Parliment Building Products, Inc.
You Can Rely On Us

THE PARLIMENT PAGES

April 2011

THE PHONES ARE AGAIN RINGING –

It sure feels good to be busy again. One of the methods for measuring our internal results has always been through the use of 12 month moving averages (12 mma). Without getting into detail, the use of 12 mma takes out seasonal fluctuations and month to month variances. When you plot a 12 mma on a graph and compare it to a regular monthly plot, real trends become more apparent. Our historical analysis has always shown that once the 12 mma has shown a consistent move of at least 4 months, it is typically a safe trend to predict forward. At Parliment we are now seeing our 14th straight 12 mma increase in sales. Additionally, the velocity or the magnitude of the change is also moving in a positive direction.

There really can be no doubt that we are headed for better times ahead.

FUNDAMENTAL CHANGE IN OUR INDUSTRY –

For many quarters now we have been talking about the consolidation that has taken place at all levels within our industry. We have continuously sounded the bells of encouragement, as this consolidation is a great opportunity for the best operators.

We have seen first hand at Parliment and with many of our customers, the benefits of this consolidation. Statistically, there is nothing to celebrate in the housing numbers. Each month just seems to get worse than the previous. And yet despite this deplorable environment, we see ourselves and many of our customers doing very well and starting to make good, and in some cases, extraordinary profits. This result can be attributed to a combination of two things – market share growth and reduced expense structures.

The reduced expense structures pretty much speak for themselves. We all know what lean operations mean. However, I do want to, once again, talk about the market share growth. Not only is gaining market share bringing in necessary revenue dollars today, but more significantly, it is having a profound and long lasting fundamental change in our industry.

Companies at all levels of the chain are still dropping like flies. Manufacturers continue to close plants, acquire weaker companies, and consolidate operations. Distributors have severely cut back in product selection, credit, and customer services. Dealers are closing and leaving the survivors with their old customers. Areas that previously had four, five or sometimes six dealers, are now finding that only one or two are left.

This vast diminishment of players is starting to result in more strategic alliances, as owners at all levels have to find better and more dependable sources of supply. While we have all spent the last several years reducing our inventories and product selection, we now must get more aggressive and do just the opposite. With fewer sources of supply, there is real opportunity for the companies that increase their product availability and selection. For many of our customers, they have the opportunity to be the only one-stop dealer for their community and possibly capture segments of their customer's buying that they never have had before.

As the number of companies in our industry continues to reduce, it should be obvious that customers are also losing their source of supply and sales contacts. It is amazing how many sales feet have been taken off the street because of various expense reductions. We have found several very good operators who recognize this opportunity and are actually beefing up their sales staffs to make sure that no orphan customers are left untouched. They are finding that it is dangerous to assume that those customers will just walk in the door. They again, must get proactive in their sales efforts.

This need to increase inventories and expand sales staffs is a fundamental shift in the philosophies that have dominated our thinking over the past 4 years. Those that have the courage to make that change will find themselves in a very favorable competitive situation able to gobble up yet more market share.

Market share growth today does not yield huge recognizable dividends. However, remember that market share becomes an exponential growth as the industry goes through its recovery. Position yourself to seize this opportunity.

PRODUCT AVAILABLITY AND PRICING –

No one is expecting housing starts to march right off the charts of growth. The overhang of foreclosures and the slow moving existing home markets are still creating incredible headwinds. However, despite those headwinds, houses are still being built. We predicted at the beginning of the year that we were likely to see a 10% increase in residential spending. So far, that prediction is looking pretty good. While it is too early and there are too many unknown variables to accurately look at 2012, we do see another increase. We think it will be substantially greater than 2011 with an outside possibility of about a 30% growth. Now don't go getting all that excited, as you must remember that we are starting from a historically low base. Percentage growth is a lot easier when you start so close to the bottom. But, a 30% growth is a significant increase from our present revenues.

Whatever the growth rate, a greatly reduced distribution chain will be needed to handle this increase. While there are still lots of capacity at the distributor and dealer levels, there is not much capacity left any longer in the manufacturing sectors. Too many plants have been shuttered. Manufacturing has scaled back to today's levels with little room for expansion. As the market expands, this will likely lead to some pretty big product shortages. Reopening manufacturing facilities is not an easy process. Permitting and getting code approvals on old facilities will be difficult at best and impossible in many cases. Hiring and training a snake-bit group of workers who have moved into other industries will also provide challenges. The end result of this will be bare shelves at a time when everyone needs to capitalize on this narrow window of opportunity.

Relationships up and down the distribution chain will become increasingly important. The loyalties established now in the down market will pay off handsomely when these shortages occur. As these shortages begin to appear, you will also see the market driven forces start to move prices upward. Manufacturers have had to absorb numerous cost increases without the ability to pass those increases on. Manufacturing margins are historically low and it will not take too much to convince those guys to start increasing their prices. As soon as the first shortages appear, you can bet you will see price increases. Furthermore, there are already considerable inflationary pressures on many of the base commodities that are integral to the manufacturing process. As this inflation continues to increase, prices will naturally increase. How soon will this happen? We have already seen a couple of trial balloons floated. Some have stuck and others have not. However, we believe that certain products will begin to see increases that will hold happening in the next couple of quarters. We believe we will see a broad based increase throughout 2012 and beyond.

APRIL FOOLS DAY –

As I go through all of my notes in preparation for writing this newsletter, I am again reminded how we must suffer the fools. Maybe Washington's foolery was bad before, but it was not as threatening as it has now become. Read on to see more of what the fools running our country are doing.

QUOTE OF THE MONTH –

Before I shock you with an unbelievable statement, let's quickly ground ourselves with a basic understanding. This country, as a sovereign entity, and its populace has created a grievous situation through the accumulation of debt. Individually, we have taken on more debt obligations than ever dreamed possible. Home values are underwater because of greedy decisions, out of control credit card debt, and our country has a virtual non-existent savings rate. As the population starts to reign in this awful combination of consumption through debt, the national and local governments are taking over in the accumulation of debt department. Recently, the current federal administration took on more debt in a single month than 40 years of administrations before them. How can these "intelligent" people do such things?

Well, here comes the quote of all quotes. Joe Biden, the Vice President of the United States of America, issued this statement. It is scary, but this is his position. "Pretty soon, if the Republicans and Conservatives have their way, only people who can afford a house will be able to buy one." What kind of insanity rules Washington that our leaders can utter such fantastic statements?

DEATH BY FIRING SQUAD, HANGING OR BEHEADING? –

The leaders at the Federal Reserve are faced with a few decisions. All of the decisions will most likely lead to the death penalty with the only question being which method of execution is preferred. The final and most damning evidence soon to be introduced will be the direction of the interest rates. The choices for the Fed are clear. Keep rates low or let them rise. Neither option will ensure survivability.

3031 Westside Blvd. Jacksonville, Fl 32209
Ph# 904-387-8444 Toll Free – 866-387-7601 fax 904-387-8465
www.parlimentbuildingproducts.com

For the past several quarters the Federal Reserve has been purchasing Treasury Bonds at auction. Remember that the Treasury Department issues these bonds to pay the overdraft it is accumulating at the rate of $1.5 trillion per year. By purchasing these bonds, the Fed becomes a willing buyer at a well below market value interest rate. They will buy the bonds at whatever discretionary rate the Treasury decides to put on them.

You may remember from our last newsletter that the Fed doesn't really care to make money and in fact, will return the bonds to the Treasury at a later date without even asking for payment. This transaction results in a totally artificial market where rates are not driven by supply and demand but instead are set at a predetermined and artificial rate.

The downside to this action will ultimately be two fold – hyperinflation and the devaluation of the dollar on the foreign markets. Fortunately, the deplorable state of many of the other leading world currencies has delayed an absolute crash of the dollar for the time being. Because of this, the Fed has remained fairly safe in their assumption that by buying these bonds and injecting this vast amount of artificial stimulus would not crash the dollar. However, recently there are signs that the dike may be cracking as the dollar is starting to lose its position in many different areas. There is a more determined cry for an international currency. The dollar is no longer the exchange traded settlement instrument in many of the mega international transactions. Investors are starting to leave the dollar in favor of commodities and even the stock market. Foreign national banks are reducing the dollar holdings in their reserve accounts and are switching to other baskets of currency.

These are the preliminary signs that the dollar could be facing severe valuation issues in the not to distant future. If the dollar crashes or even loses some valuation, the result will be inflation in many of our products. Since so much of our consumption comes from overseas, those products will begin to price higher and start to drive a cost driven inflationary spiral. And unlike inflation caused by internal valuations, there will be no corresponding increases in wages to counter the higher expenses. This will further result in a continual erosion of the standard of living as costs for necessities increase without pay raises to pay for it.

The question for the Fed, which must be answered by sometime this early summer, is do they continue to buy the bonds or not? If they do, the dollar is most certainly likely to crash and inflation will begin to accelerate to a possibly unhealthy level.

So, let's assume they decide to choose that form of death, pull out of the market, and let the natural market forces price the value of the bonds. With deficits of over $1 trillion as far as the eye can see, there is no doubt in the international community that the United States does not have its fiscal policy under control. Ask yourself this very simple question. If you had an opportunity to invest in a company that was spending 50% more than its revenues, what kind of return would you demand? I doubt you would settle for 2% or 3% interest. I think you would first ask yourself whether this is even a safe investment in the first place and then if for some reason you believe it is safe, you will price in a high risk factor. Could rates hit 10% or even higher?

As soon as these Treasury bonds are put on the open market, you can bet interest rates will rise. We are already being given hints that this might be the policy decision in June. High rates will have two particularly devastating impacts. All cost of borrowing will move quickly upward. For a housing market that is already on life support, this will be a big step in the wrong direction. It will result in more financial institutions failing, as their customers can no longer meet the new interest rate expense. As they fail, they will again tighten the noose on further lending making it not only much more expensive, but equally difficult to get. This will hurt the economic recovery that is starting to gain some momentum.

Additionally, the increase in interest rates will further add to the federal deficit. Right now about 12% of our national budget goes to paying the cost on the debt. If interest rates double, triple or even go higher, it will further exacerbate the deficit and cause an upward spiral as a larger deficit begets higher interest rates, which further begets yet a higher deficit and on and on.

<u>PRETTY BLEAK – HUH? –</u>

While the death sentence seems certain, the appeals process will take years. At present, I can see no other outcome other than what was previously set forth. However, the good news, and it is very good news, is that this unwinding may take years. And during that time, something miraculous could happen. This country has a history of resourcefulness and if we make some radical changes in our political behavior, we are a large enough economy that we may be able to pull our way out. The question remains, how much political courage do our leaders have to do the right thing to avoid economic disaster? We are truly sitting squarely on the fence. Will we fall off and become economically inferior, or will we understand fiscal responsibility and once again insure our prominence in the world's financial community? Our hopes and bets are on the former.

SHORT-TERM –

With this heavy threat hanging over us, we must keep our heads up and focus on the short-term. For the next couple of years there will be some great opportunities to make hay and get it in storage for the future. There is little doubt that we are seeing signs of an economic recovery, albeit a rather anemic one at best. While the recovery itself will not be strong enough to produce significant profits, the recovery combined with the continued consolidation will present marvelous opportunities for growth and unheralded profits. The time has come to quit worrying about Washington and instead, focus on the day-to-day job of making money in our businesses.

THE ABSURDITY OF THE NUMBERS –

Business owners require good financial information to make intelligent decisions. Some of that information comes internally from our accounting processes or from our sales force. Some comes from industry experts and trade publications. Much comes from the "official" government releases that are supposed to give us an understanding of the macro environment under which we operate.

Evidence is starting to suggest that either the government is intentionally misleading us or they are the most incompetent financial managers to ever have walked. Take these following examples:

1. At the beginning of the recession, it was announced that it would take the creation of 200,000 new jobs per month to lower the unemployment rate one tenth of a percentage point. At that rate it would take 8 years to get the rate down to pre-recession levels. Since that announcement, we have had monthly job creation numbers averaging just a little over 40,000 per month and yet unemployment has magically fallen by over a full point. The explanation is buried in how new jobs are measured and how people actually not working may not be included in the unemployed numbers and a bunch of other gobble de goop.

2. Inflation is reported at under 3%. Gasoline is up over 50%, corn is up 34%, wheat is up 59%, and cotton is up over 70%. What kind of crazy formula does the government continue to insist on using when they produce such absurdity in their calculations? Go to the local grocery store or look at your last purchase of rebar and say with a straight face that inflation is under 3%.

3. Remember the government announced that the recession had ended over 2 years ago?

4. Manufacturing has left the country. That is a well-known phrase echoed continually out of Washington. The fact is, that manufacturing as a percentage of our economy is basically where it has been for the past 50 years. What has happened is the number of manufacturing employees has been reduced. That, my friends, comes from the efficient use of technology and innovation. That is not a bad thing.

5. The Federal Reserve will one minute issue a policy (QE 2) to prevent deflation. A scant 4 months later, they are talking about reversing that policy because they are afraid of inflation.

6. Health care reform was going to cut the deficit by $1 trillion. Now the accounting guys are saying that is not quite true. In fact it is totally unknown how much it will ADD to the deficit.

7. When the leaders talk about government spending cuts, they take the current cut and multiply it by 10 years and then publicize that number as the budget reduction.

8. The very method used to calculate inflation excludes food and energy costs and grossly overinflates the cost of housing.

I could go on for pages with other examples out of Washington. However, the bottom line is becoming increasingly clear. The government is in the job of manipulation of data. This type of widespread manipulation in the private sector would lead to quick failure.

Remember, the problem is not with our idiot leaders. The problem is with the idiots that continually elect those leaders.

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