

Economic Outlook for 2006

Wholesaler-distributor revenues grew 8.9% in 2005

Now that 2006 has begun, it's a good time to review building products and industrial distribution in 2005 and look forward to the economic outlook for 2006.

By Adam J. Fein, Ph.D.

Overall Wholesale Distribution

Total revenues of wholesale distributors grew by 8.9% in the past 12 months, marking another year of strong performance (See Exhibit 1 on p. 3). This revenue growth rate exceeded our original 2005 forecast of 7.7% due primarily to higher than expected commodity prices. Three of the four largest sectors contributed half of the industry's revenue growth during this period:

- Oil and Gas Products Wholesale Distributors contributed 24% of total revenue growth as the price of crude oil shot above \$60 per barrel in 2005 versus \$32 in late 2003;
- Industrial Distributors contributed 14% of total revenue growth as this sector rebounded along with the U.S. manufacturing industry;

2006 Wholesale Distribution Factbook

This article is based on Pembroke Consulting's comprehensive new market data reference guide to the \$3.6 trillion U.S. wholesale distribution industry, *The 2006 Wholesale Distribution Economic Factbook* (available for purchase online at www.PembrokeConsulting.com/factbook). The Factbook supplies detailed channel benchmarking data for 111 distinct sub-sectors of the overall wholesale distribution industry. Data include revenue and employment growth trends, the number and size distribution of companies, gross margins, wages, and other operating statistics. All information is presented using a consistent format to permit direct comparisons among sub-sectors.

- Pharmaceutical Wholesalers contributed 11% of total revenue growth due to increased pharmaceutical consumption in the U.S. and branded drug price increases averaging more than 6%.

Many sectors experienced growing revenues but shrinking employment as a result of productivity improvements. Employment growth, which was only 1 percent versus the previous year, continues to lag far behind revenue growth as wholesale distributors benefit from product price inflation and the application of technology to operations.

Despite an uptick in consolidation activity in 2005, most distributors are small and medium-sized private companies. Less than one percent of the country's 270,000 wholesaler-distributors have annual revenues above \$100 million.

Building Material Wholesaler-Distributors

Total revenues for wholesaler-distributors of building and construction materials grew by 6.7% in 2005 to \$147.5 billion. This is one of the few wholesale distribution sectors not to have experienced any year-on-year sales decline during the past five years due to the strength of the housing market and the rebound in commercial construction (See Exhibit 2 on next page). Looking forward, 2006 promises to be another good year for wholesale distributors in this sector. Total private construction spending was up 9.0% in the 11 months through November 2005.

Private residential construction grew more than twice as fast in 2005 as non-residential construction. However, growth in home building by the private sector is flat, which could signal the expected slowdown in this sector as rising mortgage rates cool housing activity. Mortgage purchase applications declined by 5% in

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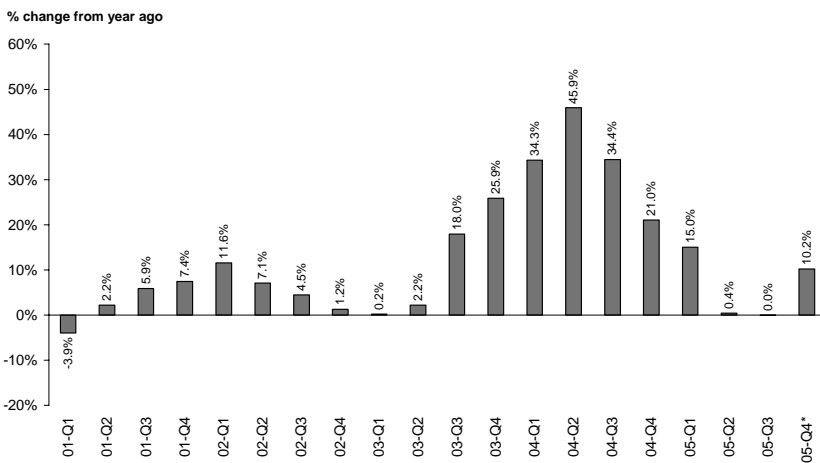
the fourth quarter of 2005, suggesting a gradual slowdown rather than a crash. In contrast, public construction activity is up almost 12% from last year due to the federal highway spending bill and post-Katrina rebuilding. Public construction activity is growing fastest in the South because the migration of Katrina victims has accelerated school building.

Private non-residential construction, which contracted sharply in 2002, was up 3.5% in 2005. The commercial real estate market looks very promising for 2006. About \$220 billion of U.S. commercial real estate changed hands in 2005, up from \$186 billion in 2004. Average sale prices of office buildings and apartment complexes are rising. Office vacancy rates in the top 50 markets

fell to 14.5% in 2005 from 16.8% in 2004 and are expected to fall below 13% in 2006.

Product inflation boosted top-line revenues of wholesale distributors without requiring an equivalent increase in labor costs, although distributors of some products could not fully benefit due to shortages of products such as drywall. Prices for construction materials especially lumber products, spiked in 2004 but have moderated somewhat since then. For example, the price index for plywood was up 35% from summer 2003 to summer 2004, but has dropped by 10% since then. Despite the recent decline, plywood prices are still 20% higher than two years ago. In contrast, cement prices remain high as demand continues to exceed supply.

**Building Material and Construction Wholesale Distributors
Revenue Growth, 2001 to present**



* 2005-Q4 compares Oct. & Nov. 2005 to Oct. & Nov. 2004

Industrial Distributors

Revenues for industrial distributors rebounded in 2004 and 2005 along with the U.S. manufacturing industry. Total revenues for the more than 43,000 industrial distributors reached \$316.0 billion in 2005, up 15.5% from the previous year. Exhibit Three shows the 18 sub-sectors of industrial distribution and sales per employee in 2005.

Industrial distributors are tied more closely to the industrial manufacturing economy than any other wholesale distribution sector. Manufacturing capacity utilization is now running above 80%, substantially up from the twenty-year low of 72% in 2001. Many economists expect capacity utilization to rise to 82% by the end of 2006, suggesting increased capital investment and

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U.S. Wholesale Distribution Industry: Revenues & Employment

(Last 12 months - Dec 2004 through Nov 2005)

Major Sector (Largest to Smallest Sector Revenues)	2005 Revenues (\$B)	% change vs. previous period	
		Revenues	Employment (Nov 2005)
Grocery and Foodservice Distributors	\$429.0	4.4%	-0.2%
Oil and Gas Products Distributors	\$349.2	25.8%	-0.6%
Pharmaceutical Wholesalers	\$328.8	10.5%	0.4%
Industrial Distributors	\$316.0	15.5%	1.8%
Commercial Equipment and Supplies Distributors	\$301.4	4.0%	0.5%
Motor Vehicles and Motor Vehicle Parts Distributors	\$289.3	5.8%	1.0%
Electrical and Electronics Wholesalers	\$269.8	6.4%	3.5%
Other Consumer Products Distributors	\$196.8	8.8%	-1.3%
Miscellaneous Durable Goods Distributors	\$196.4	10.3%	2.8%
Building Material and Construction Distributors	\$147.5	6.7%	4.9%
Metal Service Centers	\$132.3	12.7%	-1.1%
Apparel and Piece Goods Distributors	\$115.9	6.8%	1.3%
Agricultural Products Distributors	\$115.1	-11.9%	1.2%
Beer, Wine and Liquor Wholesalers	\$94.1	11.3%	2.4%
Office Product Wholesalers and Paper Merchants	\$85.3	8.4%	-1.6%
Hardware, Plumbing, Heating Equipment & Supplies	\$83.6	8.7%	-0.2%
Chemicals and Plastics Wholesale Distributors	\$83.6	14.0%	1.0%
Furniture & Home Furnishing Wholesale Distributors	\$64.3	6.0%	0.5%
Total industry	\$3,598.4	8.9%	1.0%

Source: The 2006 Wholesale Distribution Economic Factbook™ by Pembroke Consulting, www.pembrokeconsulting.com

Industrial Distributors: 2005 Revenues & Avg. Rev/Employee

Sub-Sector (defined by primary products)	2005 Revenues (\$B)	Avg. Revenues per Employee (\$000)
Farm and Garden Machinery and Equipment	\$46.2	\$483
Construction Machinery and Equipment	\$46.0	\$547
General Purpose Industrial Machinery and Equipment	\$43.4	\$444
Aircraft and Aeronautical Equipment and Supplies	\$27.0	\$1,171
Other Industrial Machinery and Equipment	\$23.8	\$507
Service Establishment Equipment and Supplies	\$18.2	\$353
Materials Handling Machinery, Equipment, and Parts	\$18.1	\$328
General Line Industrial MRO Supplies	\$15.3	\$383
Metalworking Machinery, Equipment, and Parts	\$14.6	\$495
Fluid Power Machinery, Equipment, and Parts	\$14.4	\$410
Oil Well, Refinery, and Pipeline Equipment and Supplies	\$10.3	\$495
Mechanical Power Transmission (Bearings) Supplies	\$8.5	\$483
Industrial Valves and Fittings (except Fluid Power)	\$8.1	\$492
Industrial Containers and Supplies	\$8.0	\$472
Food Processing Machinery, Equipment, and Parts	\$4.6	\$395
Welding Supplies	\$4.3	\$368
Marine Machinery, Equipment, and Supplies	\$2.7	\$429
Other Transportation Equipment and Supplies	\$2.5	\$494
Total Sector	\$316.0	\$475

Source: The 2006 Wholesale Distribution Economic Factbook™ by Pembroke Consulting, www.pembrokeconsulting.com

continued growth for industrial distributors. Production is growing fastest for manufacturers of business equipment such as computers, electrical, and defense equipment. In 2006, distributors of Oil Well, Refinery, and Pipeline Equipment and Supplies will benefit from reconstruction spending as Gulf Coast production reaches pre-Katrina levels.

The weakest part of the U.S. manufacturing industry continues to be the automotive vehicle and auto parts manufacturers. Shares of General Motors fell to a 23 year low in December 2005. The company announced job cut targets of 30,000, although S&P downgraded GM's credit rating by 2 notches on skepticism about the restructuring plan. GM also suffered by comparison with Toyota, which announced that it will surpass GM as the world's biggest automaker by volume.

The economic rebound has allowed industrial distributors to work down excess inventory in 2003 and 2004, bringing the inventory-to-sales ratio back to historical averages achieved during the 1990's. The low level of product price inflation for industrial products has also encouraged distributors to keep their inventories lean.

© 2006 Pembroke Consulting, Inc. Adam J. Fein, Ph.D. is the founder and president of Pembroke Consulting, a firm that provides business and marketing strategy advice to executives operating in channel-intensive industries. He can be reached at (215) 523-5700 or on the web at www.PembrokeConsulting.com. This article is adapted from The 2006 Wholesale Distribution Economic Factbook, which is available for purchase online at www.pembrokeconsulting.com/factbook.

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