YOU ARE PROBABLY PAYING TOO MUCH FOR YOUR THIRD PARTY WAREHOUSING -- OR, *WHEN YOU NEGOTIATE RATES, YOU SHOULD ONLY BE NEGOTIATING YOUR 3PL PROVIDER'S PROFIT!*

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Every user of third party or contract warehousing always has some doubt in their mind that they may be paying too much for the services they are receiving. Every 3rd party provider of contract or public warehousing feels that he is giving his services away. It's almost like the relationship that exists between the car salesman and the car purchaser.

With the purchase of a new or used automobile there is the red book, the blue book, and all types of lease options for you to compare, to understand how much over invoice you are really paying. Take heart, there is also the same type of information available for negotiating your public or contract warehousing costs and many times this information can be provided by your 3rd party provider!

The Assumptions

Let's assume a hypothetical operation, with the following characteristics:

- 200,000 square feet facility
- 100% pallet in and pallet out
- all inbound and outbound via truck load, one SKU per truckload
- pallets stored four high
- building capacity 30,075 pallets
- annual throughput 500,000 pallets
- labor productivity 25 pallets per hour inbound, 25 pallets per hour outbound
- facility will operate two shifts, five days/week

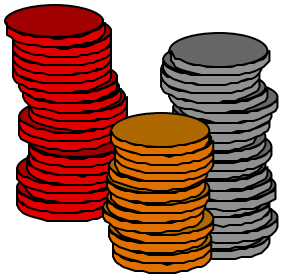
With the above information we can determine that:

- The facility will have 16.6 inventory turns
- Will require 20 warehouse operators.

Cost information for our hypothetical facility is as follows:

- Warehouse lease, one-year term, $4 per square foot NNN.
- Warehouse operating expenses, taxes, insurance etc. $1.50/square foot per year.
- Cost of leasing a fork truck $750/month.
- Fully loaded hourly cost per warehouse worker: (includes, clerical, supervision, benefits, fuel, etc.) $38.00.

At this point is it easy to determine who is a 3rd party provider and who is a user, the providers have now filled the margins with their rate calculations, while the users are continuing to read.



The Rates

The rates, without profit would be calculated as follows:

Storage total costs $5.50/sq ft or $1,100,000 per year. Calculated cost per pallet, assuming split month billing:

Recurring storage
30,075 pallets X 12 months = 360,900
Storage on Receipt
500,000 X .75% = 375,000
Total Pallet Charges = 735,900

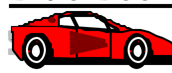
Storage Charge per pallet
$1,100,000/735,900= $1.50

Handling Total handling expenses will be 20 operators X 8 hours per day X 5 days per week X 52 weeks X $38/hour
= $1,580,800
Plus cost of leasing 11 fork trucks @ $750 per truck per month for 12 months or $99,000.

Total Handling expenses $1,679,800

Handling cost per pallet
$1,679,800/500,000 pallets = $3.35

Blue Book Information

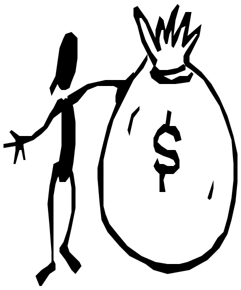


Getting information like the hypothetical cost information above is almost as easy as going to the library for a look at your blue book.

For storage charges; many times the 3rd party provider will let you actually see his lease, so you know what his actual costs are. For operating costs, your provider may also review these with you or it may be possible to estimate these from costs in a company-owned facility. Utility companies will provide their rates, so determining charges based on a company-run facility in another location is not difficult.

For labor charges, the 3rd party provider is one source. An alternative source for labor rates is to contact a provider of temporary services. Discuss temp to perm rates, where a forklift operator would be a temporary employee for 3 months and then become "your employee". Usually, as a temp the charge could be 50% higher, $22 per hour as a temp, $14.65 per hour as a full time employee. As a rule of thumb, hourly operating costs per hour including benefits, clerical, supervision, fuel, shift differential, etc. will be fairly close to 2.5 times the hourly rate. Our example above, with a total operating rate of $38 per hour, would indicate a direct labor hourly rate of $15.20.

How Much Profit?



The total revenue expected from this facility is $2,779,800 per year. If we were to agree on a 10% profit as a percentage of revenue, the profit on top of our rates would be 10%. Storage would become $1.65 per pallet and handling would become $3.68 per pallet. Seems reasonable? Maybe.

As the 3rd party provider what is really invested in this operation?

- One month's security deposit, equal to one month's rent equal to $66,666.
- One month's security deposit on fork truck equipment equal to $8,250.
- And assuming that the tenant will pay his bills after they are 30 days old, two months of receivables equal to $509,000, assuming we did provide a profit of 10% of revenue.

Therefore, the total investment by the 3rd party provider for this operation is $583,916.

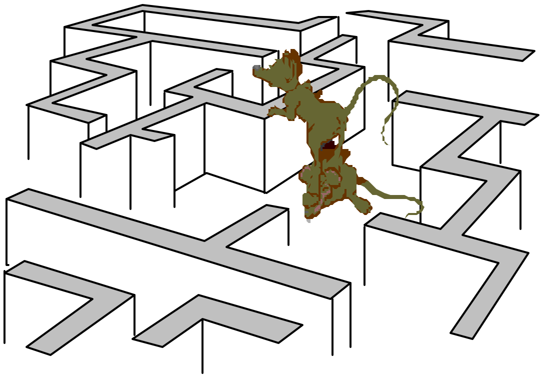
Assuming a 10% of revenue profit, our profit in this example would be $277,980. If we had "invested" $583,916 in this facility our return on capital invested would be 47.6%, not too shabby. The result is that the user of the 3rd party services is paying too much!

What is reasonable? For the past several years if you followed the DJ 500 or S & P you would have been able to earn about 25% on invested capital. In our example, this would be a profit of about $146,000; or a profit of 5.25% of total revenues. Also, as a user of 3rd party warehousing services, examine what the return on invested capital is for your business. In a true sense of partner-shipping you not want to provide a greater return for a 3rd party provider than you are generating for your own business. There is no correct

answer, just think about different points of view to be sure that you are getting the best value for your dollar.

Watch your Inventory Turns!

In our example, our average inventory was 30,075 pallets, with annual throughput of 500,000 pallets, an inventory turn of 16.6. Storage costs per pallet were $1.50, without profit. Assuming business improves so that our annual throughput becomes 600,000 pallets, an inventory turn of 19.9, and our cost per pallet for storage would become:



Don't forget to examine inventory turns and throughput <u>each time</u> you renegotiate your 3rd party warehousing rates!

Recurring storage
30,075 pallets X 12 months = 360,900
Storage on Receipt
600,000 X .75% = 450,000
Total Pallet Charges 810,900

Storage Charge per pallet
$1,100,000/810,900= $1.35

MANAGEMENT CONSULTANTS

In Conclusion:

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Howard, has extensive logistics and supply chain experience and has worked in every region of the world. Projects have involved product; warehouse and customer rationalization; warehouse construction and automation; logistical organizational studies; information systems development and implementation; and outsourcing. As Director of Transportation and Distribution for a Fortune 100 manufacturer, Howard was a major user of 3rd party warehousing. In addition, he has also been a senior executive for a 3rd party warehousing provider.

Howard is an active member of the Council of Logistics Management (CLM) and a past President of the Warehousing Education & Research Council (WERC). He is a frequent presenter at professional conferences.