Parliment Building Products, Inc.
You Can Rely On Us

THE PARLIMENT PAGES

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<u>What Up, How goes it, What's happening, How is it hanging, How are we doing?</u>

No matter how you ask it, the question is always the same, "Where is our industry headed?" We gave a preview of our predictions last quarter, and it turns out that *<u>those previews were pretty much on target with what we see now.</u>*

USA Today, one of the great journalistic pieces of all time, reported that *<u>new home sales were up in December for the 3rd month in a row</u>*. These sales were spurred on by builder incentives and the buying public finally realizing that this was the time to get serious. This is right on track with what we said last quarter. The press has gradually shifted away from the doom and gloom and is now talking about housing getting back to normal. *<u>Inventories are beginning to be absorbed</u>*. How much more inventory is out there? There is some question on that because there are still a lot of unfinished units and the real speculator impact is still not definitively determined. However, the conclusions are that the *<u>inventory hangover isn't nearly as bad as once predicted</u>*.

We believe, as stated earlier, that enough inventory absorption will have taken place by mid 2nd quarter to cause construction starts to finally begin the road to a sustainable pace. It will not be like a faucet turned on full force but rather a gradual increase in flow. *<u>This increase will become apparent to you by April and you will begin "to feel comforted" by May or June.</u>* From that point it will escalate over the balance of 2007 until such time as we hit the sustainable rate of growth. And that sustainable rate of growth will be activity levels consistent with 2004.

How certain are we of this prediction? This is not crystal ball gazing. Let's look at the facts behind this forecast. *<u>As we have stated in many issues, housing is driven by 5 fundamentals and influenced by perhaps a couple more</u>*. The 5 fundamentals are:

1. Job growth (Job growth today is at the highest level in 15 years)
2. Population growth (North, West and Central Florida and South Georgia continue to be in the top 5 hottest growth areas in the country)
3. Interest rates (Mortgage rates today are lower than they were 12 months ago with no foreseeable major increases in sight)
4. Foreign investment in real estate (Florida continues to lead the country in foreign buyers. The continual threat of weakness in the dollar and the overall low pricing of Florida real estate drive this demand.)
5. Population demographics (The largest real estate bucks are spent by those 45 – 54 years of age. For the next 17 years, it is predicted that Florida and South Georgia will lead the country in the growth of that population demographic.

Pick it apart, analyze it, hang it upside down. There can be no doubting that *<u>these fundamentals are still strong and have no apparent threat to them in the foreseeable future.</u>*

While these fundamentals absolutely determine the direction of housing, the speed of the journey is influenced by a couple of other fundamentals. These would be the overall macro economic conditions and the house buying consumer sentiment. No matter how strong the fundamentals, these two factors can slow down a recovery. Mind you, they may slow things down, but they will not take units out of the mix. In other words, housing may slow, but units backlogged during the slowdown will be built at a future date.

There is no doubt, these two factors have had an impact on the fundamentals. The overall economy presented, what appeared to be, an ideal investment opportunity for speculators. Hence, the overbuilding to meet speculator needs. This economic reaction goosed up production beyond sustainable levels. And then, all of a sudden, consumer sentiment entered the picture. Consumer sentiment is responsible for the homebuyers putting on the brakes and disappearing from the market for the past 4 or 5 months.

Well, these influencers are moving into the shadows. The speculators are gone for a long time and the *real homebuyers are starting to come out of the trenches and are signing contracts once again.*

So again, this is not tarot card reading, it is the *proven belief that fundamentals will ultimately always rule.* Keep your eye on those fundamentals. If they continue strong, you can predict the future.

Why 2004 Construction Levels?

If you look at historic levels of housing starts, you can find a very *discernable relative pattern between starts and population growth.* That really makes a lot of sense because houses are usually only bought by primary or secondary homeowners. Secondary home ownership, as a percentage of population, remains very constant. Primary home ownership has remained about the same relative percentage of the population for over 40 years. *Therefore, population growth (see fundamental above) will almost always dictate the amount of housing demand.* That was skewed in 2005 and 2006 by the large number of speculators in the market. With them gone, it is easy to take the population growth and apply it to a baseline of 2003. Doing this math will yield a housing start number in the range of actual starts in 2004. Adjust that year to year for population growth and you now have what is termed the *"sustainable level of housing demand."*

Nationally this sustainable growth number will be about 5% per year. The question is whether our region will be above or below this national average. I think most people would agree that our region will probably beat this national average.

Conclusion – *we will resume our housing start rate at the 2004 levels and those levels will increase between 6% - 8% per year in the future.* Again, this is not crystal ball gazing but is really a prediction based upon solid economic and demographic facts.

Other Industry Trends

Our readers always look to us to get an idea on product pricing. We have been quiet on this subject for the past few quarters because there was not much to talk about. We were in the midst of a market torn by a slow down in the housing industry and yet propped up by the sudden surge in commercial construction. The net of these two factors have helped keep prices fairly stabilized. Looking to the future, we don't see this stabilization going away anytime soon. There may be some isolated and temporary price increases or decreases from time to time, but *you can basically count on a stable pricing market through 2007.* Supply and demand seem to have reached an equilibrium with enough excess production capacity available to cover the increase in residential activity.

What Should Be Your Strategic Focus Going Forward?

The volumes and profits from 2005 spoiled most of us. And like most spoiled children, we have a tough time dealing with anything less than that, even though a repeat of 2004 would be a banner year for most of us. So the question becomes, "*how do we do better than 2004 levels*?"

There are two areas that we would suggest you focus on - selling additional products to your customers and better inventory management.

Inventory Management

Most of our customer base is either lumber dealers or redi-mix yards. We are impressed with the level of employee knowledge we see on your primary products. You have proven that with your primary products, you have the systems and processes necessary to control purchases, inventory levels, pricing and promotions. *What we don't see, however, is that same level of sophistication on your other products.*

In the past, you may not have felt the need for concern. After all, sales were rising faster than ever, profits were extraordinary and your customers were just happy to have product almost on time. That was then. The future is going to require a different strategy. *Rising sales, especially rapid rises, will hide all sorts of basic problems within a company*. Rising sales forces us to focus on reactionary, get it done work. The result is that for many of us, those extra profit opportunities were not addressed because we either didn't have the time or the need for it.

Before we get cranking again, we would like to recommend that you address some of these issues now. You can now *turn your focus away from the reactionary mode and shift to a more strategic mode concentrating on fixing some of these issues in your company*.

Several years ago, we developed a report that we call "turn and earn." It is simply the gross profit % on a product, multiplied by the inventory turn on that product. So a product that earns an average of 25% gross margin and turns 4 times per year would earn a factor of 100. A product that earns 30% and turns 6 times per year would be 180. If you rank your products using this formula, *you can see the relative value of your inventory*.

Once ranked, you can determine products that need to be examined. Is it a product that needs to be liquidated and not restocked? Is it a product that needs to be redisplayed or marketed, or a product that needs to be substituted by another? Are there products that you could add that will yield a higher turn and earn factor?

We have inventory specialists on our staff and they would welcome the opportunity to look at your inventory and see if there are some suggestions that could lead to future profits or reduced inventory cost. Either give us a call or let your sales person know you would like to have more information on inventory management.

Product Diversification

When all of the debits and credits are finished flowing through our books, Parliment will end the year with revenues slightly above 2005. Many have asked how we can maintain revenue growth despite a market that is clearly off 40% from the previous year. Several years ago, we recognized the need to place a huge strategic effort on finding, stocking and selling additional products other than our core. We have been relentless in that effort and the results are apparent in our current revenue structure. *Our product diversification is the primary reason we were able to keep our revenues growing.*

There are 3 legs to this strategy: selection of the right products; marketing and promoting; and direct selling.

The first step in selection is a thorough understanding of the market place. We have a simple form that we have completed on most of our customers. We call the form, "Buys From Us, Buys From Others." We have listed all of our main product categories and have identified with each customer which of these categories are purchased from us and which are bought from a competitor. When a competitor has that product, we then try to understand why we are not making the sale.

The end results of these forms are very valuable, however the most useful piece is the discipline that the sales people go through in finding the answers. Once this is complete, we then try to find the holes in the market that need to be filled. When selecting new products, we use a process that evaluates the following:

- Is there a change in the market or building codes calling for this product
- Can this product save customer's labor dollars
- What is the expected volume as well as the earn and turn factor
- How well recognized is the brand
- What training and marketing support are available
- What products compete and how is this product differentiated
- Can this product lead to other sales

Don't make a decision until you have your arms around each of these questions.

One of the more difficult areas is the marketing and promotion of the product. Questions you may need to ask here would be:

- Where can I display the product to give it maximum exposure
- How can I develop demand for the product from my customer base
- What promotions can I put in place to stimulate buying activity
- How can I arrange training and gather product support knowledge

However, even if you successfully the product selection and the marketing, *the biggest piece will always be, "how can I get my salespeople to sell it?"* That doesn't sound like it should be difficult, but we have struggled ourselves for 4 years on this issue. The light bulb went off for us a couple of years ago when we attended a seminar on new product introduction. The seminar was standing room only evidencing the fact that there are a lot of people feeling the same frustration when it comes to introduction of new products. The common complaint seemed to always circle back around to "*how do you motivate salespeople to sell new products?"* It seems sales leaders have used both the carrot and stick approach with limited success. We listened to tales of incentive plans, bonuses, prizes, whacks on the side of the head and even some threats of cattle prods. After allowing the room to vent their frustration, the seminar leader then explained a very basic fact. He claims, with clear substantiation, that only *16% of the sales people will aggressively sell new products.* No matter which carrot or which stick you use, those 16% are the only ones who will be successful with new products. The others just plain will not sell them until such time as "they no longer are new products."

The suggestion, which we have since followed, is to identify who on your sales staff will fit into that 16% category. Once identified, *realign your sales organization so that person(s) is tasked with the introduction and sale of new products*. We started this process several months ago and it is now hitting on all cylinders. I have seen this concept work in almost any industry and produce astonishing results.

In short, your best opportunity for revenue growth will almost always be with your existing customer base. These are the people that know you, trust you and have a history with you. *Most of them would welcome the opportunity to buy more from you*. Take advantage of that and you will find that those 2004 levels will not be bad.