

Charting a course for distribution

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DISTRIBUTION OPPORTUNITIES GOING INTO 2024

Distribution is a sector that has much to look forward to in the year ahead. As well as the obvious challenges, the aftermath of COVID-19 has brought positive changes to the industry, with companies learning how to rapidly shift the way they work when necessary, and being better prepared for unexpected disruptions. The M&A market for distribution remains active, while steps are being taken to make it an appealing sector to work in, as an essential and very significant part of GDP at a global level. All these matters, along with a range of other pertinent topics, were discussed at Oaklins' recent webinar focused on distribution's current and future landscape.

The event was led by **Don Wiggins**, Oaklins' distribution specialist based in Jacksonville, Florida, and **Martin S. Harrell**, president of Beacon Waterproofing, a division of Beacon Building Products. Beacon is a US\$9-billion, Fortune 500 company based in Herndon, Virginia.

As an introduction, Don set out the background to the relationship between Martin and Oaklins, explaining how the latter acted as sell-side advisor when Martin sold his company, Coastal Construction Products, back in 2018 to a private equity group. Having helped Coastal grow in partnership with the management team, the PE firm sold it a year ago to Beacon.

There are a lot of decisions being made now that will affect the future course of the distribution industry

“Distribution is a very strong segment. Logistics account for about 14% of GDP in the world. That's substantial. You've got to get things from one place to another, and that is a big part of the economy.”

DON WIGGINS
DISTRIBUTION SPECIALIST, OAKLINS



The webinar's full title was 'From disruptions to decisions: charting a course for distribution in 2023'. "The question is," said Don, "what's the state of the industry today? A lot has gone on in the past five or six years, with transactions, with COVID, with supply chain disruption." Technology advancements are also having an impact — "there are a lot of decisions being made now that will affect the future course of the distribution industry," he added.

CHANGING HABITS AND LOYALTIES

From 2020 through very recently, the supply chain was, unsurprisingly, under a lot of pressure. "A lot of this was caused, of course, by COVID. I know our clients really had difficulties, especially if they were buying raw materials, metals, wood, building supplies, aluminum, steel, all of those areas had supply chain disruptions," Don commented.

As a consequence, the 'just-in-time' concept has been "damaged substantially". These supply chain disruptions led to "companies buying what they could when they could," he continued. "And in a lot of cases it resulted in excess inventory but they had to do that to protect themselves."

However, in turn, such events can improve supply chain resiliency, i.e. what businesses do to adapt to change when difficulties occur. Two or three years ago, resiliency went up as companies sought to protect their supply chain. But recently, it's fallen. "I think there are a lot of factors involved in that," Don said. "One is that companies had to react,



DON WIGGINS
Principal
Oaklins Heritage



MARTIN S. HARRELL
Division President
Beacon Building Products

had to be resilient, had to adapt during COVID. But what's happened since then? A lot of those efforts were made and a lot of structural changes were made. And recently, with the cost of technology and with financing difficulties, but it's come down to some extent."

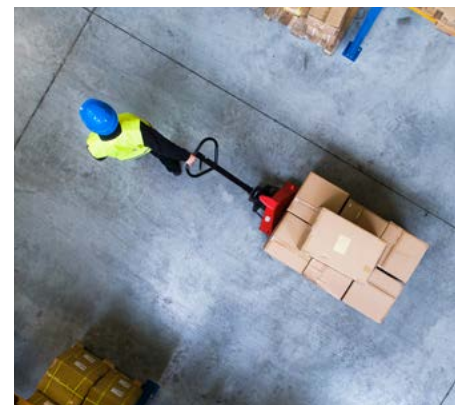
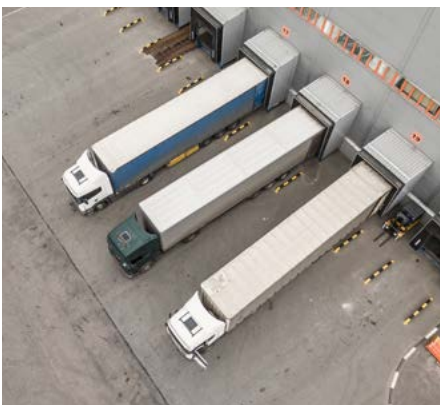
COVID saw customers lose confidence in manufacturers' ability to produce materials, and distributors' ability to have inventory in stock

At this point, Don asked Martin what his company did during COVID to adapt and ensure its supply chain had resiliency. "It was a real challenge, primarily because the customers changed their ordering habits," he explained. "They no longer had confidence in the manufacturer's ability to produce the material, or our ability to make sure that we had the proper amount of inventory in stock for their daily needs.

So they would change their ordering habits. They may start trying to pre-plan and order a month, two months, three months in advance. But they didn't have necessarily the sophistication to plan that far in advance."

What's more, they would overorder, Martin noted. "If the job was going to take 100 units, they may order 150 just to ensure that they had the right amount of material on hand." However, they might not end up collecting it all, leaving Beacon with the remainder.

Another issue was a loss of manufacturer loyalty. Whereas in the past, contractors preferred to work only with a particular supplier, during the pandemic they were primarily concerned with getting their hands on materials, regardless of supplier. "Then once you try a different product and get used to it, that's now your new product of choice." This has led to a shift in consumer preferences, and a change in the relationship between manufacturers and contractors.



A MATTER OF VISIBILITY

Following this, Don looked towards advancements in supply chain technology. “This is to me probably the single most interesting topic” in the sector at the moment. “AI has become a buzzword, and AI is just an evolution. We’ve had artificial intelligence for a long time. I think it’s just developed to the point that it’s really becoming a major player.” However, he added, “AI still has a long way to go to become mature and developed.”

One of the key subjects in this area is end-to-end supply chain visibility, the ability to track products to know exactly where they are, sometimes even from manufacturing right up to delivery.

In the case of Beacon, said Martin, the company aims to be as visible as possible, but customers have high expectations on this and “it’s really difficult from a technology standpoint to make sure we can offer it to them.”

Consumers have become used to quick delivery which puts a lot of pressure on the supply chain

The impact of Amazon in this development is significant. “As a consumer now, if I can’t get an order tomorrow, I’m disappointed,” commented Don. Whereas in the past, it was usual to wait weeks for a delivery, now it might only take hours. “I think as a society, we’ve become used to that and it really causes pressure on the supply chain.”

THE ROLE OF AI

The role of AI cropped up several other times during the webinar, “I would say we’re actually on the front end of our journey,” Martin said when asked about Beacon’s experience in this area. “What I have seen from the advancements that

have been made is the work that typically an analyst would do to understand changes at a branch, changes in a region, changes with a manufacturer from a profitability standpoint or from a sales standpoint, these things are now becoming automatic.” So AI can quickly spot inconsistencies and flag them to a manager, then action can be taken much faster than before. “I think that’s an area that’s going to influence our business dramatically moving forward, and quickly. It’s not going to take much time for those types of resources and tools to be put in place,” he said.

“If you look at how fast the speed of any technology moves,” Don added, “once you get over that initial inertia and it starts moving, it moves faster and faster as you go along.” Martin agreed, saying it would get to a point where AI is doing 60 or 70% of the work for an executive, leaving them to use their skill set, knowledge and history to really understand what that information means to them and their business.

The Oaklins distribution panel



From left to right: Don Wiggins (Principal, Oaklins Heritage) and Martin S. Harrell (Division President at Beacon Building Products, Inc.)

As labor costs increase, there's the question of how to make operations more efficient

The conversation then turned to other technologies that could replace labor. With the costs of labor continuing to increase, there's definitely the question of "how can you make operations more efficient?" Martin commented. This could be through driverless trucks, or finding ways to make warehouses run better, for instance by splitting shifts or identifying technology that allows workers to pick and pack much faster. "We're not at the stage of robotics or anything like that but it's not too far off."

MANAGEMENT OF RISK

Another area where the impact of the COVID pandemic is evident is in risk management. "No question a lot of companies make better decisions now," said Don. "So how do you make that decision on risk management and business continuity? How do you plan for that?"

"You do a lot of scenario planning of what could go wrong," commented Martin. "I think the one thing that COVID taught us is that if something can go wrong, it will, and it's not good enough to say that'll never happen."

One aspect in distribution's favor is that, coming from a lower tech environment, it's easy to switch back to practices that have worked for decades, if needs be. "For example," Martin said, "in all of our branches, we can go to a manual paper ticket system within seconds. We have the ability to just go back in time and do everything on paper." It takes more time and is less efficient, but it does mean being able to keep serving customers. As Martin pointed out, risk management means running through different events, and assessing how the company, the executive team and the branches would react.

DEAL-MAKING IN DISTRIBUTION

Turning to M&A, Don noted that "activity is still relatively strong although there is somewhat of a downward trend. And what we're seeing in the market is private equity groups are still active, there's still a lot of money on the sidelines, but deals are definitely taking longer."

He also noted that the availability of financing is currently a big factor in M&A. "I've had many PE groups tell us that five or three years ago, they would have 20 or 25 potential financing sources to finance a deal. Now it's three to five." What's more, interest rates have gone up and multiples have dropped a bit. But deal activity is still good despite all this.

Looking ahead to what he thought would happen in the coming year, Martin said his opinion was in part influenced by the area of distribution he's in. "The waterproofing space is consolidating, and consolidating very quickly. And Beacon has what I would call first-mover advantage, having acquired multiple companies in this space over the last five years. So we expect M&A activity to continue in our industry over the next year or two. We feel like it's an opportune time to buy."

Between the post-pandemic supply chain challenges and current international situation, companies want to be part of a bigger organization as they seek safety and security

On a wider level, he also sees consolidation happening in multiple fields. In addition, between the supply chain challenges that came after the pandemic and the international situation, companies are "looking to be part of a bigger organization, seeking safety and security." But he also pointed out that having an exit plan in place is essential.

"Exactly," agreed Don. "The single biggest mistake we see people make

in thinking about selling their company is lack of preparation, not preparing to enter into the biggest economic transaction, in all likelihood, of their life."

GLOBAL FACTORS

Several times during the webinar, global issues took center stage. On the one hand, there is the constantly evolving global trade environment, which is seeing companies move production from China to other countries, such as Vietnam and Mexico, in an attempt to avoid tariffs and reduce labor costs. An advantage for the USA of Mexico is also proximity. "The logistics problems of shipping from Monterey to San Diego or Chicago are certainly not like shipping from Ningbo to those cities," noted Don.

Also discussed was the impact of international conflict, natural disasters and national strife around the world. From labor issues in Canada to various domestic and international relation issues in China (such as Taiwan, droughts and floods), COVID, the Israel-Hamas conflict, the invasion of Ukraine, attacks on commercial and military ships in Yemen, a drought in the Panama Canal region — the list is long. How does all this affect distribution?

"While most of our products are manufactured in the US, raw materials come from all over the world," Martin said. What's more, most of Beacon's manufacturers run global organizations, so when things happen around the world that negatively affect them, it will have a knock-on effect on the company.

"So we're not insulated from it. It may take a little bit longer to catch up with us but we're certainly not insulated from it."

DOING THE RIGHT THING

Another topic that came up at different points was environmental, social and governance (ESG) concerns. Don commented that there has been a growth of European companies

buying in the USA: “I think that’s clearly a trend now.” And from this experience, he’s observed the great interest European firms have in ESG. “Not that it’s not considered in the US but clearly, in talking with European companies, that’s one of the first questions they ask.”

Martin later returned to this matter, giving his perspective on what is undoubtedly a hot topic at the moment. “I’ve been an executive in a public company for just over one year, and I can tell you that this comes up in every single investor conference that I participate in. ESG is becoming a much, much more important part of our daily lives, and the way we think and the way we organize our business.” The products that Beacon sell, both

for waterproofing and roofing, are primarily used in restoration, which is more environmentally friendly than new construction, better for landfill and the environment in general. In addition, the chemicals in items they stock have changed, and Beacon has to be able to educate its customers on how these products now react and perform.

MAJOR CHALLENGES

Winding up the webinar, Don asked Martin what he viewed as his major challenge right now. “Finding the right labor with the skillset that we need.” He noted that Beacon has a lot of open positions at the moment, and some have been open for three to six months. What’s more, they tend to be entry-level

positions. “The reality is folks coming out of college today aren’t seeking a distribution position. No one in college is telling them about this exciting industry, the fact that it’s a significant part of the economy, and that there’s significant career growth opportunity in it.” But, he said, Beacon was trying to influence and change that.

Another challenge in general is consolidation, whether at the manufacturer level, as a distributor or at customer level. “The size of the manufacturers that we’re dealing with is only getting larger and larger and larger. And the same with our customers.”

Q&A

To bring the event to a close, questions for Martin were invited from those attending. Below is a selection of what was asked and his responses.

How do you address customization and specialization?

So I’m going to give you probably not the answer you’re expecting. We have seen customization actually go backwards in our industry. Because of the supply chain challenges that happened in 2021, customers got used to using whatever they could get their hands on. Color choice is a big deal in my industry from an esthetics standpoint. And people have had to adapt to fewer color choices to select from, because the manufacturers are not making the color choices they used to. So a manufacturer that used to have 30 colors of this one particular sealant, may now only offer eight. Or if you want a special color, there’s not only a time, a lead time, but a significant upcharge.

How do you differentiate yourself from competitors?

We look at our value proposition as three things. One, we have the most technical sales team in the industry, bar none. So if you have an application that is tricky and you talk to either our inside sales team or our outside sales team, we’re going to be able to find you an answer and the correct answer — that’s critically important. Then, you need to be able to back it up with inventory. A lot of our competition, they absolutely have access to these materials, but it’s typically in a catalog. It’s page 40 of this catalog or it’s on this part of their website, but they may not actually know about it and they may not actually have it in inventory. They have access to it. Access versus immediate availability are two very, very different things. And then the third thing is we want to be a trusted partner for our customers. So we want to be able to provide a technical resource to them, provide immediate availability of inventory to them, and we want to be a trusted partner for them.

You did a great job of building a management team for the sale of Coastal. How did you do that?

I don’t know that I can actually take credit for it. I think the founders of our business need credit for that. Our business was originally founded in 1975 and the two founders started their retirement planning in around 2009 or 2010, and they were willing to invest in two management teams. So not only were they paying themselves but they were paying me and ultimately my two other business partners. So three people took the position that two founders had. They did a really nice job of understanding the strengths and weaknesses we each brought to the business and offsetting those. The other thing they did is they created a very slow transition plan for the organization. So I would say the willingness for the first generation to invest in the talent, invest in the time, invest in the risk that comes along with letting management make some mistakes and do things on their own — it took patience, but it was the right thing to do.

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 <p>has acquired</p>  <p>M&A BUY-SIDE Logistics/Private Equity</p>	 <p>has acquired</p>  <p>M&A BUY-SIDE Logistics</p>	<p>Liegl & Dachser Kft.</p> <p>has been fully acquired by</p>  <p>M&A SELL-SIDE Logistics</p>
 <p>has been acquired by</p>  <p>M&A SELL-SIDE Business Support Services/Logistics/Private Equity</p>	 <p>has joined forces with</p>  <p>M&A SELL-SIDE Logistics/Private Equity</p>	 <p>assets have been acquired by</p>  <p>M&A SELL-SIDE Logistics/Private Equity</p>

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If mergers, acquisitions, or divestitures of businesses or business units are part of your strategy, we would welcome the opportunity to exchange ideas with you.

✉ DON WIGGINS

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Don leads Oaklins' distribution team. He is also the CEO of Heritage Capital Group, Oaklins' member firm in Jacksonville. Don has advised multiple clients in the distribution sector, including companies in storage, trucking, moving, rail services, local delivery and logistics technology. These clients have included Atlantic Quality Parts, Custom Wholesale Floors, Diabetic Supply and Medical Services Company. He has also completed significant transactions for a wide variety of companies with both strategic acquirors and private equity buyers, including Iron Mountain, Liberty Medical, HIG Capital and Pfingsten Partners.



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