DC VELOCITY

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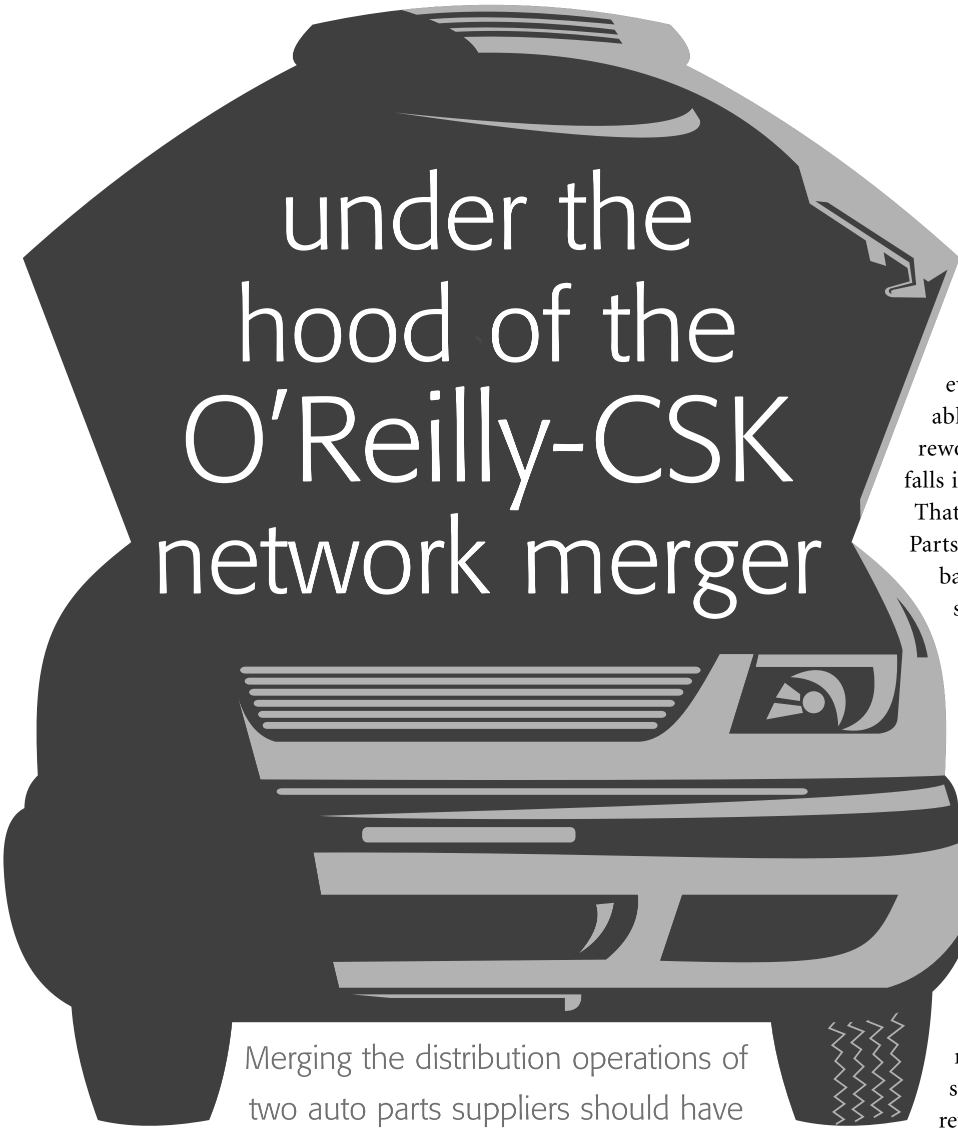
AUTOMOTIVE

vertical focus



# under the hood of the O'Reilly-CSK network merger

Merging the distribution operations of two auto parts suppliers should have been as easy as replacing a windshield wiper blade. But it turned out to be more like an engine rebuild.

CREATING ONE COMPANY FROM two after a merger or acquisition is a bit like assembling a jigsaw puzzle in which not every piece is designed to fit. Almost invariably, the companies involved end up having to rework a few of those pieces before everything falls into place.

That was certainly the case when O'Reilly Auto Parts, a large auto parts distributor and retailer based in Springfield, Mo., purchased the 1,340-store Phoenix-based CSK Automotive Inc. in July 2008. From a geographic standpoint, the CSK acquisition made eminent sense for O'Reilly—O'Reilly's stores are located mainly in the Midwest and Southeast, while CSK's are mostly in the Upper Midwest and West. But the purchase also brought with it the need to unite two disparate operations. And one of the merger's biggest challenges arose out of the fact that the two companies had very different distribution models.

Almost from its founding in 1957, O'Reilly has pursued what it terms a "dual market strategy," serving both the do-it-yourself market (customers who do their own auto repairs) and the do-it-for-me market (garages and repair shops). The two markets carry very different service expectations: While the do-it-yourselfer may be willing to wait for a part, an auto technician with a car on the lift doesn't have that luxury. He wants the part no later than tomorrow. So O'Reilly had designed its distribution network to provide daily replenishment to both its stores and professional installer customers. Among other things, that meant it had a fairly extensive DC network (the company currently operates 19 facilities in 15 states), with sites strategically located within overnight reach of customers.

By contrast, CSK had built its business around the do-it-yourself market—a model in which weekly replenishment was deemed sufficient. That was reflected in its distribution network, which included just four main DCs at the time of the acquisition—DCs that were set up to handle bulk picking, not the piece picking that typically takes place in O'Reilly's DCs.

## Tick tock!

It was a given from the start that O'Reilly would convert the CSK network over to its distribution model, rather than vice versa. The company considers its daily replenishment capabilities to be a key market differentiator. "One competitive advantage we have is the ability to provide overnight service to our stores," explains Greg Johnson, O'Reilly's senior vice president of distribution operations. "That's what we've built our reputation on. To run our fleet of 350 tractor-trailers nightly is costly, but we are confident that this more costly model continues to provide the highest level of service to both our do-it-yourself and do-it-for-me customers, and therefore continues to drive higher revenues for both our company and our shareholders."

It was also clear from the outset that the team charged with overseeing the distribution network integration would be working against the clock. O'Reilly is committed to completing the project by the end of next year, so that it can move forward with plans to expand its business in the former CSK markets. "We cannot grow the wholesale model to its fullest extent until distribution is in place," explains Johnson, a 27-year O'Reilly veteran and one of the key executives involved in the CSK integration. "We cannot go to installers and say 'We deliver once a week' and expect them to make us their primary supplier."

Adding to the challenge was the need to carry out the integration project while simultaneously overseeing a long-planned expansion. So far this year, O'Reilly has opened a new DC in Greensboro, N.C., and moved its Kansas City distribution operations into a new, larger facility. In addition, the company is on track to open 150 new stores in 2009.

## Network news

In order to meet the aggressive network integration timeline, the team began planning months before the acquisition was completed, says Johnson. The first step was to conduct an overall network evaluation to determine where the company would need to add DCs and what should be done with the existing CSK facilities. At the time of the acquisition, CSK was operating four main DCs—located in Arizona, California, Michigan, and Minnesota—plus four smaller facilities.

Based on its network review, O'Reilly decided it would need to add four more centers, to be located in Seattle, Denver, Salt Lake City, and Moreno Valley, Calif. The Seattle DC is scheduled to open in November, with all four scheduled for completion by June 2010.

That left the question of what to do with the four CSK sites. After some review, O'Reilly decided to close CSK's Minnesota facility, consolidating its operations with those of an existing O'Reilly DC in the Minneapolis/St. Paul area. O'Reilly has also decided to relocate operations at the former CSK facility in Dixon, Calif., to a larger DC in Stockton, Calif., that will give it more room for growth.

But not all of the former CSK facilities are slated for closure. O'Reilly decided to keep but remodel the Michigan and Arizona DCs, installing additional automated equipment to support the company's daily delivery model and to accommodate projected growth. The Michigan remodel was completed in April; work at the Arizona facility is under way.

In both cases, the conversions have involved upgrading the facilities' material handling systems to shift from bulk picking to piece picking. For instance, the Michigan remodeling included the addition of a three-level pick module, conveyor, automated sortation equipment, racking, seven shipping lanes, and a new returns area.

## Down to business

At the same time, planning was getting under way for the new DCs O'Reilly would open. With deadlines looming, the team got right down to business, reports John T. Giangrande, a senior account executive for Fortna Inc., the systems integrator and supply chain consulting firm that's working with O'Reilly on the DC remodeling and construction program. "We took a look at the time frames and broke those down into site selection, design, engineering, and implementation phases and go live dates," he says. "We worked through all that in the first few weeks."

Despite the time constraints, O'Reilly opted against the one-size-fits-all approach to DC design. "We cannot build 'cookie cutter' DCs because we design our DCs based on market potential," Johnson says. "The last five or six are similar, but no two are alike."

The design work has truly been a team effort, involving input from Fortna, O'Reilly, and managers from the former CSK. Larry Ellis, former senior vice president of logistics for CSK and current Western divisional vice president of distribution for O'Reilly, praises his new colleagues for their open communication. "The O'Reilly team has not only worked with us to … teach us the new systems," he says, "but they have also included the West Coast distribution team in the numerous planning meetings through each phase of the conversion."

All the planning has paid off. The project continues on schedule well into year two, putting O'Reilly in a strong position to move ahead with its expansion. When the integration is completed, O'Reilly will have a total of 23 DCs—and enough capacity to give the planning team a short breather. "Prior to the CSK acquisition, we were on pace to open a new DC about every 18 months," Johnson says. "With this plan, we will have the capacity in the distribution network to take us out for a couple of years." □

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