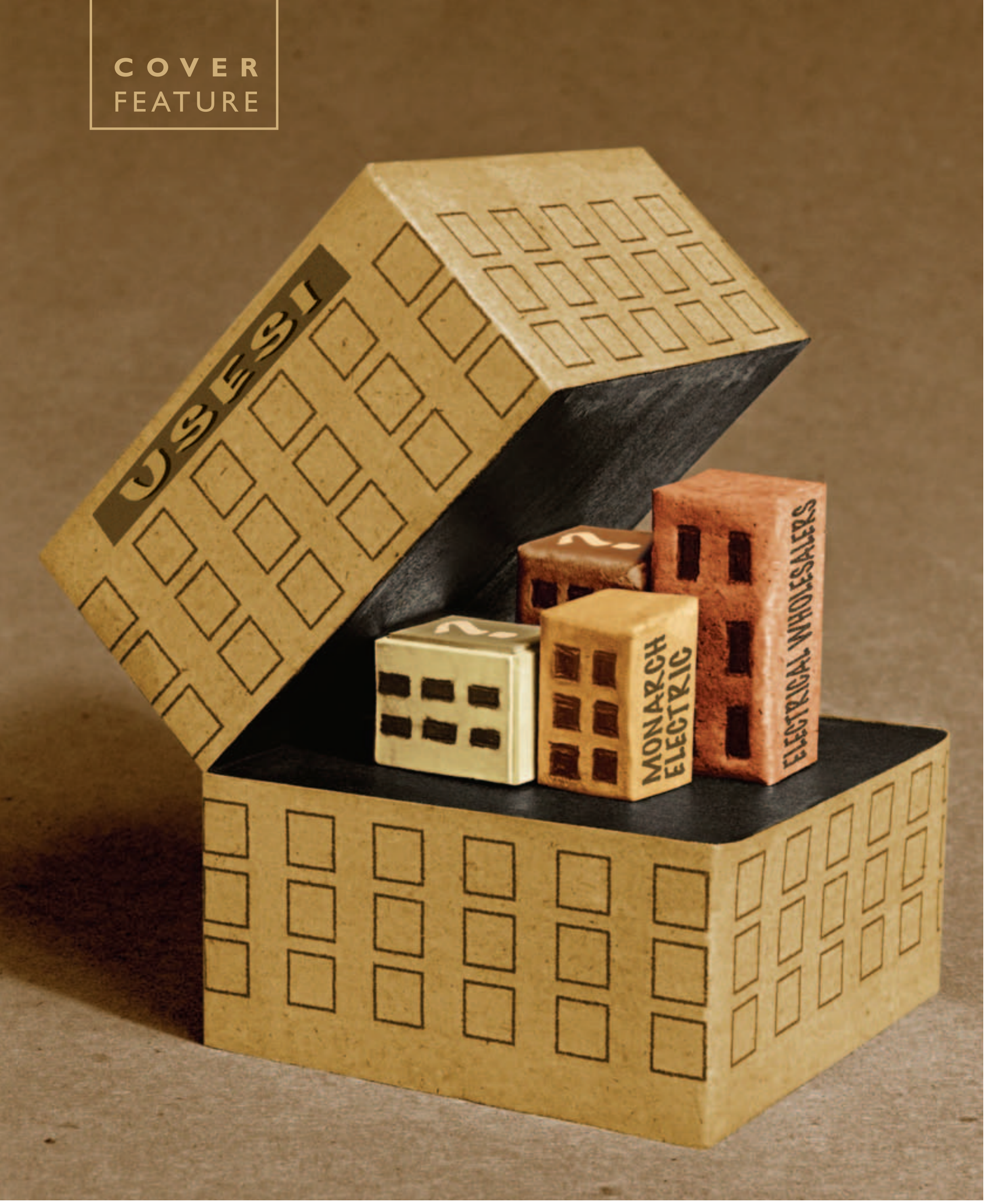
COVER FEATURE



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In the suburbs of Philadelphia, a storm of consolidation is brewing. Headed up by industry veteran Richard Worthy, USESI is positioning itself to create an acquisition vortex—one that could result in $2 billion in sales by 2011.

BY JOE SALIMANDO

DISTRIBUTION Repackaged

LOTS OF FOLKS HAVE PREDICTED A NEW ACQUISITION BOOM in the electrical distribution business—or, to say it another way, a renewal. After all, much was left unconsolidated, these experts feel, when the music stopped in 2001. The electrical industry is still fragmented, and it can't stay that way forever. Between now and forever, then, something—like a lot of acquisitions, creating much bigger companies—has got to happen.

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Few, however, would have predicted that a new name might emerge to become a major player in such a mature market. Enter U.S. Electrical Services (USESI) in Chester Springs, Pa. Founded by former Sonepar/GE executive Richard Worthy, who serves as USESI's chairman/CEO, the company is not a roll-up—it's a build-up that might well reach $500 million in annual sales within a year. By 2011, Worthy's goal is to acquire and grow USESI's annual sales rate to top $2 billion.

Dell family antes up

USESI's backers include two private equity firms: Kelso & Company and MSD Capital. While the Kelso folks have some 30 years of experience funding promising long-term investments (with demonstrated patience in watching them come to fruition), it is MSD's interest that shakes the very pillars of the electrical distribution world.

"MSD" is Michael and Susan Dell. The company is the investment arm of the man who founded Dell Computer (and his family). This is even bigger news than one might initially suspect, as Michael Dell's net worth (as estimated by *Forbes* magazine) is in the vicinity of $18 billion.

Kelso and MSD have four of the five seats on USESI's board. According to Worthy, the backers are not typical private equity (or hedge fund) investors—each has a time horizon that seriously exceeds the "typical" private equity time frame of one to three years.

That, Worthy added, was the key criterion when he began looking for backing.

How much backing is there? "We can complete any foresee-

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FOR LOVE OF the Game

With a net worth in the vicinity of $18 billion, *Forbes* magazine ranks Michael Dell as the fourth-richest guy in America. So what's he doing investing in an electrical distribution industry "build-up" company?

Explained Richard Worthy, chairman/CEO of USESI: "I don't have too much contact with Michael—he has three men who work with our company and with their other investments—but I've learned that he really does like distribution!"

As it turns out, Dell is not the only one at USESI who "likes distribution." Worthy has left the industry twice—and keeps coming back.

Richard Worthy is back in the game as the chairman/CEO of newly-founded USESI.

In his General Electric career, Worthy worked for GE Supply. He moved on to other assignments, including one job that took him to Russia for more than a year—working in GE's locomotive business.

But he came back to electrical distribution (and the United States) in 2001 when he was hired to build a presence here for Sonepar. When his initial employment contract expired in late 2004, he elected to go in another direction.

In leaving Sonepar, however, Worthy had to honor a 12-month "noncompete" clause in his contract. That took him away from the distribution business once again—and gave him time to look around. He took on some consulting work for a few manufacturers. He talked to people about jobs outside of electrical distribution. He looked into, and was made aware of, other opportunities in other fields. And he came back anyway.

What's so great about electrical distribution? "I like it. I like the customers. I like the employees. I just like the business. It's a very honest business, very straightforward," Worthy answered. "It's feasible. It's functional; it's not theoretical. After all of these years, I think I know who I am and I'm very comfortable with distribution.

"While I was looking around, I kept coming back to thinking about this business, to the opportunity we have here," he continued. "In electrical distribution, you can create a business in which if you work harder, and smarter, and faster than the next guy, you'll probably succeed. That's not necessarily the case in many of the businesses at which I looked.

"Just take one of those for example—working harder," Worthy reflected. "You have to work hard in this business. But if you're willing to work hard, though you might not become the richest guy in distribution, you can't fail.

"That makes electrical distribution a good business to be in," he said. "It gets better, of course, if you work smarter and faster, too."

Interestingly enough, this time Worthy has come back to electrical distribution with a new perspective. His enforced absence, if you will, appears to really have made the heart grow fonder.

"When you're in the midst of 'doing' electrical distribution, you can't appreciate it," Worthy noted. "You're busy making sales, or making your quarterly numbers, or whatever is involved in handling the day to day.

"But from my perspective in 2005, it just all seemed so…clean. Not only is it a great business, but it's one in which you really can control your own destiny," he concluded. —*J.S.*

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able electrical distribution industry transaction, and have the capital to build a $3 billion company if one utilizes industry standard ratios," Worthy said.

But how patient can investors like MSD and Kelso really be? Won't there be a certain amount of pressure on Worthy and the companies that USESI acquires?

While "get rich quick" sounds great, it usually doesn't work out. Some people who are in the business of using money to make more money—private equity firms—go the other way with a "get richer slowly" motto.

Kelso & Company has $2.5 billion of capital to put to work. The company has been around for more than 30 years, and can be very patient: Six- to 10-year investment horizons are not uncommon.

Such is also true, Worthy noted, of MSD Capital: It is also interested in longer-term plays. According to media reports, more than 50% of the Dell family's $18 billion net worth is not invested in Dell stock.

"By its own internal rules, Kelso can invest up to 10% of its capital in any one investment," Worthy said. "In theory, that's as much as $250 million."

And MSD Capital's potential stake? "The Dells have available many multiples of that," Worthy said.

"These investors are patient because they can be," Worthy added. "They know that distribution generates a fantastic cash-on-cash return, if you are willing to wait. The simple fact is: A leveraged transaction in our business can generate a great internal rate of return. And that's what they are looking for from USESI."

Electrical Wholesalers, Hartford, Conn., with 22 locations, and Monarch Electric, West Caldwell, N.J., with two, were the first two companies acquired by USESI. Both acquisitions were announced in May.

What USESI will become

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In a 10-day period, USESI went from just four employees (at its Chester Springs headquarters) to nearly 400 or so in Connecticut and 70 in New Jersey.

USESI's sales at this point probably exceed $200 million—and it plans to acquire at least four more companies before year's end.

If Worthy's past strategies repeat, the acquisitions will be of both first-class companies and "fixer-uppers."

USESI, according to Worthy, will not stress any specific niche—like datacomm, for example. "What we do will depend on the companies we acquire, and the regions in which they operate," Worthy explained. He also noted that the company won't implement SAP, or anything similar, and, because customers like to have a choice, brands carried will remain a local decision.

How about private labeling? "You need scale to do private labeling effectively," Worthy offered. "And the discussion of that today is all part of our industry's maturity curve. As manufacturers focused on lowering their manufacturing costs, they spent less time on marketing and new innovative products—and as a result, many products are delivering higher price points for the manufacturer or the distributor.

"If we had more emphasis on marketing, the customer would have a reason to buy one product over another. There would be higher margins for everyone. Manufacturers would seek to capitalize on product innovation, as well as constantly lowering their costs. Overall, it would be a more profitable industry," he added.

Does that mean USESI will work more with manufacturers who invest more in marketing? "As I said, it's a local decision—and we're going to work with whoever will work with and commit to us," Worthy answered. ■■■

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