Challenges Ahead for Many Distributors

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The distribution industry continues to be challenged by intense price competition and increases in commodity costs which adversely affect both gross profit margins and operating expenses. The volatility of petroleum products is particularly worrisome because of the adverse impact of increases in these products on distributors' operating costs and on consumers' disposable income to purchase the products distributed to retailers. In addition, many large retailers are disintermediating the distribution channel by buying directly from manufacturers and contracting with freight logistics companies to deliver inventory to their locations. Further complicating the picture is the expansion of regulations affecting distributors and logistics companies and the uncertainty concerning future tax and regulatory policies.

These factors coupled with the fragmented nature of the industry have led to several trends over the past four to five years that we do not see abating in the near future. The competitive nature of the industry combined with the need for increased scale and the difficulty in a weak economy of achieving organic revenue growth has resulted in an increased level of acquisition activity both by private equity and strategic corporate buyers. Distribution companies that are strategically located with scale and a diversified and unconcentrated customer base are particularly attractive acquisition candidates. Another trend that we see continuing is the aggressive pursuit by distribution companies of reductions in inefficiencies in their operations through the increased use of technology and the implementation of process improvement methodologies, with warehouse management, inventory management and route and scheduling optimization software solutions just a few of the technologies that are being used widely.

The business model of distribution companies requires that they typically carry large amounts of inventory and finance significant levels of receivables. As a result of these working capital requirements, many distributors finance their inventories and receivables, often through asset based lines of credit. Distribution companies with strong balance sheets should be able to attract favorable financing terms and covenants in today's low interest rate environment, but those that are highly leveraged with limited or no profitability will find it challenging to maintain or refinance their lines of credit due to the increased scrutiny of their lenders and the increased scrutiny of lenders by regulators.

Keiter 's partners and staff regularly consult with our distribution and logistics industry clients concerning strategic planning and business financing considerations and to discuss the impact of industry trends such as those noted above on their businesses.

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