

# End Customer/Market Ramifications on Increasing Raw Materials

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**Mr. Gregory Lampert**, Session chairman

Let me introduce our forth and final speaker of this session, Giulio Berardesca. He is Executive Vice President of Anixter Wire & Cable. He is currently responsible for the direction of Anixter's wire and cable business in North America, Europe and the Middle East. In this position, he directs responsibility for sales, purchasing and marketing of a \$1.4 billion business, which includes wire and cable as well as services and related products. He has over 30 years of experience in the industry with Anixter. We are looking forward to Giulio's encouraging perspective on how wire and cable manufacturers can manage this increasing raw material environment.

**Mr. Giulio Berardesca**

Thank you for inviting me to your 2006 Congress. I am honored to be here. Yesterday coming into the session I thought that we didn't build rockets for a living. After the last 3 presentations I am not so sure that we don't build rockets for a living. If that is the case we need to charge more than we actually do.

I want to talk about changing landscape. We talked about things that are out of our control today like copper, polymers and everything that is going to effect wire and cable. What I want to talk about is things that are in our control and what we call a changing landscape. Before I do this, a few words about Anixter.

## Partner With A Global Leader



Anixter has over 220 sales and warehouse locations around the world. We operate in 45 different countries.

Anixter is the world's largest distributor of communication products and electrical and electronic wire and cable, and a leading distributor of fasteners and other small parts ("C" class inventory components) to original equipment manufacturers.

Anixter adds value to the distribution process through our cost-reducing supply chain services, nearly \$725 million in inventory of more than 325,000 products, logistics network of 197 warehouses with more than 5.0 million square feet of space.

## Changing Landscape

Anticipate  
Manufacturing  
Distribution  
Customer  
Opportunities

What does a changing landscape mean? Obviously we would have missed something leaving this congress without talking about the environment that we control, a changing landscape that we have been part of for the last 50 years, but we have seen a lot of progression within the last few years. To us a changing landscape means that things are changing in the manufacturing sector and have been changing dramatically over the last 5 to 7 years in the distribution space. We need to understand the dynamics of what is happening there. But most important is the customer's expectation, because the customer's expectation is what will drive all of our behaviour and is really going to be the catalyst of how that landscape gets shaped. Hopefully, we better understand it! That is where our margin and future profitability is coming from. Anixter likes to share that with you, i.e. our perspective of how we see the customer's expectations are moving forward.

## Changing Landscape

### Manufacturing

- How does manufacturing get price increases to gain a reasonable return on the cost of capital employed
- Cannot afford to devalue inventory in the channel as adjustments are made for a declining copper commodity

Let us talk about manufacturing in the changing landscape. We talked about polymers and copper, everything that effects the prices of cables either going up or the profitability of copper drops. I want to go back to free copper. This is out of our control right now. And I want to ask the question on something we have to deal with, because we have to make sure that we don't have short memories. Let's go back 3 or 4 years. One of the challenges we were facing was how do manufacturers get price increases in play based on supply and demand. We all lived through a very strong supply and demand and we have seen the deterioration of pricing in our industry. That has not gone away. When copper is out of our control, let's deal with it. Out of necessity not discipline we had to put dramatic copper price increases in play. Guess what, the distribution channel absorbed it. To our surprise the customers had to absorb it. Let's use an example: Copper is inevitably going to drop - we don't know when. But we are still in a very strong economy, so there is still a supply demand imbalance. Your lead time is still out 14, 16 or 18 weeks. So the economy is good, copper drops. My biggest fear as a channel partner is not so much the copper dropping, it is the pricing deterioration that goes along. Inventory builds up at the manufacturers. The distribution channel has to take down your inventories, because they don't know where the bottom of copper is going to happen. So there is disconnect there. Now the manufacturer has to dump products into the channel. But the channel says: I am not going to buy it, give me an incentive to buy it, because I want to reduce my inventory. That lag in time which starts pricing deterioration is the biggest challenge that we have as an industry. Typically we did not have the discipline to manage through that.

## Changing Landscape continued

### Manufacturing

- Need to continue to take costs out of product & manufacturing sector.
- Cannot continue to act as a distributor without making the distributor margin.

Manufacturers need to continue to take cost out of the product and manufacturing sector. What does that mean? You have all done a great job over the last 5 to 10 years to continue to take cost out of your manufacturing processes through all kinds of creative initiatives. Every single time you created those pricing advantages for you, 9 times out of 10 they were dumped into the market place. When you create these pricing advantages for yourself, put them into your pocket. Please do not pass them on to distribution, because distribution typically is very undisciplined. They will try and take an advantage which really lasts for 24 hours. In 24 hours it will become a geographical price, within 48 hours it will be a national price. What do we do? We are not disciplined enough. Hence, who wins? The end user, the customer!

Another challenge manufacturers have is to continue to act as a distributor without making the distributor margin. If you are going to build inventory, you have two options. You keep trying to reduce the cost of materials in your facilities, you rationalize products, close plants, there is consolidation. One of the biggest costs you have is carrying inventory, i.e. the products and services that go along with the inventory that you have. Now you got two options. If you try to take cost out of your business, don't take cost out of the manufacturing sector, take cost out of the distribution sector you are actually doing. Or the other choice is: If you are going to be a distributor, then make that distributor margin, because there is a big associated cost of doing that business. When you look at the real cost of a distribution center you will probably be surprised. The biggest problem we have as a distribution channel is that our level playing field is no longer level, when we allow a distributor or a fringe player to access your inventory within 2 to 3 points of your major channel and they have your products sitting in their warehouse. It influences our behavior. For instance, people are shocked when the manufacturer's inventory builds up, distribution actually takes their inventory down.

## Changing Landscape continued

### Manufacturing

- Need to clean up channel to market
- Need to continue to rationalize products, manufacturing, inventory, distribution facilities.

We need to clean up the channel to market. Let me explain our channel today. In our channel today we have wholesalers, we have agents, we have stocking agents, we have distributors, we have specialty distributors, we have redistribution, we have value-added distribution. Now we have one new element to contend with and that is the big building boxes. If all else fails you reserve the right to sell the product direct. There is a really strong strategy there.

There is a need to continue to rationalize products, manufacturing, inventory, distribution facilities. That is an ongoing process. It does not matter what industry you are in, we are challenged to take cost out of our operation.

## Changing Landscape continued

### Distribution

- Wholesale channel redefining core competencies

The wholesale channel is redefining the core competencies. That is a channel right now that is in a defensive mode. Every time you are in a defensive mode you got a business that is potentially in trouble. What is happening? You got the big specialty distributors up here, the cable specialists, the wiring specialists, all the electrical specialists. They are piece-mealing their business up here, because customers are asking for more for less. We will talk about this shortly. Their day-to-day business, their pick-up business, which is their most profitable business, is getting impacted by the big building boxes, your Home Depots of this world. A contractor now doesn't have to go into an insecure part of town where this warehouse has been there for 40 years and it is not even safe anymore. Now you got a Home Depot at every single corner. There is probably a dozen to 15 on your way to the job site. You can stop in anyone of these and go in without standing at the counter. You can pull up and drive through. They are open from 6 o'clock in the morning until late at night. They got some competitive pricing, they extend credits. So, the most profitable part of that pick-up business of wholesalers gets eaten by the big building boxes.

You got the specialists here, the building boxes there, the wholesalers are in the middle trying to defend their business. I cannot remember the last time that we lost a specialty piece of cable to a wholesaler. Now, if you want to talk about building wires in the residential and commercial area it is a different ball game.

## Changing Landscape continued

### Distribution

- Impact of “Big Box” companies as a new competitor
- Agent channel adds no value
- Re-distributor channel adds no value

The big boxes as a new competitor are also a challenge for the manufacturers. These people seem to have all gone to the Wal-Mart school of negotiating. They have one question in mind: What is your price this week and will your price be different next week? We may have to consider that. There is real value there.

The agent channel adds no value. If you want to talk about pricing deterioration, mismanagement of pricing out there, mismanagement of information flow that allows you to lower prices, just look at your agent channel, where agents did have a place and a value 10 or 15 years ago. Today they have one interest and that is their own pocket. Whether they put a \$1000 or \$1 in their pocket in any single transaction, it is of self-serving interest. I think, this has to be addressed. As you get more value-adds to distributors or through the distributor's function that are going to step into remote areas and get to remote sites, where the agents play today, one has to ask how that landscape needs to be changed.

The re-distributor channel is a channel that definitely is going away. I should not say that, because Anixter owns one of the biggest re-distributor channels out there, called Wire Express. The fact of the matter is, as Anixter gets to a broader penetration and geographies deeper into customer verticals, we eventually get to the customer's customer of the re-distributor. The more we do that it will impact their business. This business cannot effort two uplifts in price which is happening today in the re-distributor channel. Again, where will that go?

## Changing Landscape continued

### Distribution

- Weak competitive landscape financially
- Cost of doing business going up (should not be at the expense of manufacturing)
- Ineffective systems
- Quality of management
- Margin issues
- Distribution intellectual laziness “Buy Better” mentality needs to change.

Taking away the last couple of years, most distributors have a weak competitive landscape financially. That has been shored up.

Here comes a good one: Cost of doing business is going up. Customers are asking for more value and by doing so, it is going to increase our cost of doing business. How many discussions did you have with distributors that hold you accountable for their margins? As the cost of doing business is going up they expect you to do something about it.

They have ineffective systems to compete. The quality of the management team at the distribution level, I think, is very weak. They have margin issues. The expectations are that the manufacturers will bail them out.

I have always accused distribution of intellectual laziness, which means: Give what the customer wants, don't try and buy better, to just give a better price and win on price. That is a dead end street.

## Changing Landscape continued

### Customer

- Need to take more costs out of their business and focus on their core competencies.
- Challenged to do more with less resources
- Need to change internal cost models to maintain competitive edge in their environments
- Easiest thing for a customer to do in our business is find the floor price of a commodity called wire & cable

Let's talk about customers. They are challenged and need to take more costs out of their business and focus on their core competencies. It doesn't matter what customer vertical, that isn't challenged to continue to take costs out of their business including the retail channel. Take mining, oil and gas, industrial, OEM, etc., every single customer vertical is challenged to do more with less resources.

They need to change their internal cost models to maintain a competitive edge in their environments. The easiest thing to do for any of these customer verticals in our business is to find the floor price of the commodity called wire and cable. If that is the easiest thing for them to do, we are in deep trouble.

Where do we go from here? Obviously, understanding what the customer's needs are, how their life is changing, and help them to move forward.

## Changing Landscape continued

### Opportunities

- How do you win without low price
- Customers need to continue to take costs out of their business
- Each customer vertical that uses wire and cable gives us the opportunity to package a value add proposition that would help them take costs out of their business.

How do you win without low prices? Customers need to continue to take costs out of their business.

One of the approaches we have taken: Each customer vertical that uses wire and cable gives us the opportunity to package a value-add proposition that would help them take costs out of their business. If you go to a customer and the immediate thing to do is to find the floor price of the cable, where do you go from there? Because for the next 3, 4 or 5 years they are still challenged to take cost out of their business. If you can find a vertical that you understand, and the old sale's approach would be to go to a vertical and say: How can I help you? But you go in and say: By the way, let me show you, how I can help you to take costs out of your business for the next 3, 4 or 5 years based on this commodity called wire and cable. There is a better chance that you will be able to take the discussion away from: What's my price? vs. more forward thinking about: How can you help me?

## Changing Landscape continued

### Opportunities

- Each customer vertical that uses wire and cable gives us the opportunity to package a value add proposition that would help them take costs out of their business.
  - ♦ Financial
  - ♦ Logistics
  - ♦ Technology
  - ♦ Just In Time Services
  - ♦ Specialization
  - ♦ Inventory / asset management

An example: The big 3 car manufacturers DaimlerChrysler, Ford and GM. Did any of you try to do business with them in the last few years? We have and we walked away from every single contract. The reason for this is, they are very old school. They are old school on two fronts. They give everything away. Just flip on the TV and you can see that they give something away, that will eventually cost them money. Then there is the old school of pricing instead of creating value and quality out there. At the procurement end they negate any price increase. They are the only 3 companies where we have not been able to pass on the copper increases. After negotiating for 15 months with them on this issue, they were stalling and stalling, we finally walked away. You go into a Honda or Toyota – by the way, those are not offshore manufacturers anymore – the dialogue is very different. It is not about pricing, we have been able to get our price increases. They allow us to make a reasonable margin, because their scope of doing business and the value that they want us to create through their manufacturing process in this commodity called wire and cable. They understand that we have been able to take costs out of their process through efficiency and productivity. They share with us some of their cost savings.

The opportunity is to take every one of these customer verticals, that we can sell wire and cable to, and if you have the ability to understand how they use this commodity called wire and cable, then through financials, logistics, technology, just-in-time services, specialization and management of inventory through asset management we have been able to win and create value at the end user.

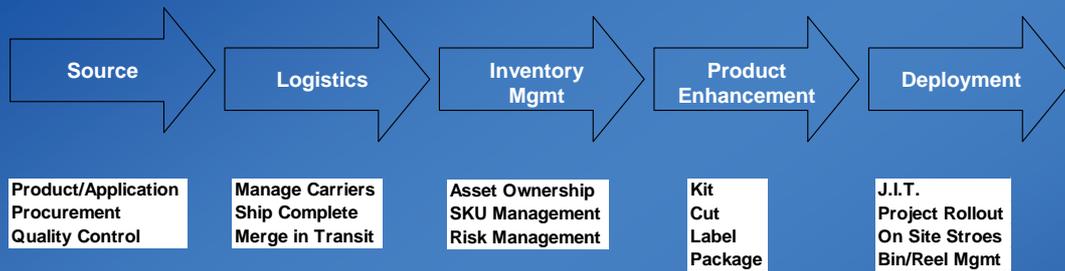
## Customers

### 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 do the customers expect from distribution? They expect to eliminate production and installation delays, minimize or defer investment, turn fixed costs into variable costs, reduce back office / field and factory personnel, minimize inventory risk, provide information and visibility, reduce supplier base and provide product / application expertise.

## Tailored Supply Chain Solutions



**Flexible and Scalable, Information System**

**ERP-ERP, B-B, Integration**

When you look at tailored supply chain solutions, you have to consider source, logistics, inventory management, product enhancement and deployment and all of the subsets, you can drill down. You can turn soft dollars into hard dollars for any of these customers with a flexible and scalable information system, which is what is required, and with ERP (Enterprise Resource Planning) to ERP or Business-to-Business integration. If you can find out where you fit in there, obviously it is going to tell you, how much value you are creating in there.

Here is the interesting thing. You get to this point with a customer you will also have a customer for life. There is not a whole lot of people who could displace you at that point in time. Again you turn this value away from a pricing where it is not a transactional pricing on a day-to-day basis anymore, it is really a partnership.

How many people talk about partnerships? There is one mistake distribution makes. They go in and talk about partnership between them and the customer. In reality, there is a third person missing in that partnership. We can only provide the value and can assure them that we provide the low cost product. But the third most important person is the manufacturer.

When we go in we try to create a value-add proposition for the distribution channel and the manufacturer. Collectively you create a win-win position for the customer. This adds a lot of credibility.

## 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

- Customize to fit customers environment

What are the resources needed and how is that landscape changing from what I have been describing for distribution? The resources needed are effective operations, processes, planning, implementation, I.T. We have 278 I.T. people sitting in our corporate offices here in Glenville. We need material management, purchasing and engineering expertise.

In technology we need centralized, integrated, portable and scalable systems, in-house integration capabilities (ERP-ERP) and B-B internet capabilities.

From a process standpoint we need consistent, repeatable and scalable processes and Quality Certification (ISO, 9001:2000).

The presence has to be national and global. That is absolutely key, because customers are asking us to move with them on a global basis. Organizations which have the ability to do that are going to succeed in the Fortune 100 or 500 space.

Do not underestimate the financial strength and size. Distribution needs financial strength and size to compete in a global market and to be able to customize to fit customers environment.

## **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**

How does tomorrow's specialty distributor look like? He needs a broad geographic coverage, scalable and flexible I.T. systems, process focused, cost effective access to capital, service any size customer and product and application focused. He should be the supply chain partner to customers and suppliers.

## Changing Landscape continued

### Opportunities

- The challenge in this room is how do you redesign your channel strategy and who do you want to go to market with!
- The combined strength of manufacturer and a distribution channel that offers the best in class Value Add solution to each customer vertical will continue to grow profitably.
- Manufacturer cannot do it on their own!
- Distribution cannot do it on their own!

As a conclusion I like to point out the opportunities for all of us in this changing landscape.

The challenge in this room is how do you redesign your channel strategy and who do you want to go to market with!

The combined strength of manufacturer and a distribution channel that offers the best in class value-add solution to each customer vertical will continue to grow profitably.

Manufacturers cannot do it on their own!

Distribution cannot do it on their own!

The combined strength of your channel, our partners means a profitable healthy industry and business.

Thank you!