Parliment Building Products, Inc.
You Can Rely On Us

THE PARLIMENT PAGES

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OUR ANNUAL PREDICTIONS –

Instead of just throwing out the predictions, I think a little drum roll and introduction is called for. I want everyone to have a good understanding of the "why" of our predictions instead of just the "whats." So hold on and read a few pages, the predictions are in this issue someplace.

THE IMPORTANCE OF FUNDAMENTALS –

As I get older, I get closer to understanding some of what I learned 40 years ago in my college economics classes. For those of you who can remember those boring sessions, the thing that always seems to stick out as the most prominent was the mundane theory that so permeated the discussions. Upon graduation, nothing in the real world seemed to come close to the economic discussions we had in those overheated and uncomfortable classrooms. Finally 40 years later, I am able to look back at our economy from the days of Nixon and Carter through the reign of Reagan and to the modern day experiment by Obama. As I look back at this relatively long period in our economic history, I begin to see the theory that was drummed into our heads. Those theories were called Economics 101, 102 and Advanced Economic Studies. (I think I got "Cs" in all of them.)

Today, I call those theories the "fundamentals" and the older I get the more I realize the importance of fundamentals in everything from economics to business success and even to raising a family. And it is these fundamentals that have given me the confidence to look into the future for our predictions for 2010 and beyond.

THE FUNDAMENTAL OF SPENDING –

A basic fundamental that was not taught us very well in our childhood is that you can't spend more than you make. The failure of learning this lesson has caused us to spend willy-nilly on whatever we wanted as long as we could get the credit and sometimes make the payments. Instead of using the simple rule of not spending more than you make, we, as a society instead said, "Spend however much someone will lend to you." That mentality of massive credit expansion led to the near collapse of the western banking world. After 40 years of pushing the limits, we were finally reigned in and today find ourselves forced into living to the basic fundamental – don't spend more than you make. We will see this as buyers choose smaller houses that will fit their budgets.

THE FUNDAMENTAL OF SPENDING CHEAPER –

Unable to totally purge the habit of consumption, we have started to reward the "Wal Mart" business model - cheap products. Given the choice of going without versus buying something cheap, we are now buying cheap. It makes no difference how long it will last because we have set aside the future in exchange for the pleasures of today. After all, that is what got us into this problem initially. Many companies specialized by offering top of the line products. To stay competitive, several years ago they found the need to offer substandard products and you begin to hear the options of, "good, better, or best." Now, many of these same companies have seen the market virtually evaporate for the better and best and find in many cases that good is not even competitive. To keep up, they now offer an even cheaper "good enough" alternative. I have a friend in the kitchen cabinet business. For years he was successful selling an imported Chinese cabinet line. Suddenly, he found that he was no longer competitive. He was losing business to a cabinet that was inferior to his Chinese product. He told me, "The China product actually had SOME wood in it. I am now losing business to cabinets that seem to be made out of cardboard." With checkbook and cash in hand, the boomers are still hanging on to as much of their consumption habits as they can. While they know they can't outspend their earnings, they want as much for that buck as they can get regardless of the quality. In housing, that means they will buy smaller houses with lower quality amenities.

THE FUNDAMENTAL OF AGING –

Economic theory has always stated that an aging population will spend less as their needs become fewer and their desire to save for the "rainy day" becomes stronger. Again, after 40 years of ignoring this fundamental our prolific spenders have become the aging baby boomers. They felt that as they aged, their spending should go up proportionately. Their confidence in rising asset values coupled with rising incomes would easily take care of them in their retirement years. In fact, demographic studies showed that the biggest houses were being built by empty nesters who took pride in their huge homes and vacation get aways.

Today, one year after the crash, most boomers have seen their asset values eroded so substantially that they wonder if they will ever be able to retire. Now, the aging boomers are trying to sell their houses and move into smaller residences. Many are dumping vacation properties for anything they can get and have given up on the idea of living 6 months out of the year in Florida or Georgia. Gone are the gray haired success stories of spending hundreds of thousands of dollars on 6 bedroom homes. Instead of a backlog of building these types of houses, they will instead come on the market for resale at prices that will be less than new construction cost.

THE FUNDAMENTALS OF SUPPLY AND DEMAND –

It is almost impossible to find something that is in short supply. There is an incredible amount of excess capacity in everything, from restaurants, to dry cleaners, to computers, to building supply houses, to manufacturers. The law of supply and demand states that as long as supply exceeds demand, there will be downward price pressure. In our industry, we have a supply side that is daunting. First, we still have huge inventories of finished products that must be sold. On top of that, we have a huge and steady supply of foreclosed properties coming onto the market. We also have an excess of builders all scrambling to construct the few houses that will be built. To supply the builders, we have far more businesses than are necessary. The economic fundamental states that capacity or supply will ultimately gain equilibrium with demand. That simply means a huge amount of capacity must disappear.

The result will be too few customers needing less and paying too little. Profits turn to losses and ultimately to business failures. Thus, capacity will then be reduced.

THE FUNDAMENTALS OF HOUSING –

For those of you who have followed this newsletter over the years, you will remember that we have reviewed the fundamentals of housing many times. Historically, the 5 drivers of the housing business in our market area have been:

1. Population growth
2. Job growth
3. Interest rates
4. Demographics
5. Foreign investment

For years those 5 fundamentals all pointed up. Let’s look at them now. Florida is losing population and jobs. Georgia is gaining a little population, but is also losing jobs. While interest rates are low, it doesn’t do any good if you cannot qualify for a loan. Mortgage applications are becoming more and more restrictive and only the best of the best will qualify today. Demographics will turn upside down as the aging fundamentals kick in. The weaker dollar should signal foreign investment, but the European communities are as hard hit economically as we are. As it stands today, all five housing fundamentals are pointed down. What of the future?

A big portion of the population loss in Florida comes from the migration of the construction worker to more lucrative construction areas (if there are any) of the country. They will ultimately return, but not before there is a substantial increase in construction. The prognosis for job growth is even more dismal. Florida is one of the leading states in unemployment and it will get about 20% worse before it gets better. That’s right, most projections today estimate that the unemployment rate in Florida will crest at 12.5%.

Maybe with some government help, mortgages might become more readily available, but as that assistance kicks in, rates are going up. No one knows for sure, but it is quite easy to envision rates in the 9% range. That is double the existing rate, which will then start to impact the affordability quotient.

We have already discussed the demographic concerns. Foreign investment could possibly be the only fundamental that could point upward. The expected decline in the dollar will make our real estate more affordable. I am betting on a slight increase in foreign investment but nowhere near enough to have any type of significant impact on the overall housing industry.

FUNDAMENTAL OF CONSUMER CONFIDENCE –

Many years ago the University of Michigan recognized the importance of the consumer on the performance of our economy. They began a periodic study of consumer confidence, which in turn became a good predictor of consumer spending. Since consumer spending drives 75% of our economy, the U of M statistic became incredibly important. Consumer confidence is driven by a number of key measurements: job security, take-home pay, asset valuation, political leadership, adverse world-wide political events, plus a number of others. As the press is becoming more and more critical of the current political leadership, there really is nothing of promise to help resurrect the confidence level. Without consumer spending, the economy cannot recover. Confidence will ultimately rise, but the headwinds of poor political leadership will slow down the process of recovery.

FUNDAMENTAL OF GOVERNMENT SPENDING –

Many government economists have advocated that a dollars worth of government spending was worth a dollars worth of private spending. For many years, they have believed that government spending would stimulate the economy. There has been short-term empirical evidence supporting this theory; such as wartime economic booms and specific programs that drove some private sector expansion. However, it is now becoming clear that government spending does not stimulate the economy on a dollar for dollar basis. In fact, every dollar of government spending produces far less than a dollar of economic benefit. And yet despite this, the current philosophy in this country is to let government grow us out of the recession. The consequences of this are too far reaching to discuss here today.

FUNDAMENTAL OF SUPERB BUSINESS LEADERSHIP –

I did not learn of this fundamental while in college. (I don't think many of the college professors would have been very good in the role of business leader.) Instead this is a fundamental that I have learned from observing both on the inside and the outside of the business world. No matter what the economic environment will be, superb business leadership will result in business growth and profitability. While every other fundamental is pointing down, this one, by itself, can make a difference in a company's survival and ultimate prosperity.

NOW THE TIME FOR THE PREDICTION HAS ARRIVED!!! –

The housing pie in 2010 is going to get smaller. There will be fewer customers, smaller volume, lower prices and lower margins. There will be more business failures at all levels of the supply chain as the economy moves towards the point of supply/demand equilibrium.

There will be some bright spots. Certain geographies will fair better than others. Certain dealers will do better because of product selection and customer base. But overall we need to get used to having to carve up a smaller pie.

At Parliment, we are entering 2010 with the belief that we will have a very modest growth in revenues that will come mostly from new products and market share growth. We are hopeful, although, not totally certain, that we will not experience a double-dip recession.

We believe most material costs will remain flat at current levels which are the lowest we have seen in about 10 years. Production still exceeds demand which therefore will continue to restrain any significant price changes.

STRATEGIES FOR SUCCESS (Part 1) –

I am fairly certain of this prediction. I think we will continue to experience a slight market reduction. However, whether you agree with this or not, the fact remains that there are only three directions we can move: down, up, or sideways. One strategy that applies to all of the directions is to gain market share. If the market continues down, for many, the only strategy for survival will be to take market share. If it goes sideways, the strategy for many will be to gain profitability by taking market share. If the market surprises me and goes up, a gain in market share will result in exponential gains. No matter how you look at it, I fail to see why market share growth should not be the number one strategic goal of all companies right now. It covers all eventualities.

Many companies today have inadvertently taken their eyes off of market share growth. They give it lip service but are really not doing much to really make it happen. You gain market share by outselling your competition. This is the time for more creative selling, more diverse product selection, more aggressive business development activities, and more focus on the management of your sales force.

STRATEGIES FOR SUCCESS (Part II) –

As former CPA, I remember vividly the lesson given to me one day by a senior partner. "Bleech," he said, "Don't ever forget the profit and loss statement is where you make money, but it is the balance sheet that will keep you in business. Many a business with a fine profit statement have gone out of business because they failed to manage their balance sheet."

We believe the pressure for superb balance sheet management will be even greater in 2010 than it was in 2009. There are a couple of glaring reasons for this. First, your balance sheet carries the asset values of your cash,

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

inventory and accounts receivable. Proper management of these will be critical in 2010. Especially difficult will be inventory management as the pressure will build to increase product diversification and rapid customer response, while at the same time cutting total inventory investment. Too much is bad and too little is worse.

The other side of the balance sheet carries your liabilities and net worth. As interest rates start to move up, the wise leader will try to fix the rate on as much debt as possible. While it may not have to be done right now, I am certain it will need to be done by the end of the year. The other interesting dynamic that will rear its ugly head will be seen when the market increases. Many companies have used up a good portion of their capital just staying alive over the past couple of years. As the market turns, many of those companies will find that they don't have the capital or lending capacity to build inventories and finance the resulting receivable increase from a resurgence in business. How ironic it would be to fight for years to stay alive and then find that you do not have the capital base to enjoy the growth of a turnaround. Again, the wise leaders have figured this out and will take substantial pieces of market share from those that cannot capitalize their growth.

STRATEGIES FOR SUCCESS (Part III) –

As prices level off at rates about 30% to 40% cheaper than a couple of years ago, it is important to remember that the old traditional gross profit percentages may not contribute enough gross profit dollars to keep profitable. In today's market, it is crucial that you look at your pricing structure and review, in tandem by product line, your gross profit % and your gross profit dollars.

THE TALES OF UNCERTAINTY –

Last quarter I talked of the frustration of not being able to accurately see the future. While that is difficult, it is not nearly as dangerous as seeing the future wrong. Specifically, I am talking about the incredible misrepresentation of the economic figures. Our government is reporting a growth rate of 2.8%. Not a great rate, but it sure is encouraging in view of the declines in the past. However, if you drill down, you will find that over 2% of that growth is due to price increases and over 2.5% is due directly to government stimulus programs such as the cash for clunkers. Factor those out, and I am not sure that I see growth at all. Now, let's turn to the Christmas sales numbers which have been reported as "not good, but not bad." What is not being said is that the Christmas sales period was moved forward an entire week because of the Thanksgiving date. If you remove that week to keep the numbers consistent with prior years, the Christmas sales are dismal. We are also seeing reports of increases in housing construction and real estate sales. Unfortunately they are measuring the activity and not the dollars. Permits and contracts are up, but the construction dollars are still way off. The good news is that the press seems to have discovered this manipulation and have taken off some of their gloves that they have had on while dealing with the present administration. In the next few months you will see more and more press questioning the government on their economic recovery analysis. Maybe by then there will be a little more clarity, but until then, we are really flying blind.

LET'S END ON A MORE POSITIVE NOTE –

Recently, I had a discussion with one of the major bank presidents. He was talking about a new strategy that his and other banks were moving towards. He explained to me that the cost of developing new business for a bank is extremely expensive. Banks are willing to spend that money in business development because they believe they can keep an account for many years. Because of this understanding, his bank has adopted the philosophy that customers who are presently in compliance on their loans must be good companies. To have survived the past couple of years and still be able to make payments is a tribute to the strength of the management of the company. He believes these are the customers that the bank needs in the future. He is therefore taking an aggressive stance on the non-performing loans and doing everything he can to be rid of those customers. However, the performing companies are what he thinks are the core customer group of the future and accordingly he is doing everything he can possibly do to work with them through the present events.

That is classy strategic thinking and if it permeates the banking world, us survivors might find our banks as our allies again. What an incredible competitive advantage that will give us as the market ultimately recovers.

A TRULY REMARKABLE EVENT –

We don't typically take space in this newsletter to talk about our company. However, we are breaking with tradition to report to you a tremendous accomplishment. Jim Cook was our first employee hired. During the 7 years of our existence, Jim has been our number one salesperson every single year. To stay on top of the heap for that long is a tremendous accomplishment in any business. Jim has decided to go out on a high note and retired at the end of 2009. Jim has been a great inspiration to all of us and we all feel honored to have worked shoulder to shoulder with him.