THE PARLIMENT PAGES

APRIL, 2013

IT'S A GRAND SLAM HOME RUN –

As the opening days of baseball are upon us, we are beginning to see something in this season other than strikeouts. In fact, the bases are loaded and we have our power slugger at bat. On first base, we have low interest rates. On second, we have housing affordability and on third sits pent-up demand. The batter is equipped with the lowest inventory of new homes in years. This is the scenario that we have been waiting for. Let's address each of these.

LOW INTEREST RATES –

Even though there has been a recent uptick in mortgage rates, they are still at historic lows. The recent increase is not substantial nor is it expected to continue its upward march. In fact, most predict that we will maintain long-term rates in the present range for at least another two years. In addition, it looks like credit terms are beginning the slow process of loosening up and it is no longer necessary to have the last name of Rockefeller to qualify.

These abnormal interest rates are not the result of a free market economy. Instead they come directly from the Government's efforts to artificially suppress long-term rates. Let's do a quick review to see how this can take place.

The U.S. Treasury is presently running record deficits. In fact, for every dollar that the Government spends, it must borrow about 50 cents. That is truly a level of uncontrolled spending that we will deal with later. The issue as it relates to interest rates is how the U.S. Treasury borrows the money they need every month. This is where the Federal Reserve Bank (the Fed) comes in. Each month, the Treasury will put out for auction various Treasury bills and bonds. Purchasers of these bills and bonds give the Treasury cash in exchange. Some of these buyers are foreign governments who view a U.S. T-Bill as a better investment than the Euro or the Yen or some other currency. Some will be the large institutional banks who are looking for places to park the large sums of cash they have on their balance sheets. A few individuals will step up and also make purchases. However, the vast majority of bills and bonds are sold to the Federal Reserve Bank. There just are not enough buyers other than the Fed to purchase the bonds and bills in the required amount.

In fact, the Fed is presently purchasing almost $100 billion per month while the other sources are purchasing just a fraction of that. Why does this imbalance exist? Quite simply, the interest rates are not high enough to attract foreign governments, banks and private investors. In order for them to step up and buy more, interest rates would have to increase dramatically. However, if interest rates were to increase dramatically, our economy would be devastated. The U.S. Treasury is presently spending over $300 billion in interest expense at today's incredibly low rates. Market interest rates, while attracting more investors, would have a substantial impact on the Government's deficit thus causing more borrowing which in turn would cause even more interest expense. A vicious circle that would ultimately result in the demise of the economy.

In comes the Fed to the rescue. They have basically taken the position that any debt that can't be covered by other investors, they will cover. They have the power to do so because they can literally create money out of thin air to buy those bills and bonds. In doing so, they are able to avoid market conditions and artificially set rates at whatever they want. Knowing that low rates help the deficit and help spur borrowing, they have every incentive to peg that rate low.

That incentive is not likely to change anytime in the near future, so we can come to enjoy these artificially low rates for a long time. Low rates and decreased credit scrutiny is a great thing for the housing industry.

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AFFORDABILITY –

There are a number of factors contributing to the high level of affordability in housing. Interest rates are the obvious one. However, we are also at a point where materials and subcontract labor are also low. Materials account for about 13% of the total cost of a house. The lack of demand plus the relative insignificance of this to the total has kept prices from rising. However, the largest factor is the cost of subcontract labor which is, by far, the largest component of the cost of housing. Wage increases are stagnant as unemployment and underemployment are still the prevalent conditions. In addition, contractor profit percentages remain low. All of this contributes to a low square foot cost and a much higher affordability index.

PENT-UP DEMAND –

We have believed for years that the true absorption rate of new homes was somewhere between 1.4 and 1.5 million homes per year. During the bubble years, we approached 2.2 million new homes with the resulting crash that followed. This construction bubble created an excess inventory of almost a million homes. Foreclosures and short sales have also contributed resulting in an excess of close to 2 million. Those excesses had to be absorbed before new construction could make sense. Do the math. We have gone the last four years averaging around 400,000 new home starts per year which meant that about 1 million were absorbed by the bubble construction and foreclosures. While there are still a lot of foreclosures out there, the numbers have diminished and we are approaching a point of equilibrium where new construction will need to be current with 1.4 -1.5 million absorption rate. As this point gets closer, we will continue to experience an increase in housing starts.

You may recall that we predicted that starts would increase 28% per year for the next 3 years. We also said that would put us in the range of 700,000 starts in 2013 up from the 500,000 in 2012. While it is too early in the year to proclaim victory, all preliminary indicators point to starts of at least 700,000 in 2013. The pent-up demand that we have been waiting for has now appeared.

LOW INVENTORIES –

The current low inventory of new homes is due to a multitude of factors. The most basic is an increase in the value of our homes. While it is not a perfect curve, all indicators are now pointing to a modest increase in value of residential real estate. While that is good news for the homeowner, it is spectacular news for the home builder. Once the public begins to believe that the bottom in prices has passed, they come off the sidelines and start buying. As the number of buyers in the market increases, prices stabilize even further and begin a sustainable upward path. This begins a seller's cycle which will ultimately reduce inventories and further drive up prices.

Riding on the coat tails of the existing home market are new home builders. They march in lockstep with one another. New home inventories presently rest at less than a 4 month supply. While this is understandably better than the 11 months of 2009, it becomes even more impressive when you analyze the trends. Those trends indicate that the demand for new homes will rise faster than the construction. In all likelihood, that inventory number will not come down until the home builders can gear back up to meet the increasing demand.

WHAT IS BEING SAID –

At Parliment, we are continually in conversation with customers who cover a wide range of our industry. We talk with business owners from building supply businesses to concrete yards to specialty distributors. We cover a big chunk of the Southeast United States. And we are in a relationship where many owners will confide in us. A few months ago, many of these owners were whispering that they actually saw some improvement. They were hesitant to speak loudly because they were not certain it was going to last. Recently, we have sat at tables where owners from all disciplines are having upbeat conversations. There is almost a universal feeling that things are finally improving.

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THE GOOD COMES WITH SOME BAD –

We know we have discussed this next subject before, but we feel the consequences are so imminent that we should re-address it. We are in an industry that has a long chain of supply. It is not untypical to have steps that go from raw material source to manufacturer to importer or jobber to distributor to dealer to builder to buyer. This long supply chain can break down quite easily and even in the best of circumstances is inadequate in reacting to sudden changes.

The sudden crash of the market stung people all along this supply chain. While most everyone lost money during this correction, the biggest losers were those with the highest capital investments. These would primarily be the manufacturers who had tens of millions of dollars invested in expensive plants and equipment. When they went down, they went down hard and left a lot of scarred memories. Over a three year period an unimaginable number of facilities were shut down. The equipment in older plants was scrapped and in some cases the buildings themselves were torn down. Billions of dollars were written off. However, even worse were the resulting layoffs of the skilled workers who knew how to efficiently make their product.

Now, along come the signs of economic recovery. Orders begin to increase but the manufacturers are finding it difficult to fill them because they had "right sized" their operation to the economies of 2007 – 2012. The first thing they will do is sit and wait to see if this is a false positive or if it looks like the recovery will have legs. They will be cautious and cynical because there is still so much bad news permeating the national and world economic headlines.

Finally at some point, they will say it is time to expand. They must raise money, design new facilities, unshutter old plants, get all of the necessary permits, secure sources of raw material supply and then buy equipment. They must contract for the work and then begin to hire and train new employees. Use your imagination. Can you really see all of this taking place in less than a year?

So, during that year orders start to come in at increasing amounts. If they match our predictions they will increase something on the order of 30%. The capacity just will not be there anytime soon. The result will be product shortages and the potential for price increases. We have begun to see some early warning signs of this already.

To protect yourself from being left "out in the cold" without a source of supply, we recommend that you work closely on securing your "upstream" position in the supply chain. If you are a builder, make certain you have a strong relationship with your dealer. If you are a dealer, you will want to show loyalty to your distributor. And if you are a distributor, jobber or importer insure that you have the inventories that you will require.

In times of shortages, there is nothing that will lose a customer faster than not being able to supply him the products he needs, when he needs them.

WHAT IS A SELLING ORGANIZATION? –

As the business world continues to evolve, we have strengthened our belief that successful businesses in the future must have a focus on sales. The perception of product and service differentiation is becoming smaller and smaller. Everyone makes the same promises and to some extent they even deliver. However, nothing replaces an organization that can clearly articulate the benefits of doing business with you and deliver on its promise. We are asked quite often to define a sales organization. We believe it begins with superb sales management. And it ends when sales management fails. On the whole there are far more poor sales managers than good. That is not to take away from those that are fulfilling that demanding and difficult role. The failure is typically caused by a lack of knowledge and training when it comes to sales management. We have found that if you have a room of 100 business owners and ask each of them to describe sales management; you would get 100 different answers. It is no wonder. Most sales managers ended up in their position as a result of they, themselves, being good sales people. Once they landed the new role, they were

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given exactly zero training on what it takes to be a good sales manager. Even sales managers have a difficult time describing their job. The American Society of Training and Development released a survey that showed the average sales person was given $5,000 per year in some type of sales training. This could be product, skills or self-management training. The average number spent on a sales manager - $300. I am going to guess that most of that $300 was spent on books that were thrown on the sales manager desk by the owner.

If you want to truly build a sales organization, you must first ask how you are training your sales manager.

WHAT GOOD IS A MANAGER WITH NO PEOPLE? –

Rest assured. For the first time in several years, we are categorically predicting a steady rise in our industry. To survive the downturn, many companies were forced to severely cut back staffing levels. Unfortunately too many of those cutbacks were with sales staffs. Your sales staff is your most critical need as business rebounds. The opportunities that arise out of this upcoming growth will be realized by those with the most and best "feet on the street." Recruit, poach, steal or do whatever is necessary to get good people representing your company. You may be a month or two early, but it is better to be early and be in a position to capture market share rather than be late when someone else has done it ahead of you.

SUCCESSION PLANNING –

The average age in this country of the entrepreneurial business owner is 59. At that same time as our company ownerships have aged, statistically there are fewer next generation "kids" stepping up with an interest in the parent's business. This is creating a monstrous problem in many industries, ours included. With space growing short in this issue, we are going to table further discussion on this until next quarter. In that issue we talk about how to develop a succession plan that will work for everyone involved. Stay tuned.

ON THE HORIZON –

We are certain that most of you have followed to some extent the surplus of natural gas and the impact that could have on our economic future. One of the consequences of this will be a move towards natural gas fueled trucks. The cost of fuel is a significant P/L item in our industry and natural gas could be a major boost to many of our bottom lines. Proper fueling stations do not presently exist and the entry cost into natural gas engines is still prohibitively high. However, when you consider $1.50 per gallon savings as compared to diesel. Also, you will realize 30% - 40% better fuel efficiency. It is a cleaner burning fuel as compared to diesel fuel. These advantages will cause the market to accelerate at a faster pace. We will watch this carefully and will keep you posted.

NEW PRODUCTS –

Since our last Newsletter we have added 46 SKU's to our inventory. We now have 3218 SKU's in our warehouse. We have added more SKU's to our Column and Post Line and our Prosoco Line. We also, now stock 3/8" Yellow Zinc Threaded Rod.

We are pleased to announce we now stock the Robetex Line of Roof Underlayment. They also do a great job on Private Label House Wrap. Please talk to your salesman for all the details of our new product offerings.

THE BLAST –

The purpose of this newsletter is to address issues that are specific to the building supply industry. The purpose of "The Blast" is to address many other factors such as economic and geopolitical issues. If you would like a free subscription to this monthly publication, simply send me an email at jbleech@no-excuses.com