MODERN DISTRIBUTION MANAGEMENT
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Stem the Tide: Rising Fuel Costs

Consider strategies beyond passing increases to customers

Plan for consistently higher fuel prices through 2007 by improving transportation efficiencies. Here are actions some distributors are taking, including comments from a recent Channel Marketing Group/MDM online survey. Half of respondents say they are absorbing the increased costs; some are reluctant to institute fuel surcharges before the competition does.

By Lindsay Young

The average cost of a gallon of diesel has hovered above $2.90 recently, up 33 percent from the year before. While the West Coast has endured the highest prices – California is averaging $3.24 a gallon – prices in the Rocky Mountains and the Midwest have risen the fastest, at 35 percent since last year.

Fuel costs are burning the bottom lines of all distributors. Fastenal, for example, has seen its fuel costs double over the past two years. The company, which runs its own fleet of delivery vehicles, reported fuel costs averaged $1.2 million per month in first quarter 2005 and steadily climbed until they hit $1.8 million a month in the first quarter 2006. But just two years ago, its fuel costs averaged $0.9 million a month. In its annual report, Fastenal attributed much of this increase to the rising price of fuel.

Impact

The impact of rising fuel costs on distributors varies.

One electrical distributor's costs have gone up $3,000 a month; another said his costs are up 37 percent in the first quarter 2006 compared with the first quarter 2005.

One distributor said the impact of rising fuel costs is felt in cost per delivery – which for him is up 10 percent year-over-year. But he says that perhaps a more important number to consider is delivery cost as percentage of profit dollars delivered: This is up about 5 percent for his company.

Still others have reported minimal cost increases, including an electronics distributor who said the company had absorbed just a 1 percent increase. Others say that the impact on their businesses has been hard to pin down because they must take many factors into consideration.

An electrical distributor reported his fuel-related costs are up 16 percent but sales have jumped 36 percent; he says increased profits have made up for the jump in fuel costs.

Nearly two-thirds of survey respondents report fuel costs have had some impact on their profitability. Half of respondents say they are absorbing the increased costs; some are reluctant to institute fuel surcharges before their competition takes that step.

As long as fuel prices stay up – and they will in the near term – distributors will have to deal with surcharges passed down by suppliers and logistics providers. Tripp Dunman, managing director for risk management firm FCStone's fuel surcharge group, says shipping companies have seen a 20-40 percent escalation in the fuel portion of their freight bills in the past two to three years. What's more, diesel prices have risen at least 16 percent since January.

"They have to recover the cost of fuel," Dunman says. "It's probably not something that is going away anytime soon."

Holding the Line

Most distributors are tackling rising costs by controlling other costs or charging surcharges based on per order, per delivery or weight, says David Gordon, principal at Channel Marketing Group, Raleigh, NC.

Another strategy distributors are employing is differentiating prices based on pick-up vs. delivery, or as an incentive

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to achieve minimum-order sizes. Others are negotiating fuel prices with local gasoline stations, changing delivery schedules or reducing the number of deliveries.

Distributors in the recent MDM-Channel Marketing Group survey described strategies they have been using to mitigate rising costs.

Delivery charges. One distributor says: "We really haven't applied surcharges because this implies it's temporary. We've increased delivery charges – one for out of town and one for 'city' delivery."

But some distributors are encountering resistance to this idea. Interestingly, one remarked: "While I'm certain that most or all of our customers would balk at a delivery charge from us, none seem to have a problem paying UPS, courier or LTL charges. This stems from the industry's practice of bundling in free delivery."

Fuel surcharges based on order size. For example, an $8 charge for orders less than $500. One distributor, which runs a fleet of 10 trucks, said: "We instituted a $1 surcharge per invoice to try to recoup some of the high fuel costs. Most customers are accepting this charge as a cost of doing business."

Nearly half of survey respondents are not adding a fuel surcharge to orders or deliveries. The rest vary anywhere from $1 to $10 per order.

Sales team's role. Sales people should consider the size of an order before making a commitment to delivering it. At one company, this means making smaller customers wait until it's economically feasible to deliver. The company may ask larger customers to increase their order size, and marginal customers may be asked to will-call an order.

"This approach has always met with mixed results but with fuel costs on everybody's minds it has become easier to increase order size because both the sales person and the customer truly understand that costs have risen significantly," the distributor says.

Other ideas for mitigating fuel cost hikes:

- Roughly two-thirds of survey respondents are using UPS/FedEx/DHL or a local courier/delivery service more often. Some distributors have chosen to pass on those costs to the customer; others have not.
- Integration of rising costs into the price of products. One distributor raised prices 1 percent across-the-board. Another did the same and said customers didn't notice the change.
- Consolidating delivery runs/smarter routing. Some distributors are considering buying truck routing software. One distributor is limiting special runs: "All (deliveries) must be on a standard route."
- Restricting delivery by order size/ increasing minimum-order requirements.
- Driving slower and using more fuel-efficient vehicles. Also, improving maintenance on company vehicles.
- Many fuel companies offer rebates through their credit cards – distributors can use these as a savings tool.

MODERN DISTRIBUTION MANAGEMENT

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Manage Transportation Costs

"As transportation costs keep rising, companies will only be able to pass along to customers part of those costs," says Dan Miklovic, managing vice president for manufacturing and industries advisory services at Gartner Consulting, an Information Technology group.

"Those companies that can manage to keep transportation costs low will have a price advantage over those companies that have higher costs. Either those companies must absorb the costs to match the more efficient company's process, or have a higher price point."

Miklovic believes that managing your transportation costs is just as critical as optimizing labor and material costs. He says targeting reduced shipping costs could have as high a payback as other supply chain management techniques.

Help from Technology

Transportation optimization technology analyzes and determines the most cost efficient ways to distribute products. The method balances less-than-truckload, truckload, rail, container, air and ocean freight to get the best solution based on source, destination and time constraints. Miklovic says you can also factor in planning which distribution center to fulfill orders from.

"For example, it might be more cost effective to source from a more distant DC if you can fill the truck from that single DC and pay full truck rates than having to do LTL from two DCs, if neither can fill the order alone," he explains.

Though a full transportation optimization IT package might cost big bucks, and therefore may be limited to larger distributors, smaller distributors can still analyze their transportation networks to determine whether there are more cost-effective ways to deliver product and fulfill orders.

One solution: Direct orders to branches instead of a central facility to avoid compounding costs with internal transfers. A downside to this strategy is that it may challenge in the areas of inventory and staffing.

Analyze Replenishment Practices

Just-in-time inventory replenishment requires more frequent and smaller deliveries. This usually requires the use of LTL, or Less Than Truckload, Miklovic says, which has higher costs because trucks have to travel more complex routes. Fewer but larger shipments allow for full truck rates, based on point-to-point least distance rates.

Distributors should analyze replenishment cycles and minimum-order quantities to decide whether potential inventory increases are justified based on current fuel and transportation expenses on a per-unit basis, Miklovic says.

"Bottom line is there are lots of supply-chain related things any company can do. Some will have minimal impact (on costs) but every little bit helps," he says. "All the evidence says energy costs will continue to rise and that while there will be short-term decreases, the long-term global economic forecasts support a period of continued high energy costs."

Summer Forecast

Crude oil prices surged in April and have almost doubled in the past two years, according to the U.S. Energy Information Administration.

Retail regular gasoline prices are projected to average about $2.57 per gallon in 2006 and 2007, 34 cents higher than last year's average of $2.37 a gallon. The EIA estimates retail diesel will average $2.79 a gallon in the second quarter 2006, and $2.74 in the third quarter.

By September 2006, fuel prices are expected to be lower than last year because of the return of crude oil and natural gas production and refineries affected by Hurricanes Katrina and Rita in 2005. Important note: EIA's projections do not reflect any new production or refinery outages due to hurricanes. Forecasts indicate another busy hurricane season in the oil and gas rig-heavy Gulf of Mexico.

The EIA projects motor gasoline consumption, which had no growth in 2005, to grow 0.9 percent in 2006 and 1.5 percent in 2007 as a result of continued economic growth and the stabilization of motor gasoline prices. Transportation diesel fuel consumption is projected to show solid growth in 2006 and 2007 of 3.4 percent per year.

Barring significant supply changes, the EIA forecasts gasoline and diesel prices won't go down, but will plateau to the end of 2007.

A majority of the 166 survey respondents to the online survey have revenues below $250 million a year. More than half have sales under $50 million. Survey responses included distributors from the electrical, building materials, electronic, HVAC, industrial, plumbing and PVF sectors.

Resources

U.S. Energy Information Administration – www.eia.doe.gov

Square D Sues Unauthorized Distributor

Manufacturer stops electrical distributor from selling counterfeit products

Electrical distributor Scott Electric Company, Greensburg, PA, has been barred from selling counterfeit versions of Square D electrical products. Square D, Palatine, IL, is a global brand of the North American operating division of electrical and industrial control products manufacturer Schneider Electric.

Square D filed a lawsuit against Scott Electric Apr. 7, 2006, alleging Scott has been selling counterfeit Square D products as well as participating in false advertising, product disparagement and trademark infringement in violation of federal and state law.

In May, Scott consented to a full inspection of its Square D inventory.

Scott Electric is also permanently barred from knowingly marketing, selling or distributing any counterfeit Square D product. Through Apr. 12, 2008, Scott has agreed to notify Square D if it suspects it is in possession of counterfeit product and must fully cooperate with a Square D inspection.

Another term of the consent order signed by Scott is that the distributor will provide Square D with a list identifying all of its suppliers of Square D inventory for the past 36 months.

If Scott complies with these terms, Square D will dismiss the lawsuit against Scott Electric.

"Armed with Scott Electric's supplier list, Square D has every intention of pursuing counterfeiters up and down the distribution chain," said Bill Snyder, vice president for channel development for the Schneider North American Operating Division. "We'll stop at nothing to preserve the integrity of our products and protect innocent customers from the serious health and safety hazards associated with counterfeit products."

Details of Allegations

Square D sued Scott Electric and retail outlet Bossert's Hardware and Sporting Goods Store in April. The lawsuit alleges Bossert's sold Square D products it obtained from Scott Electric.

Square D's products include circuit breakers, electric panels and switches. Its products are distributed nationally and internationally directly and through a network of authorized distributors. Square D's direct sales are generally confined to national accounts.

According to court documents, Square D obtained samples of purported Square D QO circuit breakers from Scott and Bossert. All of the QO circuit breakers had the Square D trademark as well as the QO mark.

Square D says it determined after inspection that the circuit breakers purchased from Scott were not authentic and had multiple discrepancies from the authentic QO circuit breaker. Among other things, the circuit breaker had a different cover thickness, no stainless steel latch plate, no jaw grease and a smaller extruded hole on the clamp plate.

Samples taken from Bossert showed variances from the originals including lack of a visible date stamp (used by Square D to identify date and country of manufacture) and contained an etched, as opposed to molded, trademark symbol for Square D, according to Square D allegations in the lawsuit.

"The counterfeit products may not function as an authentic Square D breaker and could cause or fail to terminate an arcing or over-voltage event," the lawsuit says. "Such failure could result in fire or electrocution hazard to innocent consumers."

The lawsuit alleges Scott and Bossert both knew they were marketing and selling counterfeits. "Scott further informed customers and potential customers that it was an 'unauthorized' Square D distributor and that it stocked Square D products," the lawsuit reads.

False Advertising

Starting in late February, Scott sent a flyer to customers and potential customers in western Pennsylvania, West Virginia and Maryland, according to the lawsuit.

The flyer contained "false and deceptive statements," according to allegations laid out in court documents, including that Scott is an "unauthorized" Square D distributor; authorized distributors inflate the price of Square D's products; the authorized distributors do not maintain adequate stock; Square D coaches and trains its distributors to obfuscate and to be manipulative; Scott purchases Square D products by the "trailer load"; Scott uses its quality control department to test its Square D products; and Square D's products lack features possessed by Square D's competitors.

"Upon information and belief, Scott made use of the statements in the flyer to 'bait and switch' customers and sell them products of competing manufacturers in lieu of Square D products," according to the lawsuit.

Damages

Square D claims that as a result of Scott's statements, the company and its distributors have lost sales. The manufacturer also says its reputation as well as the reputation of its distributors has been "irreparably harmed." Square D estimates harm done to it and its distributors to total "hundreds of thousands, if not millions, of dollars."

Square D asks for both punitive and pecuniary damages in the lawsuit. If Scott fulfills the requirements laid out in the consent order, Square D will drop the lawsuit.

"The swift handling of this lawsuit demonstrates how determined and serious Square D is about putting an end to the counterfeiting of its products. There will be many more battles as part of the larger war Square D intends to wage on counterfeiters," Schneider Electric's Snyder said.

Resources

www.stopfakes.gov – the Department of Commerce's Web site with information on how to protect intellectual property, as well as report counterfeit goods.

Canadian Distributor 2005 Sales Up 5.4%

Report provides overview of trends driving Canadian wholesale sector

This article provides an overview of regional and national wholesale trends in Canada based on 2005 sales results. All data and analysis in this article can be attributed to the report, "Between the Producer and Retailer: A Review of Wholesale Trade for 2005," by Jean Lebreux of Statistics Canada's Distributive Trades Division, www.statcan.ca.

Canadian wholesaler-distributors reported $470 billion (US$423 billion) in sales last year, up 5.4 percent from 2004, according to a report released earlier this month by Statistics Canada. When adjusted for inflation, the gain was 7.8 percent, the largest jump in the past six years.

Sales were bolstered by gains in the four westernmost provinces. Sales among wholesalers in Manitoba, Saskatchewan, Alberta and British Columbia have risen at an average annual rate of 9.1 percent. This is nearly double the rate of average growth for Canada as a whole, and three times the gain in the other regions of Canada combined. In 2005, these four provinces accounted for 60 percent of the total increase in wholesale sales nationwide.

The machinery and electronic equipment sector contributed the most to Canada's overall sales gains. The sector includes heavy industrial equipment, as well as computer and office and professional equipment. It represented more than 31 percent of the year-over-year growth.

Key factors affecting wholesale trade in Canada in 2005:

- Lower prices on certain products resulting in part from the stronger Canadian dollar against the American dollar
- Increased capital investment by business
- The re-opening of the American border to the trade of live cattle under 30 months of age
- The decline in residential housing starts in Canada
- China's growing role in the world economy

Machinery and Electronic Equipment

For the second year in a row, business made investments in machinery and electronic equipment and wholesale sales were more than $95.5 billion (US$86.1 billion) in this sector, up 8.6 percent from 2004. It represents the strongest gain in machinery and equipment since 1997.

Factors contributing to this growth included: record investment in plants and equipment; and higher prices for raw materials due to an increase in world demand. Also, a growing proportion of goods sold came from China, especially computers and computer accessories, as well as telecommunications equipment. Import prices on office machinery and equipment fell 17 percent – the decline for other types of telecom equipment and supplies was 7.6 percent.

Building Materials

Wholesalers in the building materials sector recorded a sharp slowdown in growth, with sales of more than $66 billion last year, up 8.5 percent from 2004. The rate of growth was less than half the increase of 20 percent during 2004.

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Sales in lumber were $13 billion, up 2.5 percent. In 2004, growth was 23.8 percent in this group. Lumber prices fell 5 percent. Overcapacity in North America combined with world competition also contributed. Results also reflect a change in the housing markets in the U.S. and Canada. The number of housing starts fell 3.4 percent in Canada in 2005.

Metal products sales (used in construction) had a steeper slowdown in growth than lumber, with $14 billion in sales, up 7.1 percent compared with a 33.3 percent gain in 2004. Prices started to level out in 2005 with China's entry into steel production.

Other building materials sales totaled more than $39 billion, an 11.2 percent increase, slightly less than the 14.7 percent increase the year before. Renovation and construction markets have stayed strong in Canada, supporting this growth.

By Region

In 2005, wholesalers in Manitoba, Saskatchewan, Alberta and British Columbia accounted for 60 percent of the total increase in wholesale sales nationwide.

Demand for machinery and electronic equipment and for building materials was the main reason for the strong growth in the western provinces. The economic and demographic boom in the West – especially Alberta – also fuelled growth.

A snapshot of regional growth, with details on each province's top markets:

Alberta: $55 billion sold in 2005, up 15.5 percent. Sharp increases in oil prices accounted for much of the increase in sales by machinery wholesalers, as oil companies have accelerated their investments.

Manitoba: Personal and household goods performed well as a result of positive economic conditions. The Agreement on Textile and Clothing, which imposed quotas on imports, expired on Jan. 1, 2005, allowing some wholesalers to acquire products at a lower cost. Even before the agreement ended, two-thirds of the clothing sold wholesale in Canada came from abroad.

Saskatchewan: Sales in farm products surged 27.1 percent with the re-opening of the U.S. border to Canadian cattle under 30 months of age. Sales in "other products" have been spurred on by higher prices for chemical farm products and recycled metals.

British Columbia: In 2005, the province sold $47 billion in merchandise, an 8.6 percent increase from 2004. Sales in lumber only grew 3.3 percent, a fraction of the 46.2 percent increase in 2004. The value of lumber exports fell in 2005 because of a drop in lumber prices that more than offset higher volumes.

Quebec: $91 billion in sales, a 5.7 percent increase. Food products, tobacco and alcohol, and the "other products" sectors drove growth.

Ontario: Saw growth of just 2.2 percent in sales. In total, wholesalers here sold $237 billion worth of goods, or one-half the national total. A poor performance in the automotive sector slowed growth. Excluding motor vehicles, sales rose by 4.3 percent. Sales of automotive parts and products wholesalers dropped 2.8 percent due to a decline in motor vehicle sales – the third straight year of decline for this group. About one-third of Ontario wholesale revenues result from exports to the U.S.

Atlantic provinces: Sales declined overall in Atlantic provinces. Newfoundland and Labrador was the only province of four that recorded an increase in sales for 2005.

Stronger Canadian Dollar

A constant price increase in 2005 can be attributed to the strength of the Canadian dollar, which maintained an average annual exchange rate of US$0.825 compared to US$0.758 in 2004.

This translates into lower prices for imports; Canadian businesses substitute less expensive foreign products for goods made in Canada. Wholesalers benefited from this substitution – the machinery and electronic equipment sector, a major player in the import sector, accounted for nearly one-third of wholesalers' sales in 2005.

The growth rate in 2005 was actually slower than in 2004. The rate of growth increased in most sectors, but three – building materials, motor vehicle, parts and accessories, and "other" products – slowed, canceling out the acceleration of growth in the other sectors.

For a link to the full report, "Between the Producer and Retailer: A Review of Wholesale Trade for 2005," go to this article under Current Issue at www.mdm.com.

Global Metals M&A Sees New Highs

Report: Steel sector leads the way in deal-making

A recent PricewaterhouseCoopers report on the global metals industry provides insight into the driving forces behind consolidation among steel and other metals producers.

The metals industry continued to consolidate in 2005, as leading producers sought to control the rising cost of raw materials by purchasing suppliers outright, according to a recent PricewaterhouseCoopers report, "Forging Ahead: Mergers and Acquisitions Activity in the Global Metals Industry 2005."

Further mergers and acquisitions activity is likely, and China will be a significant source of M&A over the next few years as it continues to produce and consume steel at a record pace. Eastern Europe, Asia Pacific and Latin America will continue to be driving forces in industry consolidation. Companies in those regions accounted for deals worth $17.7 billion, or 51 percent of the total value of industry transactions worldwide, up 32 percent from 2004.

There were 250 metals industry deals in 2005, far surpassing the 166 in 2004. But the total value of deals in 2005 was just $35 billion, less than the $37 billion the previous year.

Notably, cross-border deals and their aggregate value rose sharply in 2005, with 99 transactions worth $17.2 billion, up 50 percent over 2004.

Steel Sector

The steel sector led the way in 2005 M&A activity with 165 deals worth $27.5 billion. The sharp rise in the number of transactions helped offset the absence of any deals comparable in size to the two that produced Mittal Steel in 2004. The single biggest deal – Mittal Steel's acquisition of Ukrainian steel producer KryvorizhStal – was worth $4.6 billion, barely a quarter of the $17.8 billion that went into creating Mittal.

According to the report, global consolidation is not the only factor driving deal-making in the steel sector. Many of the largest deals in 2005 involved manufacturers eager to buy iron ore mines and reduce their raw materials costs.

For example, KryvorizhStal has over a billion tons of iron ore reserves. Similarly, Ural Steel and Sitbon Investments bought Mikhailovsky, Russia's second biggest iron ore producer.

China

China now produces more crude steel than the next four largest steelmaking nations combined. The central government has signaled its determination to rationalize the sector, with the top 10 domestic producers controlling 50 percent of domestic output by the end of the decade.

Its new steel policy, launched in July 2005, has already resulted in eight transactions with an aggregate disclosed value of $1.1 billion – 25 percent of the total value that was traded in the Asia-Pacific metals industry in 2005. China is also attracting interest from overseas steelmakers eager to tap into its growth.

At the same time, China's steel consumption has quadrupled since 1998, with the construction industry playing a significant role in driving demand. In 2004, it accounted for 53 percent of total consumption, and that pattern is likely to persist for at least the next few years as the country invests in vast infrastructure projects such as the Three Gorges Dam and gears up for the 2008 Beijing Olympics and the 2010 Shanghai World Expo. China's steel consumption is forecast to rise by 4-5 percent a year, outpacing the 3 percent in the rest of the world.

China however is reliant on other countries for high quality iron ore, and, as imports have soared, so have prices skyrocketed, according to the report. Energy and transportation costs have increased, and the domestic steel sector is highly fragmented and suffering from overcapacity in certain product areas.

These factors have eroded profitability – resulting in a need to consolidate.

Resources

- A copy of the PricewaterhouseCoopers report can be downloaded at www.pwc.com/metals or at this article online at www.mdm.com under Current Issue.
- Find a link to the April 10 MDM article, "Metals Distribution Consolidates," at this article online at www.mdm.com under Current Issue or go directly to www.mdm.com/pub/36_7/features/3078-1.html.

Monthly Wholesale Trade: Sales and Inventories for March 2006

March 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 $315.0 billion, up 0.7 percent from the revised February level and were up 9.9 percent from the March 2005 level. The February preliminary estimate was revised upward $0.7 billion or 0.2 percent. March sales of durable goods increased 0.3 percent from last month and were up 9.2 percent from a year ago. Sales of professional and commercial equipment and supplies increased 2.6 percent from last month, while motor vehicle and motor vehicle parts and supplies were down 2.6 percent. March sales of nondurable goods increased 1.1 percent from last month and were up 10.7 percent from last year.

Inventories

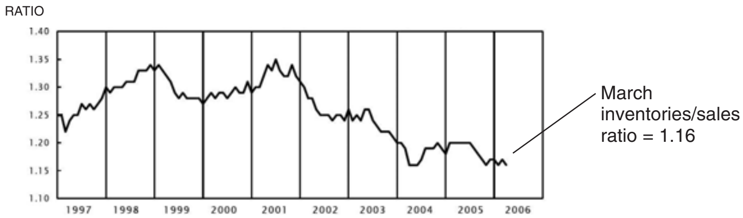
Total inventories of merchant wholesalers, except manufacturers' sales branches and offices, after adjustment for seasonal variations but not for price changes, were $366.7 billion at the end of March, up 0.2 percent from last month, and were up 6.3 percent from a year ago. The February preliminary estimate was revised upward $0.3 billion or 0.1 percent. End-of-month inventories of durable goods increased 0.2 percent from February and were up 6.7 percent from last March. Inventories of professional and commercial equipment and supplies decreased 1.7 percent from last month.

Inventories/Sales Ratio

The March inventories/sales ratio for merchant wholesalers, except manufacturers' sales branches and offices, based on seasonally adjusted data, was 1.16. The March 2005 ratio was 1.20.

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

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



Source: U.S. Census Bureau

Monthly wholesale trade: Sales and inventories March 2006

NAICS Code	Business Type	Sales $ millions	Inventories $ millions	Stock and Sales ratio	% Change in Sales 2/06-3/06	% Change in Sales 3/05-3/06	% Change Inventory 2/06-3/06	% Change Inventory 3/05-3/06
42	U.S. Total	314,996	366,722	1.16	0.7	9.9	0.2	6.3
423	Durable	155,922	231,754	1.49	0.3	9.2	0.2	6.7
4231	Automotive	26,120	36,063	1.38	-2.6	9.4	1.0	11.5
4232	Furniture & Home Furnishings	5,491	7,799	1.42	-0.3	11.6	-0.8	3.0
4233	Lumber & Other Construction Materials	11,954	15,644	1.31	1.1	10.6	0.6	5.8
4234	Prof. & Commercial Equip. & Supplies	27,072	29,624	1.09	2.6	9.7	-1.7	4.3
42343	Computer Equipment & Software	13,483	10,597	0.79	1.4	3.6	-1.4	-0.2
4235	Metals & Minerals	11,873	18,917	1.59	0.8	8.5	-0.2	-6.1
4236	Electrical Goods	22,893	28,749	1.26	0.3	5.7	0.7	4.3
4237	Hardware, Plumbing, & Heating Equipment	7,478	14,122	1.89	0.4	11.1	0.8	14.4
4238	Machinery, Equipment & Supplies	26,372	58,741	2.23	0.4	14.9	0.6	12.1
4239	Miscellaneous Durable	16,629	22,095	1.33	0.3	2.5	0.2	2.0
424	Nondurable Goods	159,074	134,968	0.85	1.1	10.7	0.3	5.7
4241	Paper & Paper Products	7,971	7,438	0.93	1.5	13.0	0.4	6.4
4242	Drugs	29,990	28,750	0.96	0.0	16.9	0.3	-3.5
4243	Apparel, Piece Goods & Notions	9,921	15,591	1.57	-0.6	6.6	-0.5	2.1
4244	Groceries &Related Products	36,582	24,733	0.68	0.3	4.8	0.4	7.7
4245	Farm-product Raw Materials	9,882	11,317	1.15	6.4	11.2	-3.0	2.3
4246	Chemicals &Allied Products	7,553	8,467	1.12	0.2	9.4	1.6	7.5
4247	Petroleum &Petroleum Products	32,112	9,838	0.31	3.9	20.9	-2.0	25.6
4248	Beer, Wine & Distilled Beverages	7,997	9,230	1.15	-1.4	3.5	2.9	8.5
4249	Miscellaneous Nondurable Goods	17,066	19,604	1.15	-0.8	1.9	2.1	12.4

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

The spring meeting season, now coming to a close, has been significantly more upbeat than for several years. Sales remain strong, with many distributors setting record sales months. Others are rebuilding sales levels back to where they were in the late 1990s.

Nearly every company can say it has fewer people working more efficiently than a few years ago. That is in some cases a natural outcome of the current part of the business cycle. But distributors are also driving lean initiatives in some form. Some of the quality efforts of the 1990s ended up a hit and miss proposition. Sales were so good that few distributors had a compelling reason to go beyond the minimum requirements of customers.

Today many companies aren't instituting official lean programs, yet they have adapted the core principles of lean to their internal operations to be more competitive. An interesting shift has been that more companies are pushing lean practices out to their channel partners.

Channel management is in fact emerging as a competitive differentiator. Of course, that has been true for a select group of distributors and manufacturers for a long time. Yet conditions this year are lighting fires to pursue what has traditionally been pushed off.

Continued consolidation, increased global sourcing, tighter customer requirements, new competitors from other channels – all these factors are creating new game plans for distributors, as well as manufacturers who rely on independent distribution.

Distributors have to ask how flexible they are today to manage new conditions and requirements, whether with their core suppliers or core customers. The old tools won't create the new relationships necessary to compete.

Rexel Inc., Dallas, TX, has acquired **Capitol Light and Supply Company**, Hartford, CN, a distributor in the New England electrical distribution market and the national retail lighting market. Capitol Light and Supply Company had sales of $234 million in 2005. With 415 employees at 22 branch locations in five states (Connecticut, Maine, Massachusetts, New Hampshire, and Rhode Island), CLS, the electrical wholesaling business, enjoys a 15 percent market share in the region. Capitol Light, the company's national retail lighting business, operates in 36 states and Canada, with distribution centers located in New Haven, Connecticut, and Fort Worth, Texas.

Regal-Beloit Corporation, Beloit, WI, ($1.4 billion in 2005 sales) has sold its **Regal Cutting Tools** business to **YG1 Co**., Ltd., Incheon City, Korea. The sale of the business will reduce Regal-Beloit's sales by approximately $17 million on an annual basis and will be neutral to earnings. See article on p. 3 of this section.

The Home Depot Supply reported $2.1 billion in first quarter 2006 sales, compared with $657 million in the same period in 2005, thanks to a series of acquisitions. **Home Depot**, Atlanta, GA, reported overall first quarter revenues of $21.5 billion, a 13.1 percent increase from the first quarter 2005. Home Depot reported net income of $1.4 billion in first quarter 2006, a 19 percent increase over the same period last year. During the first quarter, Home Depot acquired Hughes Supply for $3.4 billion. The results of Hughes Supply are included in the company's consolidated results beginning Mar. 30, 2006.

Grainger President James T. Ryan told analysts of the **Electrical Products Group**, New York, NY, he expects the company's recent product line expansion to contribute about 1 percentage point to sales growth in 2006. With 39,000 new products, Grainger's 2006 catalog features 115,000 products, compared with 82,400 last year. Ryan said daily revenue growth for May is forecast at 9-10 percent versus May 2005. Businesses and institutions are trying to reduce the cost of procuring tools, safety equipment, lighting and other products by reducing the number of suppliers they use, Ryan said in describing trends in that market.

Former Sonepar chief Richard Worthy's **U.S. Electrical Services, LLC** (USESI) has agreed to purchase **Electrical Wholesalers Inc.**, Hartford, CN, effective June 29, 2006. According to *Electrical Wholesaling* magazine, Electrical Wholesalers had revenues of more than $100 million in 2003. Electrical Wholesalers has 22 locations and more than 375 employees. USESI has also agreed to buy **Monarch Electric**, a two-location electrical wholesaler in New Jersey that employs 70 people. It serves contractor, commercial and industrial markets. The purchase is effective May 31, 2006. Both companies will retain their names and management.

Industrial Supply Corp., Richmond, VA, has acquired **C. Arthur Weaver Company, Inc.** C. Arthur Weaver Company, also in Richmond with

continued on next page

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branches in Chesapeake and Roanoke, VA, is a wholesale distributor of branded power transmission and fluid power products and services to industrial customers throughout Virginia. Industrial Supply Corp., in business for 73 years, focuses on MRO product lines and has branches in Virginia and North Carolina.

Strategic Distribution Inc., Bristol, PA, reported its revenues for the three months ended March 31, 2006, increased $7.7 million, or 26.5 percent, to $36.7 million from $29 million in the same period last year. The company recorded a net loss of $1.096 million, compared with a net loss of $1.601 million for the same period in 2005. Revenues from existing customers increased by $6.9 million in the first quarter, due to an increase in volume of product sales compared with the same period in 2005. These increases were offset by a $0.3 million reduction in revenues for a closed site. New customers accounted for $1.1 million in revenue.

Graybar Electric, St. Louis, MO, recently reported sales of $1.12 billion for the first quarter ended March 31, 2006. That's an increase of 16 percent over the same period in 2005, when the distributor recorded $967 million in sales. The electrical distributor reported $10 million in profit for the first quarter 2006, compared with a net loss of $1.9 million in the first quarter of 2005.

MRO product distributor **Interline Brands Inc.** reported sales increased 14.3 percent to $224.7 million in the first quarter 2006, compared with the same period in 2005. Average daily sales increased 16.1 percent. The company's professional contractor business had organic revenue growth of more than 15 percent. Net income was $8.4 million compared with $1.4 million in the first quarter 2005.

Enterprise software provider Infor **has agreed to acquire SSA Global**, Chicago, IL, a provider of extended enterprise solutions and services. The acquisition will make Infor a $1.6 billion company. Under the terms of the agreement, Infor has agreed to pay $19.50 per share in cash to SSA Global's shareholders. The parties anticipate closing the transaction in the third calendar quarter of 2006.

Steel pipe and fittings distributor **Edgen Corporation**, Baton Rouge, LA, reported sales were $89.7 million for the three months ended March 31, 2006, compared with sales of $64.8 million for the same period in 2005. Net income for the first quarter 2006 was $2.3 million compared with a net loss of $1.5 million in the fourth quarter 2005. This compares with a net loss of $6.5 million for the first quarter 2005.

Building materials dealer **Lanoga Corporation,** Redmond, WA, has purchased Michigan-based

Calculation of MDM Inflation Index for April 2006

		BLS Price Indices Apr. '06	BLS Price Indices Mar. '06	BLS Price Indices Apr. '05	% Sales Weight	Weighted Indices Apr. '06 (1)X(4)	% Change Apr. '06 Mar. '06	% Change Apr. '06 Apr. '05
1136	Abr. Prod.	452.7	454.2	430.7	19.1	86.47	-0.33	5.10
1135	Cutting Tools	429.0	430.8	411.3	18.9	81.07	-0.44	4.28
1145	Power Trans.	607.9	608.3	590.5	15.4	93.62	-0.05	2.96
1081	Fasteners	425.1	420.2	406.4	9.0	38.26	1.16	4.58
1149.01	Valves, etc.	717.0	715.6	680.8	7.6	54.49	0.20	5.32
1132	Power Tools	326.6	327.5	330.1	6.5	21.23	-0.27	-1.07
1144	Mat. Handling	443.8	441.5	435.5	6.2	27.52	0.52	1.91
0713.03	Belting	534.0	538.8	519.5	6.1	32.57	-0.90	2.79
1042	Hand Tools	664.7	660.9	631.0	8.1	53.84	0.57	5.35
108	Misc. Metal	405.7	402.9	400.1	3.1	12.58	0.70	1.41
"New" April Index		262.1	April Inflation Index			501.65	0.01	3.88
"New" March Index		262.1	March Inflation Index			501.61		
			April 2005 Inflation Index			482.92		

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

INDUSTRIAL MARKETS UPDATE SUPPLEMENT P. 3

Delta Truss, which will become part of Lanoga's Timber Roots Truss Division. The acquisition adds $25 million in annual sales. Lanoga businesses include United Building Centers, Spenard Builders Supply, Lumbermen's, Home Lumber, Dixieline Lumber Co., and F.E. Wheaton. Sales in 2005 were $3.1 billion. In February, Lanoga was acquired by an affiliate of Fidelity Investments and joined with Strober Organization to comprise Pro-Build Inc., with combined sales of $5 billion and 400 locations.

Non-residential construction investment hit a record high in 2005 in Canada for the fifth year in a row, according to a recent study by Statistics Canada. Non-residential investment (commercial, industrial and institutional projects) hit $31.5 billion last year, up 8.7 percent from 2004. The $1.4 billion gain in office tower investment accounted more than one-half of the total increase in non-residential construction last year. Investment in warehouses jumped 14.6 percent to $2 billion.

Home Depot Supply Hits $2.1B in 1Q 2006

The Home Depot Supply reported $2.1 billion in first quarter 2006 sales, compared with $657 million in the same period in 2005, thanks to a series of acquisitions. Home Depot, Atlanta, GA, reported overall first quarter revenues of $21.5 billion, a 13.1% increase from the first quarter 2005.

Home Depot reported net income of $1.4 billion in first quarter 2006, a 19% increase over the same period last year. Home Depot reported its supply division's operating profit was $149 million compared with $28 million in the first quarter 2005.

During the first quarter, Home Depot acquired Hughes Supply for $3.4 billion. The transaction more than doubled the size of Home Depot Supply, which has more than 900 locations nationwide and in Canada with projected fiscal sales approaching $12 billion. The results of Hughes Supply are included in the company's consolidated results beginning March 30, 2006, the date of the acquisition.

Home Depot Supply is still growing: May 1, 2006, Home Depot acquired Cox Lumber, a $396 million privately owned lumber company in Florida. Cox joins the company's Williams Bros. Lumber business, and together they operate 48 branches in the Atlanta and Central Florida markets.

"With the acquisition of Hughes Supply, we are well positioned to serve our professional customers and gain a greater share of the more than $400 billion professional contractor market," said Joe DeAngelo, executive vice president, Home Depot Supply. "I am very pleased that our Hughes integration is off to a great start and is already ahead of expectations in terms of driving sales, managing costs and achieving synergies."

Regal-Beloit Sells Regal Cutting Tools to YG1 Co.

Regal-Beloit Corporation, Beloit, WI, ($1.4 billion in 2005 sales) has sold its Regal Cutting Tools business to YG1 Co., Ltd., Incheon City, Korea.

"This is a very positive move for the Regal Cutting Tools business as it will be aligned with a world leading manufacturer and marketer of high speed and carbide rotary cutting tools," said Henry W. Knueppel, chairman and CEO of Regal-Beloit.

"As we moved aggressively into motion control systems, electric motors and power generation over the past several years, the cutting tools business was no longer a strategic focus for us."

The sale of the business will reduce Regal-Beloit's sales by approximately $17 million on an annual basis and will be neutral to earnings.

Regal-Beloit is a manufacturer of mechanical and electrical motion control and power generation products serving markets throughout the world. The company is headquartered in Beloit, WI, and has global manufacturing, sales, and service facilities.

YG1, based in Incheon City, Korea, manufactures a wide array of metal cutting tools including end mills, taps, drills and other tooling in high speed steel and carbide. YG1 is one of the world's largest end mill manufacturers and markets products in 70 nations around the world. The company was founded in 1981 and has grown to more than $100 million in annual sales with facilities in Asia, Europe, Australia and the U.S.

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1Q Construction Spending Up; Housing Starts Cool in April

Overall Construction Spending

During the first three months of this year, construction spending was $253.5 billion, 9.2 percent above the $232.1 billion for the same period in 2005. Construction spending during March 2006 was estimated at a seasonally adjusted annual rate of $1,199.1 billion, 0.9 percent above the revised February estimate of $1,188.7 billion. The March figure is 8.4 percent above the March 2005 estimate of $1,106.4 billion.

Private Spending

Spending on private construction was at a seasonally adjusted annual rate of $940.8 billion, 1.1 percent above the revised February estimate of $930.9 billion. Residential construction was at a seasonally adjusted annual rate of $672.9 billion in March, 1.6 percent above the revised February estimate of $662.6 billion. Nonresidential construction was at a seasonally adjusted annual rate of $267.9 billion in March, 0.1 percent below the revised February estimate of $268.3 billion.

New Residential Sales

Sales of new one-family houses in April 2006 were at a seasonally adjusted annual rate of 1,198,000, according to estimates by the U.S. Census Bureau and the Department of Housing and Urban Development. This is 4.9 percent above the revised March rate of 1,142,000, but is 5.7 percent below the revised April 2005 estimate of 1,270,000. The median sales price of new houses sold in April 2006 was $238,500; the average sales price was $298,300. The seasonally adjusted estimate of new houses for sale at the end of April was 565,000. This represents a supply of 5.8 months at the current sales rate.

Public Spending

In March, the estimated seasonally adjusted annual rate of public construction spending was $258.2 billion, 0.2 percent above the revised February estimate of $257.8 billion. Educational construction was at a seasonally adjusted annual rate of $68.6 billion, 0.8 percent below the revised February estimate of $69.2 billion. Highway construction was at a seasonally adjusted annual rate of $69.4 billion, 0.4 percent below the revised February estimate of $69.7 billion.

Housing Starts

Privately-owned housing starts in April were at a seasonally adjusted annual rate of 1,84 million. This is 7.4 percent below the revised March estimate of 1.99 million and is 11.1 percent below the April 2005 rate of 2.07 million. Single-family housing starts in April were at a rate of 1.53 million; this is 5.6 percent below the March figure of 1.62 million. The April rate for units in buildings with five units or more was 262,000.

Housing Completions

Privately-owned housing completions in April were at a seasonally adjusted annual rate of 2.0 million. This is 6.6 percent below the revised March estimate of 2.22 million, but is 8.0 percent above the April 2005 rate of 1.92 million. Single-family housing completions in April were at a rate of 1.77 million; this is 6.0 percent below the March figure of 1.89 million. The April rate for units in buildings with five units or more was 267,000.

Source: U.S. Census Bureau, Department of Commerce and the Department of Housing and Urban Development

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