

Specialty Distribution

Evolution

Product--> Application --> Supply Chain

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*Redefining distribution.*SM

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Ladies and gentlemen,

Today, I would like to talk a little bit about specialty distribution versus electrical wholesaling, where specialty distributors came from, about the changes taking place, forces driving the change, and a kind of one guy's view where this might end up.

Historical Specialty Distribution

- Product Focused
- Local or Regional
- Small Revenue Base
- Sell Small to Mid-sized Customer
- Limited Access to Capital

If you think about the roots of specialty distribution, you see a very much fragmented and local business with focus on specific products or specific customer types or industries. They were typically privately owned family businesses.

Historical Specialty Distribution

- Value Proposition
 - Buy Bulk - Sell Small Quantities
 - Product Knowledge
 - Traditional Customer Service
 - Product Availability
 - Credit and Collection

Distributors have to serve both suppliers and customers. They came into place hunting for suppliers, consolidating some purchasing, but it was not dramatic. They knew customers, built local relationships. They consolidated some of the credit and collection issues. They made small quantities available. For customers the good guys brought some product knowledge on cabling products that was not available in-house. They leveraged price for the customer and made the product available. Personal relationships were key.

Customers

Today's Environment

- Slow Growth
- Cash Matters
- ROI Matters
- Earnings Growth Rewarded

Over the last 10 years or so as the pressure has built up on manufacturing communities, followed by the quick downturn of the last 3 or 4 years, in most of the industries there became a huge capacity glut, which put a lot of pressure on corporations to come back and focus on the traditional business concerns such as return on cash, earnings and not just focus on top line growth. To deal with that, you look at what customers are doing today.

Customers

Today's Focus

- Process Costs
- Vendor Management Costs
- Asset/Inventory Reduction
- Reduce Fixed Expenses
- Application Enhancements
- Cycle Time
- Inventory Risk
- Cost Reductions

The focus of customers over the last 5 years is not just on price, it is moving beyond price. The focus on asset and cash management has intensified. Despite the fact that capital is cheap it is hard to come by. Customers are starting to realize that prices are as far down as they can go. But they still have business models where the cost improvement has to continue to come. Those issues cover a real broad array of customers.

Customers

- OEM's (Electrical, Electronic, Auto, Appliance, Consumer)
- Contractors/Installers/Integrators/A-E's
- Industrials (Natural Resource, Utilities)
- Corporate Enterprise Networks (Fortune 1,000, Financial Institutions, Government, Retail)

In the OEM world today everybody is facing labor issues, global competition and a capacity glut they have to live through.

The installers are not much different from the OEM. They do final installation at the site versus final installation in the factory. They are running up against the exact same issues that the OEMs are, the same labor, cash and process issues. It follows all walks of life, in the corporate enterprise networks, in industrials.

If we talk to the cable world we will not talk about utilities and telecoms as far as transport and plant is concerned. In industries where 4 or 5 customers dominate the procurement, there really is not a role for distribution. Over time, the cable industry loses focus and everybody wants to talk about utilities and telecoms. We are talking about servicing people and customers where the wire and cable they buy, fit into that 80% of the products which make up about 10% to 15% of their purchases. It is not a question of a core item, that makes up 80% of purchases being supplied by 5 or 6 guys in an industry.

Customers

Expectation of Distribution

- Eliminate Production/Installation Delays
- Minimize/Defer Investment
- Turn Fixed Costs into Variable Costs
- Reduce Back Office/Field/Factory Personnel
- Minimize Inventory Risk
- Provide Information - Visibility
- Reduce Supplier Base
- Provide Product/Application Expertise

What can a distributor do to bring value going forward and what can we do to help our customers deal with the issues I just discussed? How do we make them more efficient? They are dealing with a lot of workforce and union issues today, as well as labor costs which grow faster than the economy is growing. They try to minimize or defer assets. Customers talk about just-in-time, direct-line-feed and product management as part of their project management world. Customers are very sensitive to putting in fixed cost, they talk about a flexible model, up or downsizing. Therefore they look at distribution to help them to get there. They want us to provide the same level or more of information when they give us something that they got for themselves.

As I mentioned before: About 20% of their purchases come from 80% of their suppliers and that is not cost effective for them today. After having spent the last 3 or 4 years beating us all down on price, they finally realize - as we bring product expertise to these people – it is not just cheaper but it gives them a product which helps them through the whole process, helps the application and causes the production and the installation to go quicker. The product expertise of the past has to move further on to actually understand the product application the customer is looking for.

Tailored Supply Chain Solutions



Flexible and Scalable, Information System

ERP-ERP, B-B, Integration

SKU Stock Keeping Unit
ERP Enterprise Resource Planning
J.I.T Just In Time
B-B Business to Business

Using today's buzz word of supply chain, distributors have to provide tailored supply chain solutions. Almost everyone we deal with has different processes and different issues. If you look across the universe of that we must be able to source for them. Sourcing is not just finding the best price today. It is making sure that quality is right, the application fits.

We have to manage logistics for them, i.e. to make sure everything fits together at the right time at the right place to assure that all those labor issues do not get compounded by the fact that they wait for the product, the wrong product is there or the product is not there at all.

We must manage their inventory for them, and more importantly we must own that inventory for them until the last possible minute. We must make sure that their cash deployed is reduced. When you look at the environment today, the distributors have an advantage because the returns that are expected in distribution are not the same as in manufacturing who are ultimately end user customers. So, if we can deploy the cash in one place and the customer takes that cash out of the manufacturer who will buy from him, takes some of that cash out of the customer whom he will ultimately serve, you will bring value to both sides of the model. You will finally take cash out of the whole stream.

Tailored Supply Change Solutions (Continued)

We have to take those kind of low skill and high time kind of projects and put them in-house. We got to cut stuff, we got to kit stuff, we got to get stuff ready for installation, ready for assembly. It has to go into the right bin, with the right bar code on it. It has to show up to minimize the handling any customer can do. At the end of the day it manifests itself in a lot of buzz words. Customers look for direct-line-feed, just-in-time, kitted project rollouts, where material shows up on site every day, every 2 days for the work which has to be done that day. They want us to manage excess material off the job site. They want us to manage their reels off the job site. They want us to build these things up during the life of the project and tear them down when the project is over. Frankly, they want to be able to buy pieces of this chain, too. It is not an all or nothing or one fits all thing. They want us to be able to go in and buy pieces.

One of the major changes that has to take place is in IT (Information Technology). The foundation of being able to this is an IT system today. It is about being able to deliver IT solutions consistently that scale up, scale down, that manage SKUs, that are flexible to meet our customers' needs, that give them the information they want, that give them easy access, that help them manage cash and costs, that give them visibility of their project.

As importantly, we all lived through the B-B rage of the late 90's and early 2000. This is not a retail business. Fortune 500, Fortune 1000 does not want to go online and shop. Actually, they do not want to go on our systems at all. They want us to come into their systems, drag the information out of their systems, put the information back into their systems and completely integrate the systems, so you really become integrated in the process. This has to be done in an environment where we realize there will be no standards. If you think about how long did it take to get any kind of a standard with EDI (Electronic Data Interface). There is nothing out there today that says there is a logic for a standard coming. Therefore we must build systems, that are flexible enough, to go in and deal with whatever the format that comes out and put it back into their format and get them out of the business of trying to fit in our world. We got to fit in their world.

What this will drive is a need for distributors to bring a much broader group of skills and expertise to bear.

Resources Needed

- **People**
 - **Operations, process, planning, implementation, I.T., material management, purchasing, and engineering expertise**
- **Technology**
 - **Centralized, integrated, portable & scalable systems**
 - **In-house integration capabilities (ERP-ERP)**
 - **B-B Internet capabilities**
- **Process**
 - **Consistent, repeatable, and scalable**
 - **Quality Certification (ISO, 9001:2000)**
- **Presence**
 - **National, Global**
- **Financial Strength and Size**
- **Flexibility**
 - **Customize to fit customers environment**

In my mind, to really succeed in the environment we face – I think this is a long term environment – you have to bring real expertise to customers that is scalable. You have to bring them purchasing expertise, process and implementation expertise, IT expertise, project engineering expertise, that they pay as a variable expense, that they do not have to lock into their businesses as a fixed expense. We have to learn to come and go in all these places. We must really be able to stand up in front of IT managers of Fortune 500 companies, material procurement organizations with people that can stand in there willing to entrust what is a much more important part of their business than in the past we have been asked to deal with.

IT systems will become critical. The secret to success, as distributors go forward, it has to be a common platform everywhere. You have to be able to provide exactly the same platform to your customers no matter where they are. This is not only for cost reasons but for internal reasons for our customers as well. Because everyone of our big customers is headed down the path of one IT platform. We have to fit into that platform. I truly believe the whole integration issue is not something a distributor long term can outsource. He has to be the IT integration specialist. You bring in a third party to that you add way to much expense and you slow the process down dramatically. We must become more process focused than we have been in the past. The only answer to labor and production issues is really process. IT systems facilitate process. You have to be really good at processes to implement IT systems.

Tomorrow's Specialty Distributor

- Broad Geographic Coverage
- Scalable and Flexible I.T. Systems
- Process Focused
- Cost Effective Access to Capital
- Service Any Size Customer
- Product and Application Focused

Supply Chain Partner to Customers and Suppliers

The days of doing business with a lot of local guys will go away. It is not efficient. You have to be national in scope or you must be global in scope. You must be where your customer is. You must be able to bring capital to bear. You must be able to support the start up of that asset ownership issue and you must be able to support the start up costs. That financial strength is the key to being able to help to solve some of those problems.

Lastly, we must learn to be flexible as big companies. This is a kind of heritage from the small local businesses, which succeeded because of their flexibility. We need that same flexibility nationally and globally that the 10 million or 20 million dollar privately owned distributor brought to bear. Frankly, this is as big a challenge as any of the above. These are all customized solutions.

If you look forward, I think, for specialty distributors to be able to continue to grow, to bring value to the manufacturing community, to bring value to customers we must focus on that 80% of the products that make up 20% of what they spend. We have to be everywhere our customer is. We have to deliver state of the art IT solutions. We have to bring people and processes to bear on a flexible cost basis and we have to be willing to bring capital to bear.

On the other side, the suppliers as they are trying to service this industry, whether it be cable manufacturers or bulk manufacturers, have to learn to view distribution as part of their supply chain, not as a customer.

Tomorrow's Specialty Distributor (Continued)

In the electrical cable industry the manufacturers still view distributors too often as customers. We do not buy goods. Distributors sell goods. If you believe that we must get past this price issue and bring other values to the customer, as the manufacturing community you can actually help to expedite this process by going to the distribution world and sitting down and planning, how the distributor can help the manufacturer and vice versa. The evolution of this process can either be expedited by our suppliers or can be slowed down by the behavior of those suppliers, based on how they view distribution in their long term strategy to get the market and in what industries and places they want to see the people perform.

How do we get there? Will there be acquisitions? You will see the bigger guys buy companies, but they will not buy for volume. They buy to add product sets and to get into geographies. Eventually these have to be transformed to fit on the same platform. It is really hard to justify the back office expense, the integration expense to get them on the same platform.

Impact on Today's Distribution Industry

- Acquisitions ?
- Roll-ups ?
- Big Will Get Bigger
- Small Will Succeed in Niches
- Midsize ?

Will there be roll-ups? It will be tough because of IT, because of the capital requirements. The ones in the specialty world who have those needs to service the bigger customers on a multiple platform so far have not done very well. Could it happen? Maybe, but it is a monumental task. In the distribution industry you usually end up with a few big guys that provide the service. So, the big guys who can develop a common platform will get bigger. Even if the market does not grow, the part of the market that is accessible to distribution should grow, because it is the only way collectively, we can bring more value to the customers over time. Small guys will continue to succeed in niches. Some of them are really good. In some of these markets there will be some wonderful little 30 or 50 million dollar family owned businesses, which will do very well. The midsized guys tend to get stuck. They need the capital, the IT system. They must move forward. They are half way in between. That is a tough spot to get out of. History tells, they are also tough guys for a big guy to buy. There is so much overlap and redundancy.

This will be painful. To the extent that the economy does not get better, this will go faster. If the economy picks up some, this will go slower. Collectively, the manufacturing community has to force distribution in this direction. Customers will force distribution in this direction. All three parties will create factors over time that will cause this to go much quicker or will continue this kind of slow evolution we have been through here for the last 30 years.

Thank you for your attention.