mdmpremium monthly

March 2023

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M&A Best Practices, Valuation Advice Top March Content

This past Feb. 22-23, MDM hosted a Virtual M&A Summit in which a roster of seasoned dealmaking executives shared their insights into how to make business transactions go smoothly. It ended with an all-encompassing panel session I moderated in which BlackHawk Industrial President & CEO John Mark, Singer Industrial (formerly SBP Holdings) President & CEO Craig Osborne and Supply Chain Equity Partners Co-Founder and Partner Jay Greyson shared key lessons they've learned over the years and how the M&A market has changed post-2020.

The trio of executives did a great job incorporating lessons shared throughout the summit, and I packaged them into a three-part series of Premium articles: One on March 8 focused on build-buy-invest tactics (pg. 5); one on March 20 focused on honest communication (pg. 6); and one on March 27 focused on valuation factors of emotion, risk and retirement (pg. 8).

We began the month with my March 1 piece recapping pricing and profitability factors shared in a NAW Executive Summit session (pg. 10); and Associate Editor Brad Star followed that by analyzing the interesting results of our social media poll asking if a four-day workweek could work in distribution (pg. 12).

Elsewhere in March, I examined the latest wholesale data from the U.S. Census Bureau (pg. 13); Intuilize's Nelson Valderrama discussed how CFOs can navigate inflation (pg. 15); and Associate Editor Mark Powell took a deep dive on Distribution Solutions Group a year after the distributor's formation via the merger of Lawson Products, TestEquity and Gexpro Services (pg. 18).

After a couple of relatively quiet months on the events calendar, I'm looking forward to attending several this spring, including the Industrial Supply Association's ISA23 April 17-19 in Phoenix, and the National Association for Hose & Accessories Distribution (NAHAD)'s annual convention held April 29-May 3 in the Bahamas. If you plan to attend either of them, I'd be happy to chat while there. Further out, MDM is hosting a free, one-day virtual Profitability Summit on July 19. We are assembling a cast of great experts pricing and profitability best practices that you won't want to miss. You can find a registration page and more details under out "Events" tab.

And a bit further out still is MDM's second annual SHIFT | The Future of Distribution in-person summit on Sept. 18-20 in downtown Denver. We're putting together a who's-who of distributor executives and subject matter experts in the areas of digital transformation, data analytics, hybrid sales who can deliver the change management best practices today's leading companies need. We'd love to see you there.

Mike Hockett, MDM Executive Editor
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DATUM

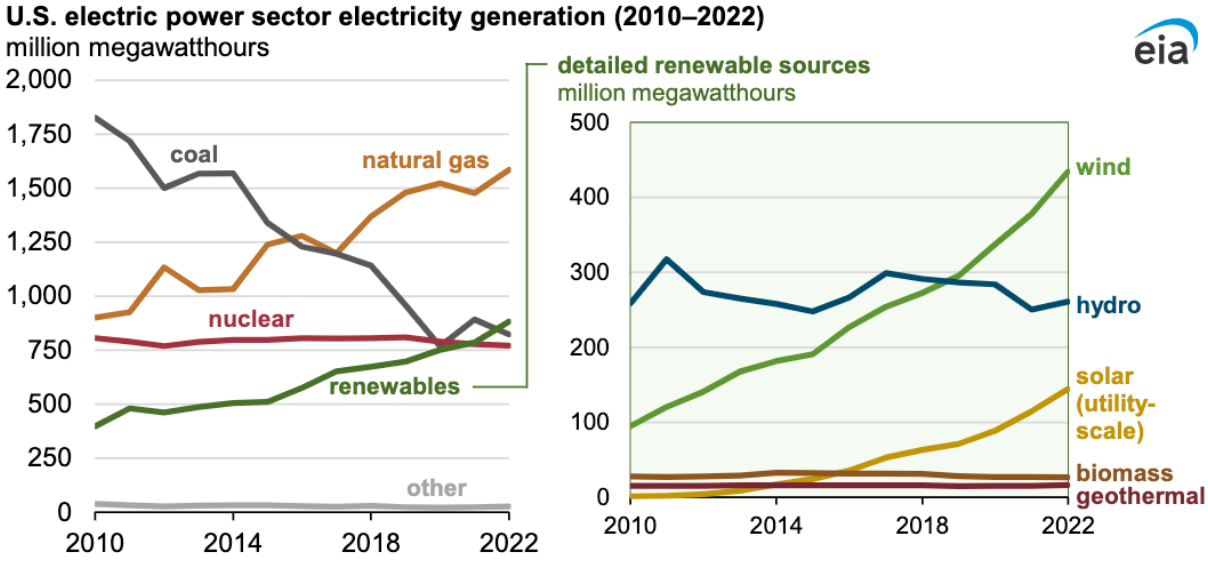
Renewables Top Coal in 2022 U.S. Energy Production

The U.S. isn't ditching fossil fuels any time soon, but their share of the country's total electricity production may have just passed a tipping point.

In data released March 27, the U.S. Energy Information Administration shared that the nation's electric power sector produced 4,090 million megawatt-hours (MWh) of electric power last year. The bigger news was that, for the first time ever, the electricity generated by renewable sources — wind, solar, hydro, biomass and geothermal — surpassed that of coal-fired generation. Renewables also topped electricity produced by nuclear generation for a second-straight year.

Natural gas remained the country's largest source of electricity generation in 2022 and actually increased from 37% of electricity generation in 2021 to 39% last year. Meanwhile, the share of coal-fired generation fell from 23% to 20% as more coal-fired power plants were shuttered or had their production scaled back. Nuclear-generated electricity likewise dipped from 20% in 2021 to 19% in 2022.

Within renewables, the combined wind and solar share of total electricity generation increased from 12% in 2021 to 14% in 2022. Hydropower remained unchanged at 6%, as did the shares for biomass and geothermal at less than 1%.



Source: U.S. Energy Information Administration

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Industry News Digest: March 2023

Click on the link in each news item to read the full report

Distribution & Manufacturing News

Core & Main's sales jumped 32.9% in 2022, the St. Louis-based waterworks and industrial supplies distributor announced when reporting its 2022 fourth-quarter and full-year financial results.

Doors and windows manufacturer Jeld-Wen has appointed Michael A. Leon as its Senior Vice President and Chief Accounting Officer, according to a March 27 Form 8-K filing with the Securities and Exchange Commission.

Homebuilding automation platform Higharc announced March 28 it has received a strategic investment from Ferguson Ventures, the corporate capital arm of industrial distributor Ferguson, and private equity firm Starwood Capital Group.

Hanover, New Hampshire-based Hypertherm Associates — a manufacturer of industrial cutting systems and software — announced successful raids of two connected counterfeiting operations in the United Arab Emirates that lead to the seizure of hundreds of counterfeit Hypertherm HPR consumables.

Atlanta-based supply chain business intelligence software vendor Verusen announced March 30 that it has appointed Scott Matthews as CEO and board director.

Illinois-based foodservice distributor US Foods announced that Andrew Iacobucci has been appointed Senior Executive Vice President, Field Operations and Chief Commercial Officer.

Cleveland, Ohio-based Applied Industrial Technologies announced that Jon S. Ploetz has joined the company as Vice President, General Counsel & Secretary.

Electrical distributor Rexel USA announced that it has acquired Teche Electric Supply, LLC, which is headquartered in Lafayette, Louisiana. Tracy Robertson also joined Rexel USA as its Chief Digital Officer, the company announced

Green Bay, Wisconsin-based fastener distributor Packer Fastener announced that is has relocated its Chippewa Valley branch from Menomonie, Wisconsin to its new location in the nearby city of Eau Claire.

MRO supplies distributor Kimball Midwest continued its centennial celebration on March 24-25 with events at its distribution center in Arlington, Texas.

Fluid and material conveyance solutions distributor ERIKS North America announced March 28 it has appointed Rich Holderman as Key Industry Director.

Chinese eCommerce company Alibaba Group said it will reorganize into six business groups and other investments in what amounts to the company's biggest operational shakeup in its 24-year history.

Economic research and consulting firm ITR Economics Partners announced a new partnership with FocusCFO, a provider of embedded fractional CFO services for a wide range of small and medium-sized businesses in a variety of industries.

Electrical, communications and data networking products distributor Graybar announced March 27 it has appointed Michael Tierney as Vice President of Strategic Accounts.

Dayton, Ohio-based industrial distributor Winsupply Inc. announced that it has named its Vendors of the Year.

Megan Friedrich has been named Vice President of Sales Enablement at Border States, the Fargo North Dakota-based electrical distributor said in a March 24 news release.

Bluon Inc. and Sera Systems Inc., two software companies serving the HVAC industry, announced plans to "join forces" and integrate their platforms.

Paris, France-based electrical products distribution giant Sonepar announced its full-year 2022 earnings, which included a 28% increase in sales to almost $35 billion USD.

In a March 21 8-K filing with the Securities and Exchange Commission, Dallas-based building materials distributor Builders FirstSource said it has appointed Stephen Herron to the role of Chief Operating Officer.

Wisconsin-based packaging products distributor Uline wants to open a new distribution center in Kenosha, Wisconsin, according to local media reports.

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Atlanta-based Genuine Parts Company announced that it has selected Google Cloud as an innovation partner to support GPC's business transformation and "further improve the customer experience."

According to its preliminary fiscal results, DXP Enterprises' 2022 sales are expected to have increased 26% to 31% compared to 2021's $1.1 billion.

Atlanta-based building products distributor BlueLinx announced March 21 that its Board of Directors has elected Shyam Reddy as President and CEO, effective immediately.

Private equity firm Auxo Investment Partners announced that its client Precision Products Group (PPG) — an Indianapolis-based manufacturer of precision-machined components — has acquired of Saylor Technical Products.

On March 21, independent distributor organization AD announced that its members have elected three directors to its Board of Directors.

Toolmaker Stanley Black & Decker announced it will close plants in South Carolina and Texas as part of ongoing plans to slash costs significantly over the next several years.

In addition to the 18,000 employees it laid off between November and January, Amazon plans to cut 9,000 more jobs as it continues to slash spending in nearly all of its operations.

Chicago-based industrial distributor Distribution Solutions Group announced that it has filed a universal shelf registration statement with the Securities and Exchange Commission.

Rexel Energy Solutions announced that it has been awarded a three-year contract from the U.S. Postal Service to supply electric vehicle charging stations at Postal Service facilities.

Electrical and industrial supplies distributor Turtle & Hughes, Inc. announced that it has launch a new brand in conjunction with its supplier expo.

Beaumont, Texas-based Coburn Supply Company, a distributor of HVAC, electrical and plumbing products, announced March 16 its acquisition of Bay Electric Supply.

Home improvement retailer The Home Depot announced that William "Billy" Bastek will be its new Executive Vice President of Merchandising.

Charlotte, North Carolina-based industrial manufacturing conglomerate Honeywell announced that Vimal Kapur, President and Chief Operating Officer, will succeed Darius Adamczyk as CEO on June 1.

A 40.6-million-square-foot warehouse project in Southern California is set to break ground later this year after more than 10 years of discussions and lawsuits, according to a report from the Riverside Press-Enterprise.

Nidec Corporation, a Japanese manufacturer and distributor of electric motors, announced March 15 that its subsidiary, Nidec Copal Electronics, has acquired Midori Precisions Co.

New York-based private equity firm Clayton, Dubilier & Rice announced March 16 it has appointed John Hayes as an Operating Advisor to CD&R funds with a focus on the industrial sector.

Federal regulators approved Canadian Pacific's $31 billion acquisition of Kansas City Southern on March 15, representing the first major railroad merger in over 20 years.

Economic & Trends News

The U.S. Energy Information Administration announced March 27 that renewable energy overtook coal for the first time in 2022 in the United States.

Real gross domestic product increased at an annual rate of 2.6% in the fourth quarter of 2022, according to the "third estimate" released March 30 by the Bureau of Economic Analysis (BEA). Real GDP increased 3.2% in the third quarter of last year.

In 2022, U.S. reshoring and foreign direct investment job announcements were at the highest rate ever recorded, according to a March 24 announcement from the Reshoring Initiative.

The U.S. Department of Labor announced it has recovered $1.1 million from two San Diego-area companies — Freig Carrillo Forwarding Inc. and ACV Logistics Inc. — for underpaying 50 Mexican nationals, some of whom the agency said were paid as little as $2.43 an hour.

Despite the March 10 collapse of Silicon Valley Bank that raised nationwide anxiety levels about a possible banking industry collapse, the U.S. Federal Reserve raised the nation's benchmark interest rate by another 0.25% in an effort to combat inflation.

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STRATEGY

Don't Break 'The Mothership': 3 Keys to a Successful Build-Buy-Invest Strategy

Mike Hockett analyzes value-creation advice for acquisition-interested distributors shared in an MDM M&A Summit session.

By Mike Hockett

If you're a regular MDM reader, you saw us frequently promote our Virtual M&A Summit through its Feb. 22-23 dates, and I'm happy to say the event was a success. It was a lot of work corralling 30+ speakers across 15 different sessions, and I can't say enough about the job our MDM team did behind the scenes getting everyone to the right place on time.

MDM frequently hosts webcasts, but this was that process amplified 15-fold, requiring nonstop communication with all of our speakers to pull it off. The result was more than eight hours of excellent thought leadership and best-practices discussion on the greater topic of distribution mergers & acquisitions.

Our speakers included numerous executives from distributors that have been very involved in M&A in recent years, investment banks, industry advisors and more — all which combined to address M&A talking points from every perspective and angle we could think of.

The two-day intensive event concluded with a "Value Creation with Build-Buy-Invest Strategies" panel session I moderated that featured the following panelists:

- Jay Greyson, Managing Director of Supply Chain Equity Partners
- Craig Osborne, President & CEO of Singer Industrial (formerly SBP Holdings)
- John Mark, President & CEO of BlackHawk Industrial

The session discussed long-term, hands-on investment strategies that support value-added distributors; what's changing in the dealmaking process and what's not; and general advice for prospective sellers. It included a plethora of great commentary and takeaways.

In this piece, I wanted to focus on Greyson's comments about value-creation for acquirers and the people element of due diligence.

Tampa, Florida-based Supply Chain Equity Partners (SCEP) is a private equity fund that invests exclusively in the distribution industry, with a current investment portfolio that includes Air Hydro Power, Coastal Construction Products, Electric Supply Inc. and Hostkin Scientific. Greyson did a great job on our panel outlining long-term value-creation and growth strategies for distributors looking to expand via bolting-on acquisitions to a core platform he referred to as "the mothership," and how to avoid breaking it in the process.

I asked Greyson to lead off by sharing a little about SCEP's acquisition, integration and value-creation strategy, and he delivered in spades.

He emphasized three pillars of value creation: Knowing your customers before investing in growth; strengthening the business platform to support growth; and executing on sales and profit growth initiatives.

First and foremost, he emphasized, is to make sure you don't break the bedrock company you're looking to build upon, or "the mothership" as Greyson referred to it as.

It all starts, he advised, with having the right direction and knowing what your customers say about you.

"You can head out with what sounds like a great value proposition program and be heading down a very different path from the audience of the customers you're looking to serve," Greyson said.

That customer feedback isn't just anecdotal, Greyson suggested. It should involve data-driven analysis to better understand customers and where the business "wins" with them. That knowledge can then be leveraged to increase sales and profitability through targeted marketing and sales programs.

On the second point, he noted that business leaders can easily outstrip their company's existing ability to support growth, trying to do too much with too little. Adding capacity for growth means investing up-front in processes, facilities and inventory. This is where software investments, data analytics tools and growth-based business planning and budgeting come in.

"If you try to press that growth too hard and you don't have a platform that can support it, it can be a house of cards," Greyson said.

That third step, he elaborated, is the actual sales and growth initiatives that drive the business forward, which are specific to the company, the situation and the customers that a distributor is targeting. Again, this growth must stay in balance with the platform's existing capacity, but may include:

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- Organic growth programs, such as additional inside or outside sales initiatives and product lines)
- Pricing and cost-to-serve opportunities
- eCommerce, and
- Strategic acquisitions

"You really have to make sure that the mothership is strong before you go ahead and start to put additional businesses on top of it or drive that business very hard with organic growth strategies as well as acquisitions," Greyson said.

That color on the functional value of distribution M&A was accompanied by Greyson's thoughts on the people side. As discussed at-length in recent MDM Podcasts, distributors aren't just businesses that sell and move inventory — they are organizations of people. And with the element of workforce culture valued higher than ever before, acquisition-hungry distributors have put cultural alignment near or at the top of their due diligence list when researching a target.

Greyson noted that SCEP — like Osborne at Singer Industrial and Mark at BlackHawk Industrial — has been laser-focused on acquiring talent and people and that it has to be a decades-long focus in distribution. He added that in the last three years upon getting through the COVID-19 pandemic, the relationship between employees and their company has become more tenuous in certain parts of the business.

"There seems to be almost a break of the linkage between the company and the people," Greyson said. "There are a lot of folks who have fought the battle for the last three years, whether that's in health issues, family issues, to managers not being able to find, retain or pay more for people. It's been over and over again, and people are just exhausted out there. So, as important as it's always been for us to focus on people, it's gone from 50 levels deep to 60. We have to make sure that the folks there are enthusiastic about partnering with you and wanting to help grow that business. That's our modus operandi."

It was great to hear almost all of our 15 Summit sessions touch on the people element of M&A in one way or another. Day 1 Ready Founder Jennifer Fondrevay set the tone for that with the opening keynote session of our event: "The 3 Cs of Human Capital in M&A: Change Management, Communication, Culture," and it was obvious that people and culture were top-of-mind for all our speakers throughout the rest of the event.

Like I mentioned earlier, there is plenty more from this "Build-Buy-Invest Strategy" M&A Summit session that I'd like to recap, and I'll provide more of that in the near future.

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MERGERS & ACQUISITIONS

In Distribution Dealmaking, Burying Bodies Never Ends Well

Mike Hockett shares a conversation from MDM's recent M&A Summit that dove into the specifics of dealmaking communication best practices.

By Mike Hockett

Much like a marriage between spouses, the success rate of merger & acquisition dealmaking in distribution typically comes down to communication between both parties. Marriages between a distribution buyer and seller involve vastly different dynamics than humans have, but the principles of transparency, honesty and trust form the foundation of that partnership between distributors and largely determine the timeline for a deal to close.

The final session of MDM's 2023 Virtual M&A Summit, held this past Feb. 22-23, was a "Value Creation with Build-Buy-Invest Strategies" panel discussion with three seasoned industry executives who are well-versed in getting deals done and the determining factors for success:

- Jay Greyson, Managing Director of Supply Chain Equity Partners
- Craig Osborne, President & CEO of Singer Industrial (formerly SBP Holdings)
- John Mark, President & CEO of BlackHawk Industrial

It was a great way to end our summit, as those three leaders covered a lot of ground that tied in best practices discussed by others from our roster of 30+ speakers for the event.

Certainly, everyone in our M&A Summit audience already knew that transparency, honesty and trust were vital in completing successful deals in distribution, but it was the specifics about that communication process our panel discussed that I think were particularly valuable to absorb.

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I already wrote about keys to a successful build-buy-invest strategy in a March 8 Premium piece, based on takeaways from this same M&A Summit session, which you can view here. Below, I'm accompanying that previous piece with a portion of this session discussion that focused on the specifics of dealmaking communication.

Hockett, MDM: The success of a deal often comes down to the quality of that due diligence and the level of communication between both sides. What are some of the most important questions that need to be asked by both sides?

John Mark, BlackHawk Industrial: I think it comes down to transparency, no matter how you look at it. You're preparing for what happens post-close, and you're transparent with each other so that there's no surprises. One element is if the contracts and things that you have with your customers are in compliance with any suppliers and other critical tenants of value that would come along with the acquired company. You have to be transparent in explaining that process so that when you get to the other side of the deal, it's not a complete disappointment or sudden shock. The same thing goes for that for the acquirer — being transparent about what's going to happen to the people or about this business is going to evolve, and what your expectations are on the other side. I think those are the key things that you want to really dig into, and get comfortable with on each side. Because again, if there are surprises post-close, then that's just a bad recipe, and it's going to make integration and the success of the deal very awkward. Given the number of acquisitions that people are doing or have done, you're not going to get away with hiding those skeletons. We're going to find them, and then you've set the process back.

Craig Osborne, Singer Industrial: Like John said, it's transparency, I would kind of characterize it as trust. Look, each deal is different; there's going to be different questions that pop out as the most important that just depending on the type of deal and different rabbit holes, depending on what's important. But, you know, you gotta have trust between the buyer and the seller, the seller knows 100% of their business, the buyer knows nothing and has to get up to speed, that's super important. I once had someone say, "My job is to bury the bodies, your job is to find them." And while that's a funny quote, that's a big turn off to developing trust, right and getting a deal done. So, really, it's about the attitude of sharing as much as you can so that the buyer can get up to speed quickly."

Jay Greyson, Supply Chain Equity Partners: Trust and transparency are two great words, and I would add honesty to that. In 99% of the distribution investments we make — we (SCEP) are the first institutional capital to invest in them. So, the relationship with folks is very, very important. And Craig's point about "burying bodies" — almost every time, the selling owner or the key managers are rolling over equity to invest in, but we're helping them in a way that they can invest in the business and get some share of the value of the profits going forward. Any of us around the table here can deal with almost anything if it's transparent, upfront and honest. If there is a breach of honesty or things are being hidden, that will kill a deal faster than anything, even if it's not a major issue.

Hockett, MDM: In the feedback from the past couple of M&A Summits that we've held, one thing that attendees have asked about was how can they better identify potential acquisition targets, and what tools they can use to do so. Do you have any recommendations for how acquirers can go about finding accurate valuations?

Osborne, Singer Industrial: As a buyer, your reputation matters. Doing what you say matters because sellers talk to each other. People talk. Some of our best deals, quite frankly, have come from prior sellers who had a good experience with us, and they recommend their friends. But our other deal-flow — sometimes vendors provide us leads, and industry associations will have an opportunity for you to network and talk to other people in this space. And then when we travel to different areas, we'll do a Google search just like anybody else and go visit and talk to businesses in the area. The other thing I would say is, often you build these relationships over the years. It's not like you identify somebody and three weeks later, you're signing an LOI. This is a process that takes years to develop these relationships.

Mark, BlackHawk Industrial: One area I'd add to that is the banking community. There's a lot of advisors and bankers out there that are shooting in the dark and trying to find potential acquirers. You want to at least establish and be clear to them about what you're looking for and plant that seed with them so that when they start advising somebody on the selling-side, they reach out to you and include you in that process.

Greyson, Supply Chain Equity Partners: Sometimes maybe only one distributor comes into play for a lawyer or accountant or broker every year, and sometimes its every three to five years. So it's being there when that opportunity comes around and being top of mind. BlackHawk, Singer, Supply Chain Equity Partners — I think we've all become very well known in the industries and segments that we serve, and that's very, very important for that first referral and for someone that if you're not finding them, they find you when that first opportunity arises. It's a lot of legwork, a lot of time and a lot of secret sauce.

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Mike Hockett: While the core principles of M&A strategy have largely remained the same pre-2020 vs. post-pandemic. I'm sure there are certain intangibles that have changed in recent years. What have you seen change in the deal-making process over the last two or three years is? Are there factors involved now that maybe weren't as crucial pre-pandemic?

Mark, BlackHawk Industrial: When you look at and you compare the timeframe of evaluation on a business, you've flushed out some of the PPP loans and the impact of that, and now we're looking at more consistent performance. You've got to back out some of the inflationary aspects to really get into the true growth drivers in the business. And then with the way that interest rates are going today and the funding behind deals, you've got to identify any potential risks and how the company reacts to those, which is what was helpful when you evaluate what took place in 2020.

Osborne, Singer Industrial: The sustainability of EBITDA is much more important now only because there hasn't been a consistent performance. There's been a lot of spikes recently, a lot of events — inflation and supply chain constraints, as well how the business has reacted to supply chain constraints. Were they able to take advantage, is that where their EBITD was up? Or were there constraints that actually held them back from performing better? So, trying to understand the sustainability of EBITDA and what we would expect going forward once inflation subsides and supply chain and freight, become calmer.

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MERGERS & ACQUISITIONS

Addressing M&A Valuation Considerations: Emotion, Risk and Retirement

Mike Hockett shares commentary and distills lessons from an MDM M&A Summit session on three key factors in the dealmaking process.

By Mike Hockett

As I've detailed in two previous Premium articles, the final session of MDM's 2023 Virtual M&A Summit, held this past Feb. 22-23, was a "Value Creation with Build-Buy-Invest Strategies" panel discussion with three seasoned industry executives who are well-versed in getting deals done and the determining factors for success:

- Jay Greyson, Managing Director of Supply Chain Equity Partners (SCEP)
- Craig Osborne, President & CEO of Singer Industrial (formerly SBP Holdings)
- John Mark, President & CEO of BlackHawk Industrial

And while only attendees of that M&A Summit are privy to the rest of the event's content, I'm providing a recap of different elements of that final session for our Premium members, as the session was an excellent all-encompassing discussion of many of the lessons shared throughout the summit and its 30+ speakers.

In a March 8 article, I focused on Greyson's comments about value-creation for acquirers and the people element of due diligence. And in a March 20 piece, I dove into the specifics of dealmaking communication best practices and what honesty, transparency and trust looks like in the distribution M&A dealmaking process.

Here in this third and final piece stemming from that session, I want to share its lessons of how to deal with three key factors when it comes to M&A valuations: emotion, risk and retirement.

Post-event polling from MDM's two previous M&A Summits — held in 2017 and 2021 — indicated that attendees were interested in how to achieve more accurate valuations for their business and removing any "owner's bias" involved, as well as what recommendations there are for buyers to likewise find an accurate valuation for a target. I asked our panel to address both sides. Read on to get their insights.

Emotion

Osborne touched on the numerous factors that may drive valuations up or down.

Osborne, Singer Industrial: "Of course, the seller is going to have emotion. There's really no way around that. They've poured their heart and soul into this business. Sometimes it's a family-generational business. They've been working in it 20 to 30 years or more in many cases. I think what they can do is just get educated. Jay mentioned

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how bigger EBITDA pulls command higher multiples, higher EBITDA percentages command higher multiples, but there's also components like end markets that could diminish your multiple. If you're in a highly cyclical business like coal or oil & gas, they are frowned upon right now. Not having a succession plan is going to reduce your valuation multiple. We're also we're kind of looking at a recessionary environment coming up — that's what the media has been talking about. MRO is perceived better because it's at least somewhat recession resistant vs. an OEM-type. So I think understanding those levers will help educate you as a seller on valuation so that you can take some of the emotion out of it."

Greyson noted that hearsay can play a role in giving owners misguided valuation expectations and that they should instead rely on facts.

Greyson, SCEP: "I can't tell you how many times we've heard, as I'm sure my compatriots have, 'Well, I was playing golf with my buddy this weekend. He just told me sold his company for 18x, so that's what I expect.' Have analytics. Have somebody do the work and understand it's not a multiple, it's a multiple times some EBITDA in terms of valuation. Maybe that person got 18x, but every company car and three houses throughout the company and all personal expenses are running in there, and his profit was one dollar. So, 18 times $1 may not be a big purchase price. So, get good advice as you go through this process, so that you have realistic valuation expectations."

Value-Add vs. Risk

Greyson elaborated on how, depending on the position of the interested party, valuations can differ based on what they are interested in.

Greyson, SCEP: "When someone who is looking to sell a company, we will go back and say, 'Who are the likely acquirers and what am I trying to achieve in the business?' For example, you may be trying to create value to sell to the next generation in a family-owned business. You may be looking to sell to some employees, maybe a strategic acquirer, maybe private equity, and each specific buyer is going to look for different things. Craig at Singer and John at BlackHawk may be looking to add on to a larger platform and looking for different things than we at SCEP who might be looking to invest in this first company as a platform. For example, information technology may be a lot more important for a platform company, in terms of their robustness, because they're looking to invest in a platform company and then make their own acquisitions, whereas John and Craig's team already have an IT system that they'd like those new partners to enroll into. So, it's very different as to what someone looks for as a platform.

Greyson elaborated that platform parties will account for the target's customer concentration, the capabilities of its management team and what markets that company is serving to determine how those factors may fit with the markets that platform is already serving.

Greyson, SCEP: "Is it a fit? Is it an adjacency? Is it something they don't want to get into? We looked at a company that at one point where they were servicing nuclear power plants. In that specific situation, that was a risk and uninsurable situation and we weren't able to bring that on to a larger company. So, the takeaway is, different attributes being looked at depending on if you'd be a platform vs. being an add-on. Start thinking again as far in advance as you can as to what capabilities you need to build so that when someone comes and looks at you, you have strong capabilities in those areas, but you're not putting money in an area that won't be valued at the end of the day."

For a relatively small, local-based distributor, their local relationships are their core value, Greyson added. They likely didn't expect to expand beyond that, so it wouldn't make sense to spend millions of dollars on an IT system just to support a smaller customer set. Over-investing in that area wouldn't pay dividends or add value if that distributor is looked at as an add-on to a platform distributor that have already invested in a robust IT system.

When it comes to examining EBITDA in distributor valuations, it often comes down to quality, not quantity.

Mark, BlackHawk: "What are the things that are really going to generate value for an acquirer? Focus on those, do them well and show some sustained performance there, because it's around the quality and sustainability of the EBITDA and the sustainability. Eliminate the risk, and focus in on where your core values are gonna be."

The Retirement Factor

One risk factor involved with distributor valuations is the age of ownership or executives. If leadership is at or near retirement age, how much of a risk is that to take on? Given all of the chaos that the COVID-19 pandemic thrust upon distributors, followed by lasting historically high inflation and a very challenging labor market, it stands to reason that a lot of owners may be at the point of saying, "I've put in my time, I'm ready to get out." And given that distribution is still primarily a Baby-Boomer-driven industry as far as ownership and top executives go, this landscape will undergo a sea-change of executive overhaul in the decade ahead. So, just how much of a risk, if any, is the retirement factor when it comes to M&A valuation?

Mark, BlackHawk: "I don't see it as retirement as much of the issue. I think they (ownership) want to de-risk more than anything else. The people in this industry — we're

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in the metalworking and cutting tool industry — they love this stuff. They got into the business to work with customers. They didn't get into it to deal with finance, HR and all the other activities that happen in the background. So if you can de-risk and take those things off the table for them, they want to stay. They love doing this, I don't think they'll ever retire, in some cases. And so if you're able to take that risk off the table and give them a stable platform to go and do what they love doing, they'll stick around."

Greyson, SCEP: "We see retirement driving a lot of transitions. A lot of times that person is instrumental in the business — customer relationships, vendor relationships, key employees look to them as a leader — and there's risk when that person leaves. Having a transition period is always nice. But I remember back in the late 1990s when we started in the distribution advisory business. Back then there were 248,000 distributors. And this thing called Amazon comes along and this thing called the Internet comes along and 'the sky is falling' and everybody is viably concerned about what this means for distribution. I think the last stat I looked said there are now 243,000 or 244,000 distributors. So the good news is that retirement does drive a lot of activity, but for a whole host of different reasons. We also see these new distributors spinning up with new value propositions and capabilities for customers. So, I think we're in a great industry that's going to continue to have the ability to invest and grow."

Osborne, Singer Industrial: "It's more of a 'What is the transition plan?' There are a lot of family-owned businesses that have been or are on our target list and that don't have a succession plan to the next generation. The last few years have been tough. There's been some real fatigue in terms of dealing with COVID, supply chain issues and staying fully staffed. So they want a partner that can help them and provide them some breathing room so that they can go tackle what they like to do. We're seeing that, for sure."

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FINANCE

What Distribution Executives Don't Understand About Profitability and Pricing

Mike Hockett distills takeaways from a NAW Executive Summit session that featured distribution executives discussing what leading companies do differently when it comes to profits and pricing strategy.

By Mike Hockett

Despite the significant fragmentation of the wholesale distribution industry, individual sectors of it still involve hundreds of similar distributors serving the same markets with more or less the same customers with the same products and services. But amid all that sameness, we see radically different outcomes in terms of these distributors' profitability.

So, what is the hidden element that makes some distributors more profitable than others?

That question was the center of a great panel discussion I attended at the recent NAW Executive Summit, held Jan. 31-Feb. 2 in Washington D.C., where more than 300 distribution executives convened to network and take in an excellent content program.

One of the sessions featured a discussion on profitable growth strategies between panelists Turtle & Hughes CEO Kathleen Shanahan, Sonepar North America Vice President of Development Scott Scheunke and SPARXiQ CEO David Bauders, who served as moderator.

Given the inflation wave that distributors have happily rode to bumper revenue and profit years in 2021 and 2022, pricing remains top-of-mind for anyone involved on the finance side for these businesses.

Now facing much tougher comparable year-over-year quarters in 2023 than the past two years and a predicted industrial slowdown in late 2023, distributors may frequently revisit their pricing strategies as the year progresses while they closely monitor demand for their products and services.

This made the NAW discussion very timely, and it was great to see two prominent distributors from the same market — Sonepar and Turtle & Hughes ranked No. 2 and 16 on MDM's 2022 Top Electrical Distributors List, respectively — share insights about pricing and profitability with an audience of other executive peers.

Bauders noted that many of the verticals within the

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NAW assortment see average EBITDA of around 4% of revenue. But at the leading edge of those verticals are distributors outperforming with 8% or even 12% EBITDA. What are they doing differently?

Ultimately, profitability comes down to two key areas: productivity gains and pricing.

"Clearly, pricing is where you can have the biggest and quickest impact," Scheunke explained. "Productivity builds and generates and it continues to build itself. So, when you combine the two, you make a compelling case. To generate the funds, you need to not only return to your stakeholders but to put it back into the business, which is clearly our strategy. We want to leverage what we can."

Schuenke added that distributors — including very large ones — are tempted to be everything to everyone in terms of solutions offered, and leadership must determine at what point resources are spread too thin. At that point, if additional solutions are still sought, it makes sense to leverage a service provider.

"It comes, 'We can do this, and we can do this,' until finally, 'Stop. We're better at other things. Let's turn over the experts to take us to the next level.'"

Shanahan followed by noting that while mergers and acquisitions are a great way to grow revenue, add capabilities and scale a business — evidenced by numerous distributors represented at NAW (including Sonepar) — profitability comes down to margin, which comes down to organic growth.

"It's all that matters in terms of being able to reinvest in your business and grow your business," she said at the NAW Summit. "It's what keeps your employees there. It's what keeps your customers coming back. I think it's really important to understand what your margin is, how you can grow that margin and how you're going to use those margin dollars to better your company."

So, where does a distributor need to be financially to achieve better than marginal profit growth? Bauders advised that, to be a leader in a particular industry, a distributor likely needs to be running at 2X the mean profitability of that industry, meaning that if you're in a industry that averages 4% profit margin, you need to be at least 8% to be among the leaders. Bauders added that most of the companies SPARXiQ works with are shooting for 10%, 12% or 14% margin, which he acknowledged are high numbers.

Bauders also noted that Sonepar and Turtle & Hughes' industry of electrical supply is ruthlessly competitive, estimating that every geographical market has around five to 15 distributors that are fully capable of serving the needs of their customers.

"In many cases, those distributors are serving very large capital projects where heavy manufacturing subsidies are driving down prices," he explained. "That makes it very difficult. Getting to that 2X industry profitability is no easy feat."

Bauders asked Schuenke and Shanahan what is holding distributors back from capturing that industry-leading profitability, and what executives don't understand about pricing as the root of that profitability transformation. While their answers involved multiple parts, they each came down to the same core element: value.

"One is just making it a priority, and two is understanding," Schuenke said. "I've always felt for my whole career in distribution that we undervalue what we bring to our customers. And early on, we turn it into a price situation, when it's not, it's about your capabilities. It's about your services. It's about all the other things about owning the customer and being that trusted adviser."

Scheunke emphasized the importance of teaching sales staff what that delivered value means to a customer. The earlier that can be taught and drilled into someone, the better, he said, as it will guide their sales method throughout their time in the organization.

"Most of the (pricing) angst that a lot of people have is between their ears. It's self-made. It's not market-driven. Most of it is self-inflicted. They have a percentage in mind. So we need to teach people how to be better thinkers and better business people on pricing. And when you change a heart and mind, that will pay dividends their entire working career. It's not just a quick uplift — you're trying to change the trajectory of our business for the next 20 years."

Shanahan echoed that sentiment and added that confidence is crucial here — not just internally for everyone involved in distribution sales, but exuding that confidence to customers as well. She noted that both of her parents were public school teachers, and that her mother emphasized the message that if you teach a child confidence, they're going to be confident.

But she said when she came into the industry as a Turtle & Hughes board member in 2015 after a career in political and public service roles, she didn't see confidence throughout distribution.

"It was always like, 'oh, we're distribution. We're sort of that person in the middle. We're just lucky to be in the room. And I'm like, 'You should act like they're lucky you're in the room because you're going to bring value to the projects. You're going to help the manufacturers get access to these projects or these opportunities.' So I think getting that embedded in people's approach is part of the process."

Shanahan elaborated that this process also involves curtailing the pressure of that pricing decision away inside salespeople that are setting a price to simply set a price without maximizing the value of what a distributor is

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bringing to the table.

"All pieces of the process need to be looked at, evaluated, incentivized and then rewarded," she said. "Once they (sales staff) start to see an increase in their paycheck, they begin to understand that the customer is not necessarily looking for the bottom-line price. They're looking for 'how do you manage my logistics?' 'When's it going get to the job site?' All the other components that we just sort of give away, you should charge for all that. But you need to get smart about what your customers need to for them to be successful and then measure that out in terms of what you can charge them. Trust me, they will pay."

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HUMAN RESOURCES IN WHOLESALE DISTRIBUTION

Poll Results: Could a Four-Day Workweek Work in Distribution?

The world's largest trial of the four-day work week drew rave reviews from companies that participated. Could the distribution industry benefit from such a change?

By Brad Star

Results of the world's largest trial of the four-day work week are in, and a majority of supervisors and employees liked it so much they've decided to keep the arrangement. In fact, 15% of the employees who participated in the trial — detailed here by The Washington Post — said "no amount of money" would convince them to go back to working five days a week.

MDM posted a poll on our Independent Distributors LinkedIn group and on our LinkedIn page asking distribution executives if they thought a four-day work week could ever be feasible for the wholesale distribution sector. The distribution industry is often considered to be an old-school business that is reluctant to change, though that narrative has started to change recently, whether we want to acknowledge it or not. The industry has come to embrace its digital transformation over the past decade. Distributors also may have surprised themselves with how quickly they were able to pivot to remote work and adjust amid supply chain disruptions caused by the COVID-19 pandemic.

Bearing those recent changes to the industry in mind, it may come as less of a shock that, of 156 total voters on MDM's LinkedIn polls, 63% said they think a four-day work week is possible in distribution. An important distinction to make in the distribution industry is that a four-day work week doesn't necessarily mean shutting down all operations for an extra day each week. Shifts could be staggered such that a business can still operate five days a week.

"A 4 day work week does not mean you cannot be open as many days as you want," Engineered Laundry Products President Michael Burk said in the comment section of the poll. "Rotating employees' days off is one way to be open 5 days unless you are working with a bare minimum staff."

The trial detailed by The Washington Post took place in the U.K. and included 61 companies, 56 of which said they would continue to implement four-day work weeks after the pilot ended. The trial is part of a series of programs coordinated by advocacy group 4 Day Week Global; companies that have participated in the programs have reported increased revenue, reduced absenteeism and resignations, and overall improved employee well-being. Skeptics of the policy, on the other hand, believe shortening the work week will result in employees' productivity decreasing in the long run.

While the response to 4 Day Week Global's programs has been largely positive, research on the policy has been limited to small-scale experiments involving mostly small businesses: 66% of the companies that took part in the U.K. trial had 25 employees or fewer. Of the 61 companies participating in the U.K. trial, 7% were in the manufacturing industry, 4% were in construction/housing and 2% were in engineering. As such, there isn't yet much data on how manufacturers and distributors might handle a four-day work week; however, a shortened work week has previously been suggested as a solution for manufacturing and distribution employees with tasks that are difficult to complete remotely.

Shortening the work week might seem drastic because most of us haven't experienced such a change in our lifetimes. One of the first companies on record to implement the five-day, 40-hour work week was Ford Motor Companies in 1926; during this time, it wasn't uncommon for employees in the U.S. to work six-day weeks. In 1940, the Fair Labor Standards Act went into effect, limiting the work week to 40 hours, which has been the norm ever since. Perhaps we're long overdue for an update.

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MARKET ANALYSIS

March Wholesale Data: 2023 Outlook Dips, Inventory Trends Negative

Mike Hockett breaks down the latest U.S. Census Bureau's wholesale trade data, covering revenue expectations and trends, inventory and more.

By Mike Hockett

After riding the wave of inflation for the past two years, wholesale distributors are seeing much tougher comparable year-over-year financials as we near the close of 2023's first quarter. We've already seen publicly-traded distributors' report much more moderate — though still strong — sales and revenue growth in the most recent quarterly earnings reporting period, as the beneficial impacts of pricing have been far less drastic when comparing 4Q23 vs. 4Q22 as opposed to, say, 2Q22 vs. 2Q21 or any time during 2021.

Thus, we expect to see far less gaudy figures reported for the remainder of 2023, even if demand holds relatively steady.

That notion is illustrated in the latest wholesale distribution economic data from the U.S. Census Bureau, packaged for MDM by Brian Lewandowski, Executive Director of the Business Research Division at the Leeds School of Business at the University of Colorado Boulder.

Revenues

The latest data — released March 7 — showed that wholesale trade's January revenue totaled $693.8 billion, up 1.0% from December and up 3.6% year-over-year, following December's 0.2% month-to-month increase and 7.3% year-over-year increase. The sector's 'real', inflation-adjusted January revenue was up 0.4% month-to-month and a flat 0.0% year-over-year.

That 'real' year-over-year revenue growth was 8.4% in January 2022 and has steadily declined since.

Inventories

Meanwhile, wholesale distribution inventories have likewise leveled off after soaring throughout 2021 and most of 2022. At the end of January, inventories were valued at $929 billion, down 0.4% from December and up 15.8% year-over-year. It was the first month-to-month decrease since July 2020, at which point inventories were valued at $649 billion — a whopping 43.1% difference in just 2.5 years.

That inventory value had grown by at least 1.2% month-to-month in of the 16 months from May 2021 through August 2022 before cresting since and finally turning negative in January.

Inventory-to-Sales Ratio

Similarly, wholesale trade's inventory-to-sales ratio appears to have crested after running well above its 30-year average of 1.25 for the past seven months. January's ratio of 1.34 was down from 1.36 it had in both December and November. After a trough from mid-2021 through the start of 2022 near 1.20, the ratio eclipsed 1.25 in April 2022 and hadn't seen a decrease until January.

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Expectations

Looking ahead, the overall 2023 expectations for wholesale distributors dipped in January, with a total sector forecast for 1.7% growth, compared with 2.3% in December. Below, see the chart for expectations as of the end of January:

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Expectations by Sector – Through January

Major Sector (Largest to Smallest Sector Revenues)	2020 Revenue	2021 Revenue	2022 Forecast	2023 Forecast	2024 Forecast
Oil and Gas Products Wholesale Distributors	-29.6%	73.5%	43.7%	-7.3%	-8.0%
Pharmaceutical Wholesalers	5.8%	8.9%	10.7%	10.3%	6.5%
Grocery and Foodservice Wholesale Distributors	-1.4%	13.5%	12.8%	6.3%	3.3%
Electrical and Electronics Wholesalers	1.6%	20.2%	14.0%	0.1%	7.0%
Industrial Distributors	-2.9%	16.3%	16.0%	8.0%	2.6%
Motor Vehicles and Motor Vehicle Parts Wholesale Distributors	-9.0%	13.9%	11.0%	11.4%	12.8%
Miscellaneous Durable Goods Wholesale Distributors	7.5%	32.7%	2.7%	-6.9%	2.0%
Other Consumer Products Wholesale Distributors	1.0%	11.9%	13.3%	1.8%	4.4%
Computer Equipment and Software Wholesale Distributors	1.1%	9.7%	7.5%	-4.4%	1.9%
Commercial Equipment and Supplies Wholesale Distributors	-4.1%	16.7%	5.7%	1.7%	4.5%
Agricultural Products Wholesale Distributors	0.3%	33.9%	29.7%	10.2%	3.2%
Metal Service Centers	-19.6%	59.5%	16.7%	-2.0%	4.9%
Building Material and Construction Wholesale Distributors	5.2%	30.5%	19.8%	-7.0%	-0.9%
Hardware, Plumbing, and Heating Equipment/Supplies Wholesalers	2.8%	12.3%	13.8%	2.4%	1.9%
Beer, Wine and Liquor Wholesalers	7.4%	8.5%	1.8%	3.5%	5.9%
Apparel and Piece Goods Wholesale Distributors	-21.1%	28.0%	4.8%	-3.3%	2.1%
Chemicals and Plastics Wholesale Distributors	-8.9%	24.0%	21.6%	-4.4%	3.0%
Furniture and Home Furnishing Wholesale Distributors	-0.3%	16.6%	15.0%	-6.1%	-5.2%
Office Product Wholesalers and Paper Merchants	-7.4%	14.1%	16.8%	-2.1%	-0.2%
Total Wholesale Distribution Industry	-4.6%	22.6%	16.4%	1.7%	2.9%

Leeds School of Business

Source: U.S. Census Bureau, Monthly Wholesale Trade; MDM 2023 Wholesale Distribution Economic Trends Report.

Of course, expectations vary from vertical-to-vertical within the fragmented distribution sector. Of the 19 industry verticals that the U.S. Census Bureau tracks, seven showed a month-to-month increase in 2023 expectations, while 12 showed decreases. Those month-to-month expectations changes were as follows, in order of vertical size:

- Oil and Gas Products: +0.9%
- Pharmaceutical: -1.0%
- Grocery and Foodservice: -1.0%
- Electrical and Electronics: -3.3%
- Industrial Distributors: +1.3%
- Motor Vehicles and Parts: -1.7%
- Miscellaneous Durable Goods: +5.2%
- Other Consumer Products: -2.6%
- Computer Equipment and Supplies: -3.2%
- Commercial Equipment and Supplies: +1.0%
- Agricultural Products: -0.8%
- Metals Service Centers: +5.9%
- Building Material and Construction: +1.6%
- Hardware, Plumbing and Heating Equipment Supplies: +1.6%
- Beer, Wine and Liquor: -5.5%
- Apparel and Piece Goods: -5.5%
- Chemicals and Plastics: -5.4%
- Furniture and Home Furnishing: 0.8%
- Office Products Wholesalers and Paper Merchants: -1.6%

Lewandowski noted that December revisions from the Census Bureau impacted several sectors.

Further ahead, revenue expectations for 2024 likewise fell to 2.9% as of the end of January, compared to 3.3% at the end of December.

Employment

February employment growth registered 2.84% year-over-year , following 3.18% in January. February's month-to-month growth increased 0.18%.

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PRICING

How Rockstar CFOs Solve the Inflation Puzzle

Nelson Valderrama discusses how CFOs can navigate market disruptions by reimagining pricing and inventory processes.

By Nelson Valderrama

Businesses will survive and thrive when inflation subsides — only if they are prepared, adaptable and agile. In the wholesale distribution sector, that means using emerging technologies to achieve pricing optimization and inventory optimization. Rock star CFOs provide guidance, strategic planning and an understanding of what it takes when things get tough.

How CFOs Reimagine Pricing and Inventory Processes

Companies must remain data-driven to survive this volatile and confusing environment. Only a rock star CFO can help coordinate how all the pieces fit together — from analyzing an ever-changing market to planning different scenarios, so pricing strategy will be in place when markets update unexpectedly or are forecasted incorrectly — even monitoring if execution matches expectations.

Gartner research indicates that "74% of CFOs believe lower profitability is the biggest risk of input price inflation — which pushes up the cost of inputs required for producing or delivering products and services." CFOs must understand the long-term risks associated with inflation. They must act now to mitigate rising input prices and shrinking margins.

4 Paths for Rockstar CFOs

1. Improve supply chain visibility: Prices change constantly. Inflation occurs over time when supply cannot meet demand. It escalates when too much capital in the hands of consumers accelerates demand. So, inflation makes it difficult for companies to negotiate deals with suppliers. To remain competitive, one rock star CFO shared with me that once they saw many cost changes from local and international suppliers, their company adjusted how they calculated landed costs to avoid being disadvantaged during negotiations. Their calculations accounted for transportation, such as containers or LTL, and on-site replenishment expenses when negotiating contracts with vendors who provide these goods — allowing them greater insight into what it will take now and down the road to remain competitive. This requires tools to trace proposed price increases back through specific inputs like labor, materials or transportation.

2. Look beyond the typical recruit and retain talent: During periods of high inflation, annual compensation increases of 3-5% actually cut employee purchasing power. This paradox could be more optimal during long-term talent shortages. Employees have gained substantial leverage, and this trend will likely continue due to economic pressures, so business leaders should recalibrate their recruiting, compensation, and retention strategies to meet the challenges of inflation head-on.

- Conduct periodic employee engagement surveys. Identify the underlying employee concerns employers can address and resolve immediately. Problem resolution only sometimes means expense to the employer, but it could keep talent from leaving.
- Recognize that some employees feel inflationary impacts. The lowest-paid employees, for instance, will need help meeting their basic physiological needs. The time has come for an expert compensation analysis and recommendations to meet livable wage standards.
- Employers can draw a picture of compensation plans. It helps to show employees how their compensation is determined and how workers' pay is competitive with the broader market. It is also time for increased transparency on company operations and finance.

3. Improve working capital (WC): Improving WC is cheaper and less risky than soliciting new bank loans, other debt instruments, or equity. WC also provides visibility on how efficiently your company utilizes its invested capital. Companies that take advantage of the latest data processing tools and analytical insights have unprecedented opportunities to gain a deeper understanding of their accounts. By analyzing numerous transactions over time, analytics can identify patterns in receivables and payables with pinpoint accuracy — right down to the exact days for orders placed or cash received/paid. The resulting visibility into customers' DSOs (Days Sales Outstanding) and DPOs (Days Payable Outstanding) allows companies to create targeted strategies along every step from order-to-cash through purchase-to-pay cycles — opening up previously unexplored avenues for optimizing working capital management.

- Inventory Optimization: Distributors must pursue inventory optimization without compromising service

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levels or risking stock outages. Inventory optimization means identifying and rationalizing underperforming SKUs (stock-keeping units) like D and E products, so the company can focus on what it does best — its A and B products.

- Payment Discipline: Improve payment discipline and optimize your internal supplier processes with strategic scheduling of payments, streamlined terms-management, and efficient ACH payment methods to replace tedious check delivery.

4. Price for profitability: The days where CFOs could rely on their ability to affect cost are long gone. With more complex products and faster-changing markets, CFOs must unlock prices to stay competitive and maximize profits through innovation. More than just viewing products on a cost-plus basis is required. To truly understand profitability at the customer, product, and volume levels — called "dynamic pricing," you need robust data about how much each decision will contribute towards your overall profitability.

The Inventory and Pricing Optimization Differential

Analyzing the cost pressures across a distribution business provides insight into what lies ahead for specific products. With thousands of SKUs under consideration, it can be hard to determine if the average price increase compares to the individual costs for each SKU.

Figure 1 (p. 17) shows the results of a distributor's pricing change for one particular product. They waited to update the cost or price practices until December 2019. Even so, the gross margin percentage neared zero around January 2022. The decision to drastically change prices finally came with the realization that the information or processes needed updating.

In this case, Intuilize allowed the distributor to revamp its processes — standard, actual and forecast costing — in weeks.

Distributors must act quickly when costs go up. If a company wants to prevent the pain of cost increases, it must raise prices ASAP. But most distributors still allow decisions to lag before making price changes. Even though they change prices more frequently in an inflationary environment, delays continue between a distributor's cost increases and the subsequent pricing adjustment. Such hesitation can result in 160 basis points worth of margin erosion.

By escaping these slower planning cycles, distributors can accelerate their reaction times and make more informed pricing decisions. That is where War Rooms come in. War Rooms host collaborating teams capable of agile innovation and response. They enable the strategic coordination of pricing and inventory activities while implementing better governance.

This approach tracks progress on an ongoing basis so you know when changes are needed and see when opportunities arise. The company will have greater flexibility with its resources leading to increased profits in the longer term.

When talking with a rockstar CEO this year, he said, "As business leaders, we are always fighting the question, 'Am I charging a fair price for my products and services?' Often, we use the few anecdotal data points available to us to make that determination. Intuilize has turned that art into a science. Furthermore, we have provided our employees with a suggested price that they can trust. It allows them to worry about serving the customer and the flexibility to make a good decision."

Distributors must take advantage of their ERP system's pricing capabilities. Many distributors must learn if these capabilities exist or how to use them. But implementing them is surprisingly easy. Most ERP systems enable users to set and provide pricing with just a few clicks while replicating pricing guidelines. This ERP feature saves time for team members while ensuring they follow best practices in controlling their win rate. A simple tweak of the ERP system can increase profits and save time.

Many companies resort to uniform rather than customized price increases in inflationary times. It is easier and quicker than figuring out how much everything costs per unit or what different customers need. But when prices begin to escalate, these simple strategies will not do the job.

Figure 2 (p. 17) shows how legacy pricing methods continue to consume this distributor's margins (blue line). They should have optimized and updated the pricing long ago.

A typical mid-sized distributor called Distri2020 has 1000 customers. They have an average number of active SKUs at around 5000 and at least three quantity breaks (few, medium, and many). That creates a whopping 15 million possible combinations needing proper pricing!

Even the most disciplined pricing gurus will attest that — without the correct data or models — those numbers would make it very difficult for any owner, CEO, CFO, or sales manager to deliver an optimal experience for every customer and their business's bottom line.

Rockstar CFOs Don't Wait — They Invest in Pricing

Companies sometimes need to relax in enforcing their discount policies and terms and conditions during stable economic periods. They make so-called "strategic exceptions" to their rule when it benefits them the

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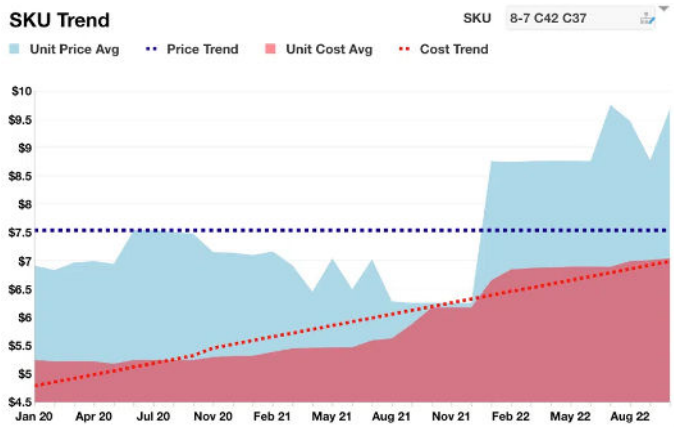


Figure 1

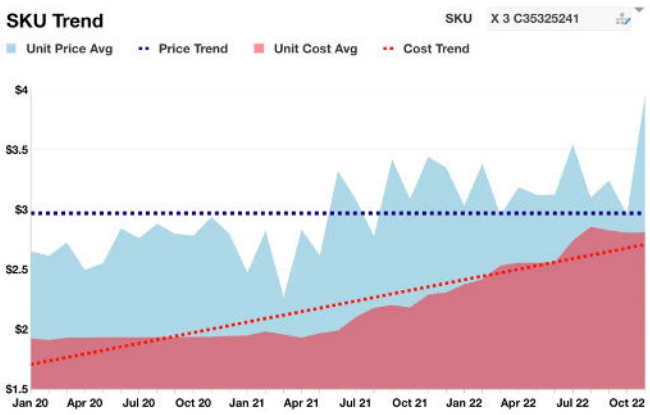


Figure 2

most. Then, BANG! Suddenly, an unforeseen event or unpredictable change, such as the COVID-19 pandemic shutdowns and mounting inflationary pressures, catches them unaware. A study by Intuilize shows that only 15% of distributors successfully pass on more than 80% of their input-cost increases to customers promptly. Visit Intuilize.com to read more about this unique research and learn how AI will unlock your distribution data.

The still-mounting inflation gives distributors a rare opportunity to transform how they price their products and services. Signs predict input-cost pressures will continue for a while, making it more crucial than ever for distributors to look forward, not back, if they want their business models capable of handling a higher customer demand.

To respond quickly and accurately in an ever-changing market, distributors need to reimagine their organizations and be empowered with the technology and skills to secure data-driven information advantages and sales leadership capabilities. This demands new business practices and business transformation in pricing, too! Moreover, when inflation declines, the era of price instability will continue. Rockstar CFOs must act now.

Click here *for web version.* ***Nelson Valderrama is the Founder and CEO of Intuilize.***

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OPERATIONS

A Year After its Formation, A Deep Dive on Distribution Solutions Group

After Lawson Products transformed into DSG last year, the multi-faceted distributor has reported strong financials. Here's why the company isn't slowing down.

Editor's note: This Premium piece was published nine days before DSG announced its pending acquisition of Hisco Inc.

By Mark Powell

When the calendar hit April Fool's Day, it marked one year since MRO distributor Lawson Products officially combined with electronic test & measurement products distributor TestEquity and industrial/electrical supplies distributor & supply chain services provider GexPro Services to form Distribution Solutions Group. And while the company will celebrate its anniversary on the year's most ridiculous day, the transformation DGS has undergone in just 365 days is no joke.

By leveraging three leading companies in the MRO, OEM and industrial technology sectors, DSG has reported strong growth over the past three quarters while also declaring itself "a powerful new force in the industry." Less than a year of financial data is usually not enough to predict how the next few quarters will go — especially under uncertain economic conditions — but the fact that DSG filed a universal shelf registration statement with the Securities and Exchange Commission is evidence the company is thinking long-term.

"Today, Distribution Solutions Group delivered exceptional performance in 2022, which we know demonstrates the power of our strategic transformation from a standalone MRO business at Lawson Products to a leading multiplatform specialty distribution solutions company with the scale and leadership to drive sustainable growth," CEO and Chairman Bryan King said during a March 9 earnings call to announce 4Q 2022 and full-year results. "We achieved sales records in 2022, enhanced margins and expanded profitability while reducing our net debt leverage ratio, creating more firepower for reinvestment in the business and M&A.

Who is Distribution Solutions Group?

Chicago-based Lawson Products first announced plans to combine with TestEquity & GexPro Services in December 2021. Under the agreement, all three companies were to operate independently with their existing management teams as separate divisions while under the DSG umbrella. At the time, Lawson said it expected combined estimated pro-forma annual revenue of more than $1 billion. On March 15, 2022, Lawson's stockholders approved the merger agreements in all-stock transaction, which was finalized just over two weeks later.

Founded in 1952, Lawson sells and distributes specialty products to the industrial, commercial, institutional and government MRO markets. In 2021 — its last full year before the merger — Lawson reported 2021 total revenue of $418 million, up 18.8% over the prior year. That placed the company at No. 34 on MDM's 2022 Top Industrial Distributor List, and No. 16 for MRO distributors. In 1Q 2022, Lawson's last quarter before the agreement was finalized, the company reported that net sales increased to $117.9 million, compared to $103.6 million in the first quarter of 2021. The growth may have been attributable to Lawson's high-touch sales rep strategy and its 2021 company goal to add more sales reps.

TestEquity, founded in 1971, distributes electronic test and measurement equipment and solutions, electronic production supplies and tool kits that support the technology, defense, automotive, electronics, education and medical industries. GexPro Services, based in Irving, Texas, provides global supply chain solutions, specializing in the development of mission-critical production line management, aftermarket and field installation programs. Both companies were retained under private investment firm LKCM Headwater Investments before the merger with Lawson.

As a combined entity, DSG now boasts more than 3,000 employees and more than 120,000 customers, according to its website. After just three quarters, the rapid expansion is producing positive results for the newly formed company.

Financial Snapshot

Earlier this month, DSG reported 4Q 2022 adjustment revenue of $328.9 million, an increase of $97.6 million — or 42.2% — over 4Q 2021. The company's 4Q adjusted operating profit was $12.7 million, compared to a $2.6 million loss a year earlier. For the quarter, DSG reported 16.7% organic growth.

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During 4Q 2022, each business unit also saw strong quarterly and annual growth. For 4Q, Lawson Products' revenue was $108 million, up 20.3% year-over-year; its full-year revenue was $429.7 million (includes $104.9 million pre-merger), a 15.6% jump vs. 2021. In 4Q 2022, Gexpro Services' revenue was $100.1 million, up 52.8% year-over-year; its full-year revenue was $385.3 million, up 50.4% vs. 2021. TestEquity reported 4Q 2022 revenue of 105.4 million, up 68.0% year-over-year, and full-year revenue of $392.4 million, up 48.5% vs. 2021.

For the quarter, Lawson's adjusted operating income was nearly $3.75 million. GexPro and TestEquity reported $4.3 million and $3.9 million, respectively, in adjusted operating income during the same period. For 4Q 2022, Lawson's adjusted EBITDA was $11.5 million, while GexPro (nearly $10.8 million) and TestEquity (almost $10.7 million) also reported strong figures in that category.

For 2022 as a whole, DSG's total adjusted revenue was $1.27 billion, up 35.3% from 2021. The figure was in line with Lawson's prediction from December 2021. That included $117.9 million of revenue prior to the TestEquity/GexPro Services agreement. The company's full-year adjusted operating profit of $53.9 million nearly doubled the $23.4 million of a year earlier. The company's 2022 adjusted EBITDA was $123.0 million, a 63.6% jump vs. 2021, while adjusted EBITDA margin likewise increased to 9.7% from 8%.

While MDM's 2022 Top Distributors Lists only accounted for the financials from Lawson Products – since that was the only available financial info available at that time – MDM's 2023 lists will account for the company as a whole. (That means that DSG's $1.27 billion in 2022 revenue will likely place it around No. 23-26 on the Industrial Distributors list.)

Outlook

During the March 9 earnings call, King said he thinks DSG's strong momentum is likely to continue.

"And this year, I believe our companies will continue to take market share, deliver margin expansion, and generate meaningful free cash flow to support DSG's capital allocation priorities in 2023," he said. "Although we are closely monitoring the macroeconomic environment and customer demand, we remain bullish about our business prospects for 2023."

It also doesn't hurt investor confidence that DSG announced Dec. 7 that TestEquity had acquired Instrumex, a distributor of test and measurement equipment in Germany. Overall, the company successfully completed five acquisitions in 2022, which produced annualized revenues of about $204 million and annualized adjusted EBITDA of an incremental $21 million, King said.

In terms of M&A activity as a tool for growth, expect more out of DSG going forward.

"Between our three dedicated corporate development professionals at the DSG level, our operating teams and the LKCM Headwater team, we are actively pursuing acquisitions that make DSG a better business and are also keenly focused on successful integrations after we close," King said. "In our pursuit of strategic acquisitions, we not only look for fit within each of our operating companies, but we also seek to find opportunities that have commercial logic for all three businesses units, bringing them closer together while enhancing each of their organic growth rates and returns on working capital investment."

King added, "We remain cautiously optimistic in our 2023 outlook and continue to be confident about our ability to manage through cycles for significant value creation. 2023 has had a strong start as the levers we have been pulling are unlocking value. We continue to build out our roadmap for initiatives to create a stronger, more enduring business without losing the advantages of three separate customer-facing efforts and operating teams that manage discrete channels to market."

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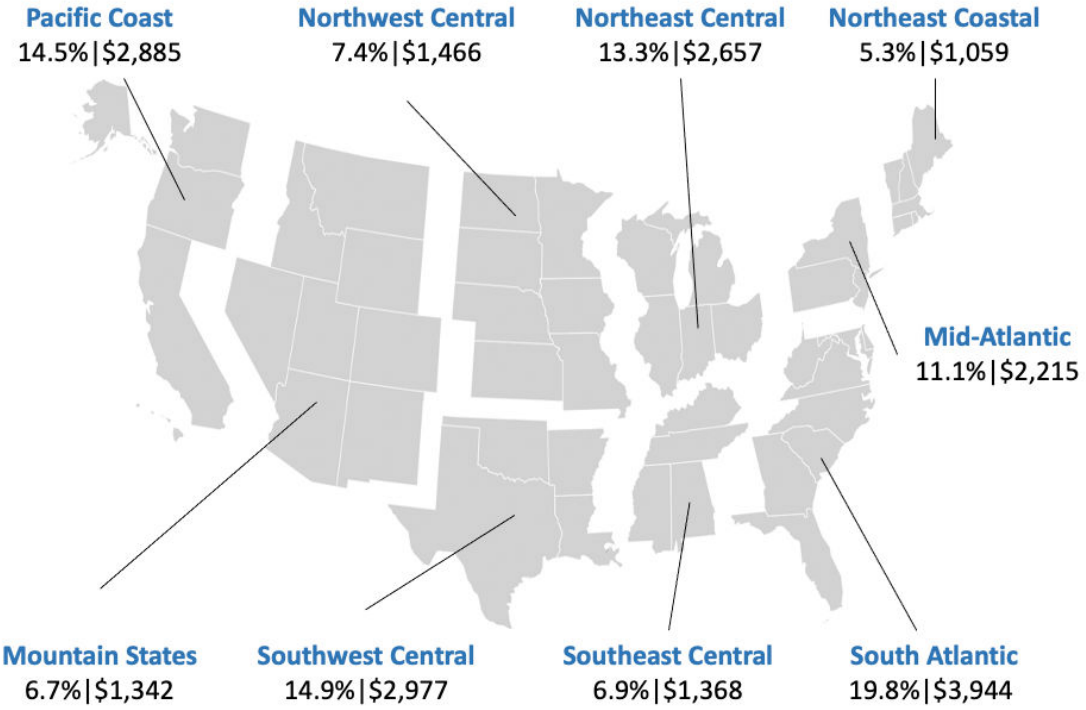
U.S. MARKET PROFILE

Switchgear Equipment Demand Totals $19.9 Billion

Market demand for switchgear equipment totaled $19.9 billion, according to MDM Analytics data. Estimates are end-user demand, in U.S. dollars, including distributor margin.

Market Demand for Switchgear Equipment by Region, $Millions (2023)

mdmanalytics



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NACIS	Description	Total Demand	Accounts
238210	Electrical Contractors/Other Wiring Installation Contractors	$6,206,484,166	116,625
221118	Other Electric Power Generation	$4,289,744,517	21,753
221122	Electric Power Distribution	$2,822,598,204	4,467
236220	Commercial and Institutional Building Construction	$513,933,789	57,505
236115	New Single-Family Housing (except For-Sale Builders)	$505,620,141	367,794
336611	Ship Building and Repairing	$398,487,598	1,260
335312	Motor and Generator Manufacturing	$232,597,963	1,522
335313	Switchgear and Switchboard Apparatus Manufacturing	$218,472,869	857
221113	Nuclear Electric Power Generation	$216,496,768	37
517121	Telecommunications Resellers	$207,771,178	12,672

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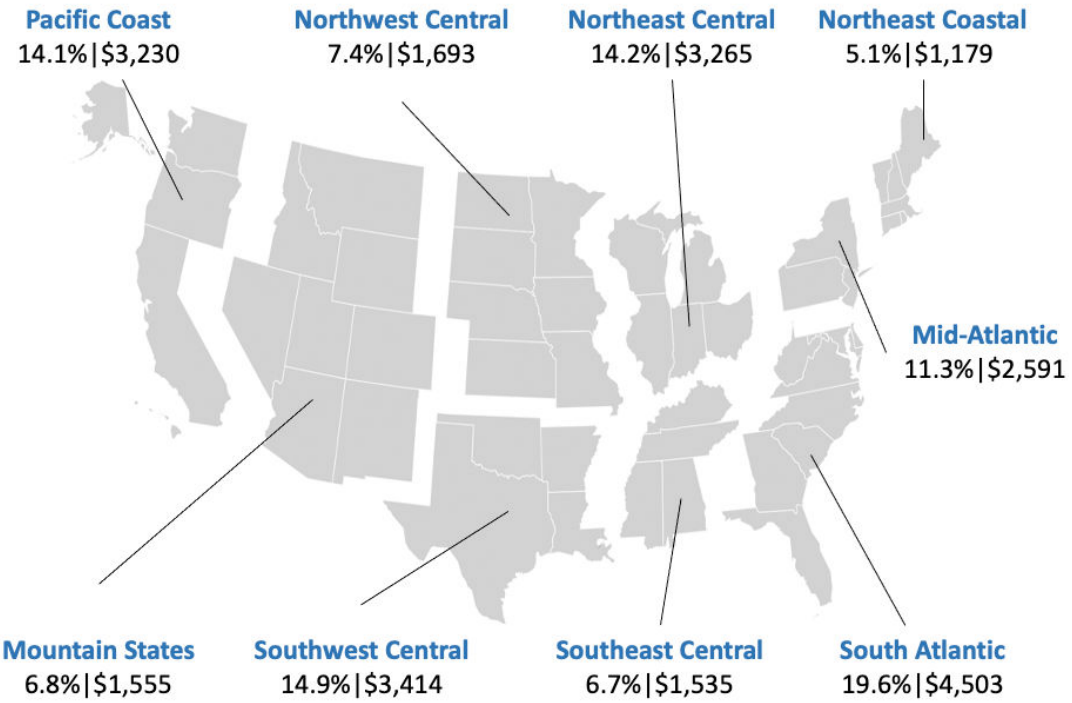
U.S. MARKET PROFILE

Power & Distribution Transformers Demand Totals $23 Billion

Market demand for power & distribution transformers totaled $23 billion, according to MDM Analytics data. Estimates are end-user demand, in U.S. dollars, including distributor margin.

mdmanalytics

Market Demand for Power & Distribution Transformers by Region, $Millions (2023)



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NACIS	Description	Total Demand	Accounts
238210	Electrical Contractors/Other Wiring Installation Contractors	$4,144,373,897	116,625
221118	Other Electric Power Generation	$4,070,343,231	21,753
221122	Electric Power Distribution	$2,677,784,097	4,467
236220	Commercial and Institutional Building Construction	$1,392,634,024	57,505
236115	New Single-Family Housing (except For-Sale Builders)	$942,252,688	367,794
336611	Ship Building and Repairing	$359,142,544	1,260
238220	Plumbing, Heating, and Air-Conditioning Contractors	$351,382,745	194,622
236118	Residential Remodelers	$338,269,131	113,318
236116	New Multifamily Housing (except For-Sale Builders)	$314,284,615	31,017
622110	General Medical and Surgical Hospitals	$300,808,647	41,867

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