well drilling (19 percent); iron and steel products (19 percent); aerospace products and parts (16 percent); electrical equipment (16 percent); navigational, measuring, electromedical, and control instruments (15 percent); material handling equipment (15 percent); and semiconductors (11 percent).

Daniel J. Meckstroth, Manufacturers Alliance/MAPI chief economist and author of the analysis, writes that nine industries are in the accelerating growth (recovery) phase of the business cycle; 11 are in the decelerating growth (expansion) phase; four industries appear to be in the accelerating decline (either early recession or mid-recession) phase; and three are in the decelerating decline (late recession or very mild recession) phase of the cycle.

"Manufacturing has been growing much faster than the general economy since the fourth quarter of 2005," Meckstroth said. "The strength of the expansion in the goods sector created concerns about supply availability within the manufacturing industry which encouraged inventory rebuilding, adding to the momentum. The industrial rebound in Europe and Japan has improved export demand."

The report also offers economic forecasts for 24 of the 27 industries for 2006 and 2007.

Seven industries are expected to enjoy double-digit growth in 2006, but only one is expected to hit that benchmark in 2007. Mining and oil and gas field machinery is the lone industry expected to enjoy double-digit growth in successive years, 10 percent in 2006 and 17 percent in 2007. In 2006, communications equipment should rise by a robust 27 percent; aircraft and parts is likely to experience 17 percent growth; navigational, measuring, electromedical, and control instruments is expected to gain by 15 percent; construction machinery production should improve by 14 percent; steel production should rise by 13 percent; and electrical equipment is forecast to improve by 12 percent.

One industry is forecast to have negative change in both 2006 and 2007. Housing starts are expected to decline by 8 percent in 2006 and 9 percent in 2007. Manufacturing industrial production grew 3.9 percent in 2005. MAPI forecasts it will grow 5 percent in 2006 before decelerating to 2.5 percent growth in 2007.

"The big-ticket consumer items have already started to falter. Housing starts and motor vehicle sales will decline this year," Meckstroth explained. "Although the production of capital equipment will continue to lead industrial activity, the equipment that uses diesel engines is expected to experience a strong 2006 followed by a decline in production activity next year. New emission control regulations have created an incentive to buy now because the new engines will be more costly."

■ *Case Study*

Price Realization

Implementing ERP system improves pricing

The following case study is excerpted from "Driving Growth and Shareholder Value: The Distribution Value Map" published by the National Association of Wholesaler-Distributors.

Improve pricing and drive higher margin. This is easy to say but difficult to achieve, but not impossible. Take the case of a pricing executive who was looking for ways to improve price realization. The implementation of a new enterprise resource planning (ERP) system presented just such an opportunity.

Before

For this distributor, pricing was a complex process with myriad influencing factors, including the oft-cited fact: This is the way we have always done it in our industry.

In this case, many of the pricing practices rooted in historical processes and terminology did not match current market realities. For example, the company's 2,000+ salespeople were compensated, in part, based on the gross margin dollars they generated. However, with little or no transparency to the margin at the purchase order or line item transaction level, they were less concerned with margin and more concerned with top-line sales.

To oversimplify it, the sales philosophy could have been summarized as this: We don't have to have insight to transaction level profitability numbers because we'll do fine in our overall mix of sales dollars.

Base prices in the pricing system (e.g., net, discount, or cost plus) were set and maintained without a common approach. However, relatively more weight was given to the sometimes unrealistic suggestions of manufacturers/suppliers, while relatively little attention was given to the actual price realized in the marketplace.

And, of course, most products or services could have been priced differently for each customer and for each sales transaction. In effect, the salespeople used their discretion to set product prices more to close deals and cement relationships with customers than to generate profits. Another problem: The distributor found it nearly impossible to be quick and accurate when entering a supplier's price (distributor's cost) changes into the information system, and just as difficult to know when price/cost maintenance i.e., distributor's cost and customer's price) was done correctly.

Nonetheless, all things being equal, the system had worked for a long time.

ERP implementation

Some key pricing objectives were addressed as part of the ERP implementation:

- Make base prices more realistic, fair, and reasonable, and more reflective of market realities, as well as future expectations. For example, the distributor recognized that some customers did not want to hear price in terms of the manufacturer's price less a discount percentage because many of the manufacturer's prices were simply not realistic.
- Manage a massive number of pricing conditions. Pricing, rebate, and incentive agreements changed often, and multiple agreements could have been applied to any given sale. The system should free the salesforce from any expectation that they could manage all of the complexities of this distributor's pricing conditions manually.
- There would be no *one right price* for multiple customers for a given product or service. Like most distributors, this organization relied on the salespeople to use their judgment in reacting to competitive pricing situations. As a result, the system should have delivered improved decision support and reporting to the field and top management.
- The new system should help the company improve visibility to applicable rebates and incentives, and thereby, help to optimize pricing decisions.

The new system rollout was not without its challenges, but over time, pricing procedures took hold. While salesforce training was important to the implementation, nothing beat hands-on system experience to help the pricing procedures become an integral part of the organization's day-today business.

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Today

Price setting and price execution are complex. The salespeople still have pricing discretion and are free to respond to competitive market conditions. However, they now are supported by realistic base prices and guidelines for establishing prices with customers. Therefore, price negotiations reflect an informed understanding of the potential impact of a deal.

The new business process and system provide margin exception reporting, which alerts salespeople when pricing decisions result in margins that fall outside a specified tolerance range.

More resources have been added to the important cost and price maintenance process, and the distributor knows that this process is continuous. The system has improved price and cost data accuracy and provides rules and functionality for better maintenance across the board.

Tomorrow

The words of the pricing executive: We've made a lot of progress, but we're not optimizing all of our pricing transactions yet. It's a continuous improvement effort for us, and we know what we need to do."

He is now turning his attention to a few closely related initiatives that are based on the fact that pricing, rebate recoveries, and margin are inextricably linked.

The current focus is as follows:

- Improve efficiency and effectiveness of cost and pricing data maintenance in order to eliminate or reduce unnecessary downstream pricing adjustments.
- Provide the field with real-time pricing tools.
- Collaborate with others in the organization to document and apply the insights they are gaining from understanding net/net pricing (i.e., price realized after supplier rebate recovery).

*This article is excerpted from a publication available from NAW at **www.naw.org/dvm** or by calling Vicky Walsh at NAW: 202-872-0885.*

Bunzl Acquires $57M United American Sales

Bunzl Distribution, Inc., a supplier of disposable paper and plastic packaging to supplies to an array of businesses and industries, has acquired two companies in North America: Morgan Scott, Toronto, Ontario, a distributor of jan/san and foodservice disposable products in eastern Canada, and United American Sales Inc., a redistributor of personal protection equipment to industrial and construction markets. The two acquisitions combined had about $120 million in revenues in 2005. UASI, which has sold only to authorized distributors, has built marketing and logistics programs for its customers in Safety, Welding, Industrial, Construction, Rental, Hardware, Jan-San, and Electrical product areas.

Morgan Scott was purchased from two privately owned companies, Morgan Scott Inc., controlled by William O'Brien and Robert Giroux, and Morgan Scott (Kingston) Inc., controlled by Robert Tremblay. Based in Toronto, the company's revenues in 2005 were C$65.6 million (US$59.2 million), and the gross assets acquired are estimated to be C$19 million.

United American Sales, Inc. was purchased from a private company owned by Joseph Sodini and Timothy Homan. UASI is based in Ohio and has facilities in California, Nevada, Texas and Georgia. Revenue in 2005 was $57.7 million, and the gross assets acquired are estimated to be $15 million.

"Morgan Scott and UASI are great acquisitions for Bunzl," says Patrick Larmon, president and CEO, Bunzl Distribution USA, Inc. "I am excited about the opportunities Morgan Scott and its people will bring to our Canadian operation. UASI is also a solid addition to our operations and shows our commitment to building the redistribution business in other segments that fit with our long-term strategy."

Bunzl Distribution, Inc., St. Louis, MO, is the U.S. headquarters and largest division of London-based Bunzl plc, an international distribution and outsourcing group. With more than 85 warehouses throughout the U.S., Canada and parts of Mexico and the Caribbean, Bunzl Distribution, Inc. is a supplier of disposable paper and plastic packaging supplies to an array of businesses and industries, including supermarket retailers, self-distributing chains and wholesalers, as well as food processors, restaurants, institutions, airline and industrial markets.

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Age Discrimination Liability

Rulings expand ways workers can claim age discrimination

The U.S. Supreme Court broadened the scope of the Age Discrimination in Employment Act. With the aging of the baby boomer generation, there is a greater statistical likelihood employees affected by layoffs or other employment decisions will be age-protected. Distributors need to be aware to protect against age claims.

By Frederic Mendelsohn

The U.S. Supreme Court decided a case that broadened the scope of claims under the Age Discrimination in Employment Act, ruling in the case of Smith v. City of Jackson, MS. Result: Older workers who believe they have been discriminated against can sue without proof of intentional discrimination and claims of "disparate impact" are permissible under ADEA.

The ruling resolved a split in the 11 federal circuit courts of appeals on the issue, and expanded the ways in which plaintiffs can viably claim age discrimination.

Legal Background

Liability for discrimination under federal, state and local laws generally involve two types of discrimination claims: "disparate treatment" and "disparate impact." The former arises when an employer intentionally treats an employee differently because of their race or any other characteristic protected by law. A classic example is the discharge of a pregnant employee solely because she is pregnant [and thus female].

To prove liability, the employee must prove "intentional discrimination," either by direct evidence such as a statement by the employer (e.g., "she's not likely to come back to work, so let's get rid of her"), or indirect evidence (e.g., termination when the employee was doing a good job and replacement by a non-protected person [a non pregnant female]).

On the other hand, where an employer takes action, or adopts a policy, that is, on its face, neutral to all employees, but has the unintended effect of treating a certain class of employees adversely, then the employer may be discriminating under the theory of adverse impact. For example, a rule that employees must be able to lift 75 pounds, regardless of their job description, may discriminate against women, older workers or the disabled, even if the employer had no discriminatory intent in adopting the policy. It is this type of policy that was at issue in Smith.

The ADEA generally prohibits employers from discriminating against employees who are 40 years of age or older.

Unlike several other discrimination statutes (e.g., the Civil Rights Act of 1964 [Title VII] and the Americans with Disabilities Act of 1990), the ADEA includes a provision that allows employers to take employment action that would otherwise be considered discriminatory if it is "based on a reasonable factor other than age" (RFOA).

This statutory language is at the heart of the dispute in Smith, and the split in the federal courts of appeals, that led the Supreme Court to revisit the issue of whether a claim of disparate impact is even allowed under the ADEA.

This was not an easy decision for the Court – while a plurality opinion, three Justices dissented (on the grounds that such claims are not cognizable under the ADEA), and others joined in the decision in different ways, such as by arguing that the proper interpretation should be left to the EEOC. Ultimately, while the Court found that plaintiffs in Smith did not prove their claim of disparate impact, such a claim is legally viable under the ADEA, clearing the way for more claims in the future.

The Facts

Smith involved the City of Jackson's police force, many of whom were over 40. In this bell-weather case, the plaintiffs sued the city and the police department, claiming they were injured by application of an allegedly neutral Performance Pay Plan (Pay Plan).

Under the Pay Plan, officers with five or fewer years of service received proportionately greater raises than those with more than five years of tenure. Consideration of the Pay Plan in light of the ADEA resulted in three categories of affected officers: 1) those with less than five years of service, most of whom were under 40 years of age; 2) those with more than five years of service, most of whom were over 40 years of age; and 3) a few with more than five years of service, who were under 40 years of age.

According to the plaintiff officers in the second category, the Pay Plan had a disparate (unequal or different) impact on them, as they received less in terms of compensation increases.

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The only issue before the Supreme Court was whether these plaintiffs could even pursue their disparate impact claims, as both the trial court and federal appeals court had held that they could not, reasoning that such claims are not available under the ADEA.

Supreme Court's Ruling

While a procedurally complex case, the findings of the Supreme Court were straightforward: A majority of the Justices held that the ADEA does allow claims of disparate impact but in this case found that the complaining officers couldn't actually prove that they were adversely affected by the Pay Plan.

One reason for this ruling was the city's explanation that the discrepancy between the differential for younger and older workers was that the junior officers' salaries had to be competitive with comparable positions in the marketplace. Thus, the city claimed that its Pay Plan was reasonable due to its reliance on factors other than age.

The Court agreed, holding that even employment actions that result in a disparate impact on older workers won't result in liability under the ADEA, where the reason is a RFOA (reasonable factor other than age). Thus, while disparate impact claims are recognized under the ADEA, the RFOA provision of the statute limits the scope of such claims under the ADEA.

If not self evident, the real reasons for employment actions play a significant role in how courts assess discrimination. For example, where there is not direct evidence of discrimination (e.g., a statement by the decision maker that the employee is "too old to do the job" or "who gave that old guy his job anyway"), the reasons articulated by an employer for any allegedly discriminatory employment decision are always scrutinized for truth.

The reasons don't necessarily have to be good reasons, but simply not pretext or false, to cover up an illegal action. Thus, in a recent case from the Sixth Federal Circuit of Appeals, where a 63-year-old administrative assistant to the CEO with a good performance record was fired, the court found that the CEO's reasons were sufficient for termination and avoided a claim of disparate treatment under the ADEA.

The two reasons for the 63-year-old's termination were: fouling up a hotel reservation and including other people in a photo shoot intended to spotlight the CEO. The court cited the holding from another case, noting that the "ADEA does not make employers liable for petty, stupid or even wicked decisions; it makes them liable for discriminating, for firing people on account of their age."

While a termination case, and thus not based on a claim for disparate impact, the focus on this case was on the reasons, much like how the Supreme Court's ruling in Smith found the reasons for the Pay Plan to be within the ambit of a RFOA.

Bottom Line

There is a bottom line to Smith. Federal law has historically recognized that an employee's age, unlike his or her race, ethnicity, sex or other protected characteristic, is often relevant to his or her ability to perform certain jobs. Where an employer adopts a policy that affects those over 40 disproportionately, it may appear actionable under the ADEA.

However, said policy will be defensible when based on a reasonable factor other than age. Such policy factors, when properly reasoned and explained, are not actionable. Two factors make claims under the ADEA something that all distributors should focus on.

First, with the aging of the baby boomer generation, there is a greater statistical likelihood that employees affected by an employment decision will be age-protected. Second, as the economy continues to fluctuate, more employers are faced with issues of layoff and recall, which oftentimes affect older, more senior workers in adverse ways.

To avoid ADEA trouble, distributors should identify legal and practical issues that affect older employees and subject to adverse action by the adoption of policies affecting pay, benefits, job retention, retirement, and other terms and conditions of employment; document steps that relate to the decision-making process; analyze the reasons for decisions, making sure age is not a "motivating factor" and/or whether a RFOA is involved in any policy implementation and/or adoption; and clearly communicate reasons for employment actions to all employees, especially those adversely affected.

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MODERN DISTRIBUTION MANAGEMENT VOL. 36, NO. 17
SEPTEMBER 10, 2006

Industrial & Construction Markets Update

PERSPECTIVE

Ten years ago, there was a flurry of activity as Wall Street blessed several industrial distributors when they went public. As MDM observed back then, distributors who ignored the changes taking place in, over and around the channel risked losing control of the company's future.

The lead article in this issue addresses how to create a seamless transition in management, even in the face of the threats to the traditional business model. Many distributors, including small to mid-sized companies, have put together strategies to ensure growth in the face of increasing consolidation.

In a somewhat related thought, the Virtual Tech Fair scheduled for Sept. 12-13 (all-day event both days at www.virtualtechfair.com) is a watershed of sorts in this industry. The industry has witnessed many niche-focused technology providers consolidate as larger companies bought their way into this sector and a few of the "legacy" distribution software companies expanded their reach into broader product categories.

The result has produced a current transition as the acquired companies reposition as part of a larger strategy. This is taking place in a strong growth period for distribution software and systems as many distributors buy upgrades postponed during the last downturn. In any industry, these changes tend to create some confusion and competitive opportunities for providers to differentiate and ultimately create more choice and value for customers.

Add to the mix the rapid adoption of technology in this industry over the past few years. As the lead article in this issue articulates, there is a new generation of management entering wholesale distribution, with a much different perspective on how to leverage technology than those planning an exit strategy.

Home Depot Supply of Canada has acquired **Grafton Utility Supply**, an electrical utility distributor in Canada. Established in 1978, Grafton Utility Supply distributes transmission and distribution products. It has 72 associates and operates in four cities: Colborne, Ontario; Winnipeg, Manitoba; Calgary, Alberta; and Surrey, British Columbia. Products include wire and cable, transformers, connectors, switches, insulators and lighting.

Motion Industries, Inc., Birmingham, AL, a distributor of industrial maintenance, repair, and operation (MRO) replacement parts, has acquired **Ruston Industrial**, Ruston, LA, and **Hydraulic Depot** in West Monroe, LA. Ruston sells bearings, mechanical power transmission, fluid power products, and industrial products with five locations in the South. Hydraulic Depot has a single location in West Monroe, LA. Its primary business is hydraulic repair and hydraulic product sales. See article on p. 4 of this section.

Motion's parent company, **Genuine Parts Company,** Atlanta, GA, has announced a new operating unit, the Heavy Vehicle Parts Group USA. The new unit will supply replacement parts for the repair and maintenance of heavy-duty trucks and trailers. The group will serve fleet operators, major repair facilities, trailer OEMs and others in the heavy-duty parts distribution channel. GPC estimates the market at $15-$20 billion annually.

Bunzl Distribution Inc., a supplier of disposable paper and plastic packaging to supplies to an array of businesses and industries, has acquired two companies in North America: **Morgan Scott**, Toronto, Ontario, a distributor of jan/san and foodservice disposable products in eastern Canada, and **United American Sales, Inc.,** a redistributor of personal protection equipment to industrial and construction markets. The two acquisitions combined had about $120 million in revenues in 2005. UASI has sold only to authorized distributors. Morgan Scott had revenues of US$59.2 million in 2005. See article on p. 6.

Mayer Electric Supply Co. Inc. will acquire **Jones & Lee Supply**, Knoxville, TN. "Jones & Lee is already a very solid distributor in the eastern Tennessee market and together we see that this will foster even quicker growth with customers in Knoxville, as well as the surrounding communities," said Jim Summerlin, Mayer's president. Jones & Lee was founded in 1948 and remains a family business. Over the past half century the company has grown from two associates to a team of 26.

PrimeSource Building Products Inc., Carrollton, TX, distributor of building materials specializing in fasteners, will acquire **Pacific Steel and Supply**, nail distributor on the West Coast. PSS currently operates their own fleet of trucks from three warehouses in San Leandro, CA, Ontario, CA, and Tacoma, WA. PSS's expertise in agricultural products is expected to further enhance the product assortment and service currently offered by PrimeSource.

continued on next page

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Beacon Roofing Supply, Inc., Peabody, MA, has acquired **Roof Depot, Inc**., a Minnesota-based distributor of residential and commercial roofing and other related building products with locations in Minneapolis and Stillwater, MN. Roof Depot is a distributor of roofing and other complementary building products. Roof Depot generated net sales of $31 million for its fiscal year ended Dec. 31, 2005.

Ferguson, Newport News, VA, has acquired the assets of **Water Works Supplies, Inc**. WWSI distributes water works products and is based in Southern Indiana, Central Eastern Kentucky and Southern Illinois. In the year ended June 30, 2005, WWSI had revenue of $29.5 million. Ferguson also acquired **Palermo Supply Co. Inc., Palermo Plumbing Center, Inc., and Palermo Wholesale Supply, Inc.** Palermo is a plumbing and heating distributor in Northern New Jersey and the greater New York areas. In the year ended Dec. 31, 2005, Palermo had revenue of $82.9 million.

Edgen Corporation, Baton Rouge, LA, a global distributor of specialty steel pipe, pipe components and high grade structural steel sections, plates and tubulars, reported sales for the second quarter ended June 30, 2006, were $98.2 million, compared with $74.4 million for the same period last year.

RONA Inc., Squamish, BC, a Canadian distributor and retailer of hardware, home improvement and gardening products, has acquired British Columbia-based **Mountain Building Centres Limited**. Mountain Building Centres is a supplier of building materials, home improvement and hardware. Mountain Building Centres posted sales of $22 million in 2005.

Atlas Copco (China) Investment Co. Ltd., Stockholm, Sweden, has agreed to acquire the **Shanghai Bolaite Compressor Co. Ltd**., with $18.7 million (137M SEK) and 309 employees. Bolaite, Shanghai, China, manufactures and distributes piston compressors and oil-injected screw compressors below 450 kW, and dryers. Bolaite has an extensive distributor network in China. Bolaite will become part of Atlas Copco Compressor Technique's Industrial Air division. Atlas Copco has more than 110 sales and service offices throughout China and more than 200 distributors there.

Graybar, St. Louis, MO, distributor of electrical and communications products and related supply chain management and logistics services, posted 19.7 percent growth in the first half of 2006 – to $2.45 billion – compared to the same period last year. "Our revenues are up nearly 20 percent, and we only increased head count 5 percent, mostly in customer-facing roles," said Robert A. Reynolds, Jr., chairman, president and CEO of Graybar. Article on p. 4 of this section.

Lawson Products President and COO Jeffrey B. Belford will retire in January after more than 26 years with the company. Thomas Neri, Lawson's executive vice president for finance, planning and corporate development, will assume the role of COO immediately and will become president beginning in January. In other Lawson news, the company is starting construction to more than double the size of its facility in Reno, NV, to about 250,000 square feet by mid-2007. In addition, Lawson will be laying off 40 employees by the end of 2006.

Airgas Inc. CFO Roger F. Millay will resign effective Sept. 20, 2006. He will become the CFO of Discovery Communications, Inc., the parent company of the Discovery Channel and Animal Planet. Robert M. McLaughlin, vice president-controller, will take over as interim CFO for Airgas upon Millay's resignation.

Ingersoll-Rand Company Ltd., a diversified industrial manufacturer, has purchased **ZEKS Compressed Air Solutions**, West Chester, PA, which develops and manufactures a complete line of compressed air treatment products, including air dryers, filters and system controllers. Sold through dozens of distributors in the U.S. and Canada, ZEKS products are used for diverse industrial and manufacturing applications in a range of industries. ZEKS will operate as part of Ingersoll Rand Air Solutions, a business unit of Ingersoll Rand's Industrial Technologies Sector.

Illinois Tool Works Inc., Glenview, IL, has agreed to acquire **Click Commerce, Inc**., an on-demand supply chain management software provider. The total value of the transaction, including outstanding stock options, is $292 million. Click Commerce has trailing 12 month revenues of $74 million. The company's software products include B2B e-commerce solutions for demand chain management, real time RFID-enabled supply chain management, service supply chain management and master data management. "We believe Click Commerce represents a solid new growth platform for ITW," said David B. Speer, ITW's chairman and CEO.

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MARKETS UPDATE SUPPLEMENT P. 3

U.S. Construction Statistics: Year to Date (Through July)

Housing Starts

	U.S. Total	Northeast	Midwest	South	West
Year to Date, as of July 2006	1148.9	102.2	177.4	581.3	288.0
Year to Date, percent change	-5.1%	-6.0%	-12.9%	-1.5%	-6.7%

Construction Spending

YEAR TO DATE 2006

	Thru July 2006[p]	Thru July 2005[r]	% Change
Total Construction	**680,382**	**630,235**	**8.0**
Total Private Construction [1]	**533,563**	**496,918**	**7.4**
Residential	**367,573**	**353,827**	**3.9**
Nonresidential	**165,990**	**143,091**	**16.0**
Lodging	10,603	7,245	46.3
Office	23,710	21,140	12.2
Commercial	42,974	38,256	12.3
Health care	18,099	15,589	16.1
Educational	7,852	7,369	6.6
Religious	4,620	4,461	3.6
Amusement and recreation	5,058	4,423	14.4
Transportation	5,070	3,893	30.2
Communication	8,446	7,544	12.0
Power	18,240	15,899	14.7
Manufacturing	20,500	16,526	24.0
Total Public Construction [2]	**146,819**	**133,316**	**10.1**
Residential	**5,221**	**4,610**	**13.3**
Nonresidential	**141,598**	**128,707**	**10.0**
Office	6,197	6,432	-3.7
Commercial	2,284	2,592	-11.9
Health care	5,365	5,050	6.2
Educational	39,120	36,943	5.9
Public safety	5,876	5,129	14.6
Amusement and recreation	7,268	6,001	21.1
Transportation	11,138	10,523	5.8
Power	4,411	4,721	-6.6
Highway and street	39,373	33,682	16.9
Sewage and waste disposal	10,339	8,668	19.3
Water supply	6,819	6,128	11.3
Conservation and development	3,073	2,581	19.1

Note: [p] Preliminary [r] Revised. [1] Total private construction includes the following categories of construction not shown separately: public safety, highway and street, sewage and waste disposal, water supply, and conservation and development. [2] Total public construction includes the following categories of construction not shown separately: lodging, religious, communication, and manufacturing.

SOURCE: U.S. DEPARTMENT OF COMMERCE

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MARKETS UPDATE SUPPLEMENT P. 4

Motion Industries Makes Two Acquisitions

Motion Industries, Inc., Birmingham, AL, a distributor of industrial maintenance, repair, and operation (MRO) replacement parts, has acquired Ruston Industrial, Ruston, LA, and Hydraulic Depot in West Monroe, LA.

Ruston Industrial sells bearings, mechanical power transmission, fluid power products, and industrial products. Ruston Industrial has a total of five locations: Ruston, LA; Pine Bluff, AR; McComb, MS; Alexandria, LA; and Creola, AL. Hydraulic Depot has a single location in West Monroe, LA. Its primary business is hydraulic repair and hydraulic product sales.

"This strategic move continues the expansion of our industrial supply group as well as our hydraulic business. We are pleased to have both Ruston Industrial and Hydraulic Depot join our organization," said Motion President and CEO Bill Stevens.

Motion also recently acquired Lewis Supply Company, Memphis, TN, the company's biggest foray yet into the industrial supply sector.

With 2005 sales of $2.8 billion, Motion Industries is a distributor of bearings; mechanical power transmission, industrial automation, electrical, hydraulic and pneumatic components; hose and rubber products; and industrial products.

Motion Industries has more than 460 operations including nine distribution centers throughout North America and serves more than 150,000 customers from the automotive, chemical, food and beverage, wood and lumber, iron and steel, pulp and paper, and pharmaceutical industries.

Motion Industries is a wholly owned subsidiary of Genuine Parts Company, which recently announced a new operating unit, the Heavy Vehicle Parts Group USA.

The new unit, based in Atlanta, will have dedicated facilities across the U.S. that supply replacement parts for the repair and maintenance of heavy-duty trucks and trailers. This group will serve fleet operators, major repair facilities, trailer OEM's and others in the heavy-duty parts distribution channel. GPC estimates the market in heavy-duty aftermarket replacement parts at $15-$20 billion annually.

Graybar Reports 20% Growth in First Half

Graybar, St. Louis, MO, distributor of electrical and communications products and related supply chain management and logistics services, posted 19.7% growth in the first half of 2006 – to $2.45 billion – compared to the same period last year.

"Our revenues are up nearly 20%, and we only increased head count 5%, mostly in customer-facing roles," said Robert A. Reynolds, Jr., chairman, president and CEO of Graybar.

"Graybar employees worked incredibly hard during the recent economic downturn, preparing for the opportunities now in front of us. Our SAP system now links our branch, zone and district facilities nationwide, increasing our ability to react faster and anticipate changes in the market."

According to Reynolds, the growth was organic. He credits the company's dedicated employee-owners, a successful ERP implementation, the expansion of the electrical and telecommunications sectors, and an improved corporate accounts program.

In 2004 Graybar successfully completed its installation of the SAP system. "This investment is now paying off with unprecedented asset and supply chain management," commented Reynolds. "It allows us to focus our efforts more directly on customer satisfaction and achieving healthy growth."

Graybar is a distributor of high quality electrical and telecommunications products, and an provider of related supply chain management and logistics services. Through its network of more than 250 North American distribution facilities, it stocks and sells products from thousands of manufacturers.

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ISSN 0544-6538

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