THE PARLIMENT PAGES

JANUARY, 2012

ANOTHER 500 MILES ON THE TREADMILL –

I was recently talking with my son who is an avid runner. He informed me that he had once again managed to hit his goal of 1,000 miles of running in a year. Being somewhat competitive, I decided to see how my routine stacked up against his. Now first, you must understand that when he runs a 1,000 miles, he is really running at a fast pace. I, on the otherhand, have had my running pace described generously as “slogging along.” So despite the difference in pace, I was determined to at least make an estimate of the number of miles that I slogged along in 2011. To my best estimates, that number is a comparatively small 500 miles. There is one more difference as well. My son is running through the hills of Tennessee in all sorts of weather. My running consists of a brief 5 am slog on the treadmill while I watch DVR recordings of my favorite hockey or football game.

As I further contemplate this fitness routine, I also realize that my routine hasn’t changed much at all for many years. Every year it is the same 500 miles on the same treadmill, year after year after year. Now, I look back at 2011 from a business perspective and I see that we have once again slogged along the same “500 miles” as we have for the past 4 years. Our industry has totally redefined the term “stale.” While there is a little exciting scenery on the periphery, by and large, it has been another boring slog on the treadmill. Will 2012 be any different? Well read on and we will review with you our annual predictions.

STATE OF THE INDUSTRY –

We think the size of the pie is going to remain about the same. More people will leave the table which will again create opportuntities for growth for those that are aggressive. We have seen some marked improvement in some of the statistics that are coming from the Ministery of Propaganda in Washington. Annualized housing starts in November hit the highest level in over 3 years. This is, indeed, good news but probably not as good as it appears on the surface. First, good weather throughout the country contributed significantly to these starts. Additionally, the majority of these starts were in multi-family construction which is the least expensive category. However, it is still progress.

There is currently a broad-based consensus that mortgage interest rates will remain at historic lows. This is a huge plus for the affordability and the psychological impact on potential buyers. Mortgage approvals are still very difficult, but there are signs that the lending institutions may be easing off on loans of certain sizes.

Consumer Confidence statistics are definitely trending upwards. Don’t be alarmed at the news stories that show a drop in this number in January and February. Winter blues and paying off Christmas debts almost always will cause a drop in confidence.

We still have much the same headwinds that have existed for the last couple of years. Most problematic is the sorry state of the foreclosure market. The most recent statistics show that almost 30% of all real estate purchases are some type of distressed driven event. The amount of “terminally late and sure to foreclose” properties continues to rise which will result in more and more inventory flooding the market and competing against traditional sales.

While some of the politicians in Washington are touting their success in dropping the unemployment rates, don’t believe it for a second. The underlying data just does not support much, if any, recovery in the job market. Despite every last minute political trick in the book, don’t expect unemployment to drop much lower in 2012.

With all of that being said, our prediction for 2012 is another boring year of seeming stagnation. At best, we see the industry improving by no more than 5%, excluding inflationary impact. However, let's put this into absolute perspective. A 5% growth is a respectable growth in every industry. The problem arises because of the nature of growth in the last decade created unrealistic expectations going forward. As we have said many times in the past – today is the new reality.

CONSOLIDATIONS GO ON AND ON AND ON –

As the year came to a close there was a flurry of major acquisitions announced. Rumor mills are awash with many more that are likely to take place in the first quarter of 2012. These consolidations are driven by a number of factors. The most compelling is the need to further contract capacity. We have discussed this repeatedly in past newsletters. Excess capacity has to disappear before consistent profits can be realized. Hoping the capacity would be reduced by others caused many companies to hold on in hopes of increased market share. Too many balance sheets have been eroded in the past few years and too many companies have finally hit the wall and just can't hold on any longer.

We will continue to see more and more consolidations throughout 2012. Those consolidations will take place at all points within the distribution chain. Manufacturers will merge toward more efficient plants and locations. Distributors will continue to shrink their inventory selections to reduce their cost of carrying that asset. Dealers will either close their doors or will merge with others as there just won't be enough demand for materials to warrant the number of existing locations. And finally, builders will continue to move down the chain. Instead of building 100 homes a year, a builder may build 10. Instead of building 10 homes a year, a builder may now be doing nothing more than remodels. Many of those have shed their chinos and sport shirts and are now strapping on tool belts and doing the work themselves.

While we are unaware of any meaningful statistics on this consolidation, our estimate is that we will see about 20% more before the trend stabilizes.

STRATEGIC OPPORTUNITY –

If you were reading carefully, you should have sat upright in your chair with that last sentence. You should have come to one of two conclusions with that sentence. Either you see yourself as one of the 20% that will disappear, or you see yourself as facing an opportunity for 20% market share growth. Which of those camps you find yourself in should determine your strategy going into 2012.

While we hate to see anyone throw in the towel and close shop or sell out under a distressed situation, it happens every day. For some it is absolutely the right thing to do, and such an exit can be done with some economic advantages if planned carefully. However, for those of you willing to keep slogging away on that treadmill, I urge you to carefully look at your strategies and your business plans for 2012. Are those plans and strategies consistent with market share growth.

Let me give you some specific examples. We were recently having a conversation with another distributor who has a small crossover in our market areas. He also recognizes the opportunity for market share growth. However, when we were discussing our future hiring plans, he told us that he was going to cut back even further on his outside sales force. Where he once had five salespeople, he now has only one. That strategy is totally incongruent with market share growth and yet he believes it will happen. Unlike the industry, we at Parliment, have seen substantial sales increases for each of the past 3 years. We attribute a major factor of that increase to the greatly reduced sales presence of many of our former competitors.

The key to success in our industry has always been a carefully orchestrated formula of, good salespeople, great product selection, high fill rates, competitive pricing, and exemplary customer service. Do your plans and strategies coincide with your desire to grow market share or are you just biding time hoping for a massive recovery that will fix all ills? Remember, "Hope" is not a strategy.

INVENTORY AND SERVICE ISSUES –

There is scientific theory (which I think is called channel stall) about traffic flow. There is some formula that calculates how long it takes for a line of cars to accelerate to normal speed once the light has changed from red to green. Putting the science aside, we have all been frustrated sitting at a light that changes and it seems that no one in front of you is moving. Finally, it works its way back to you and you can get going.

This channel stall theory also applies to the inventory channel. When inventory levels get short, it seems to take a disproportionate amount of time to build the levels up. This is particularly evident when there are a lot of steps in the channel. We are starting to see some early signs of this in our industry. We have picked up significant market share because of inventory shortages within the distribution side of the chain. Realizing this is occurring more frequently, we have chosen not to cut back inventory levels. In fact, our levels are pretty much the same as in the hay days.

As consolidation and small market growth start to impact our businesses, we will see increased demand. At Parliment we are projecting another year of double digit growth. Much of this growth comes as a result of the inventory levels and fill rates that we steadfastly maintain. It is clear that our strategic initiatives going forward are aimed directly at servicing the needs of our customers. I am not telling you this to promote ourselves, but rather to suggest that you should look carefully at your strategy to insure that you have the inventory, the selection, the distribution support and the service necessary to meet any customer's demand. None of us are in a position to have a customer go down the street because we could not fill his need.

PRODUCT PRICING, GASOLINE, INTEREST RATES –

All indications for 2012 would seem to point to fairly stable pricing. As consolidation continues, there may be a gradual increase in some items as the removal of capacity will affect the supply demand curve.

The price of oil appears to be driven by two major factors. One is the strength of the dollar. As the Euro continues to falter, the dollar becomes the currency of last resort. That will bode well for keeping the oil prices from any type of dramatic increase in 2012. The other contributing factor is worldwide demand. That is a little less certain as China becomes such a signficant player. Traditionally, one could look at the status of the European and American economy and pretty well predict oil demand. With the high likelihood of a European recession, the initial reaction would be that oil prices will fall again fairly significantly. However, the appetite for oil is China appears to be voracious. We believe that appetite will offset the European drop and oil will actually increase in 2012. It won't be dramatic, but we will start to get gasoline prices back in the high $3 range before the year is out.

There is no doubt that interest rates, both long and short-term, are going to remain low throughout 2012. The US Government simply has no choice but to do whatever it takes to keep those rates where they currently rest. I believe there is one particular area of great concern for many businesses. Most business lending today is based on a spread above LIBOR. LIBOR stands for the London Interbank Overnight Rate. This is a market driven calculation. The US PRIME Rate is pretty much controlled by the US Federal Reserve. Market forces have little, if any, immediate impact on the PRIME rate. Not so with LIBOR. Even though these rates have tracked closely together over the past years, we believe conditions are such that they could split. Such a split could see a dramatic rise in LIBOR.

Check your business loans carefully. Most of you will find that your interest is determined by LIBOR rates. If that is so, we recommend that you convert the pricing to a PRIME rate spread. There should be no cost difference, but we think there is far less risk.

ANYTHING NEW IN CHINA? –

We have not discussed China in several issues. A couple of readers have asked me to comment on the latest developments in that country. So, what is new in China? The answer is, "just about everything in China is new."

Three years ago, the Government of China announced the incredibly ambitious growth plan that set the course for multi-year double digit growth. Their desire was to create a middle class similar to that in the United States. But instead of taking 80 years to do so, they wanted it accomplished in a decade or less. This aggressive philosophy coupled with a perfect combination of capacity and world wide markets gave birth to unprecedented growth that at times reached almost 20% per year.

Well, China has slowed considerably and is now tracking right at about 8% growth. A big decrease, but it is still 400% greater than the growth in the United States. There has been some talk about a Chinese bubble and I believe it will happen. However, it will be very localized in just a few of the cities and provinces. Overall, the Chinese economy will continue to grow, albeit, a mite slower.

This is very good for our industry. Because of this growth, China continues to consume vast quantities of building materials. Their current consumption of such products is far greater than the United States. This consumption has required most of the Chinese building product capacity to remain in China. This has allowed us to keep prices steady. Just imagine the incredible price deflation that we could face if China were to suddenly start dumping their building products on our shores.

THE BLAST –

A couple issues ago, I wrote that I was splitting the Parliment Pages into two different publications. The first, which is this one, was going to be more dedicated to reporting the specifics within our industry. We would address the industry trends, economic factors that relate directly to the industry, and management leadership issues which are key to our businesses. The other publication, which is titled "***The Blast,***" is a broader look at the geopolitical, economic, and culture issues that are impacting our country. That publication is more of a personal commentary and definitely has a conservative slant. This monthly publication just released its seventh issue and the response from the readers has been very positive. If you are not receiving this publication and would like to do so, please send an email to: jbleech@no-excuses.com . We will put you on this list for all future issues and will also catch you up on the past issues you may have missed.

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