THE PARLIMENT PAGES

July 1, 2009

AND THE PULSE IS GETTING STRONGER –

Last quarter we talked about the initial stages of the economic recovery. You may recall that we related some of the subtle signs that presage a recovery. Well, the good news is that those signs have held to historical perspective and there is a broad based consensus that the recovery is in place and anytime now, there will be an official announcement about the end of the recession.

However, don't expect any economic fireworks over the 4th of July. This recovery is going to be very mild and will not show much energy. Finally, our industry has the opportunity to earn some profits. Virtually everyone agrees on this scenario. However, what are interesting are the prognostications for what happens after the recovery. Let's first look at some demographic issues and then you can read on for a broader economic view.

DEMOGRAPHICAL CONCERNS –

In many of our past newsletters, we have commented on the importance of demographics. In fact, population and economic demographics are, together, one of the five primary drivers of the housing industry. In our last newsletter we discussed the impact of buyer's demographics on the housing industry. We talked about the decline of buyers due to the decreasing population of 31 and 43 year olds. History has shown that those ages are the peak periods of home buying and, accordingly, if the population of those ages decreases, it is only logical to assume that there will be less demand.

There is another side to this story that might be even a little more frightening. The peak age for people selling homes is age 74. That is the average point in time when people downsize to condos, multi-family complexes, nursing homes, assisted care facilities, or move back in with families. If you study the aging of the boomer generation, you can see that the age bands around 74 will continue to increase at alarming rates and will remain high for the next 15 years. You will not see very many boomers in the market to purchase housing.

In addition, as the population ages, other spending patterns also change. There is less discretionary spending as more income is allocated to basic living essentials and health care. This does not bode well for the economy in general. This will be even more true in the future as so many retirees, or close to retirees, have taken major hits in their investment portfolios and as a result, are now genuinely concerned about the adequacy of their nest egg. This aging demographic and changes in purchasing are going to be major shift and drag on the economy going forward.

Now couple that with the number of people that will be selling their homes as they start to reach that age range of 74. Huge numbers of "McMansions" are going to come on the market. This will have severe negative impact on the housing industry. First, there will be more large homes for sale than there will be buyers. This is going to further erode the valuation of homes and severely reduce the demand for new construction. Additionally, a devaluation of home values at the top will cause a ripple effect all the way down the value chain further depressing the market valuations. As the market for entry and mid level homes devalue, there is less opportunity for people to sell and buy-up to the "McMansion."

Does this spell the doom for the housing industry? We are not yet dead. There will be a growing population of buyers for the starter type homes. This population will come from the intrinsic population growth coupled with increased immigration. Homes will continue to be built, however, we believe their cost and size will be smaller and far fewer will be built.

To recap the numbers, let's remember that for many years this country absorbed around 1.6 million new home starts per year. In the heydays, that number soared up into the 2.2 million range and created this huge inventory overhang that has plagued us now for several years. Going forward, it is beginning to look like the sustainable number of housing starts will probably be in the 1.0 million range and the vast majority of those will be in starter, smaller, and less expensive products.

We believe that it is essential that you look closely at this future demand and insure that you have the proper products at the proper inventory levels to service that demand.

IT'S HURRICANE SEASON –

There is a growing consensus amongst many mainstream economists that we are in a current situation that is similar to a hurricane. Starting in 2006, we started to experience the outer bands of the storm. The winds gradually picked up over the next two years until we got hit with full force hurricane winds last September and October. Those winds have now been pounding us for almost 9 months. We have been hit and hit hard and are just now coming out of the first part of the storm. At almost anytime, we can look forward to entering the eye of the storm and relaxing for a spell. Everything will appear to be calm. However, the size of the eye looks like we will only have sunshine until about the end of 2010. On the horizon is the backside of the storm. And for all of us who live here in the heart of hurricane country, we know that the backside is always the worst. The winds are stronger, the storm surge is higher, the storm is more compact and more damages arise because the ground is already saturated from the first part of the storm. And worst of all, unlike a tornado that comes through quickly, hurricanes seem to last forever. That fury of the backside will make the first part seem pale in comparison. That part of the storm will last about two years after which time there will be a gradual abatement and things will get back to normal sometime in 2013.

HOW ACCURATE IS THIS HURRICAN WARNING?

We hope this is all "doom and gloom" thinking. However, there is too much anecdotal evidence to dismiss this projection out of hand. Let's just list a few of the threats we have to our economy:

- A banking system that is still reeling and will eventually cause the failure of up to 1/3 of the existing banks
- A looming financial crisis in prime loan foreclosures due to home devaluations and unemployment
- Massive predicted credit card defaults
- Staggering federal deficits
- A broken health care system with feds throwing in huge amounts of money
- Unprecedented devaluation of our currency
- Deflation causing commercial collateral values to drop and furthering bank foreclosures
- Inevitable tax increases attempting to offset the federal funding
- Local and government failures and defaults
- Unemployment approaching depression levels
- Record setting business failures

And unfortunately, this is just a partial list. We could go on for pages listing the various major threats. Can we survive this? As a country, you bet. However, there will be severe "storm" damage and the cost will be high. As is true in any major storm, as the survivors dig out from the rubble, they will find great prosperity. Storms of this magnitude are a cleanser that removes the weak and leaves the strong with a great market presence and unlimited opportunities

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HURRICANE PREPARADNESS –

We were hardly prepared for the first part of this storm. The “weatherman” gave us no warning and we all found ourselves with too many employees, too much inventory, too little sales and too many struggling accounts receivable. This lack of warning caused a lot of businesses to fail outright while others have sustained substantial damage.

As we enter the eye, those surviving so far will have the opportunity to prepare for the next onslaught. Don’t be fooled by the calmness of this eye. There are very few people out there who don’t believe in the next storm. Pay heed because now, there are plenty of “weathermen” warning of the next storm.

We have a unique opportunity. The smart business person does not load the golf clubs in the car during the eye of the storm. The smart business person looks at his property and spends his time while in the eye shoring up the business for the upcoming surge. We are going to be blessed with a period of recovery that will allow us to strengthen our balance sheets to ride out the storm. For some of us, this period will produce long awaited profits and gains in market share.

Over the years, I have learned that the company’s profit and loss statement is what will make you money. However, it is the balance sheet that will keep you in business. I have seen too many companies make a profit and yet go out of business because they failed to properly manage the balance sheet.

The successful businessman will realize that this upcoming 18 months in the eye must be used to prepare. Pay particular attention to inventories, capital expenses, accounts receivable and accounts payable. Maintain as much liquidity as possible. Cash is your insurance going forward. Convert non-performing assets into liquidity. Review your balance sheet monthly to insure there is no degradation.

From an operational point, resist the temptation to hire back people and realize the importance of operating as lean as possible and maximizing earnings. And most importantly, use this time to grab market share. Get aggressive as possible at gaining new business while carefully watching the credit. Bank your profits and don’t spend them.

AFTER THE STORM –

There will be more business failures. Every day we hear of manufacturers, distributors and dealers who have closed their doors or severely cut-back operations. This may abate somewhat in the near future but will pick up steam in 2011 through 2013. But for those of you that can survive, the other side is going to look great. While the market will be down substantially, the capacity that once existed will have been reduced and the resulting market share for the survivors will be very prosperous.

SALES TAX REFUNDS –

Most all of us have had to take the painful pill of an accounts receivable write-off. We are aware of many of our customers that have had to write-off hundreds of thousands of dollars over the past couple of years. Most of those write-offs result from invoices on which sales tax was charged to your customer and you accordingly remitted it to the state. What many business owners do not realize is that if you end up not collecting that invoice, you are entitled to a credit on your sales tax. Please look over every invoice that you have written off and determine if you collected and paid sales tax. As much as our state needs revenue, let’s let them get it from someone else! Talk to your accountant or tax advisor to see how far back you can go and what the best method would be to recover that overpaid tax.

INTEREST RATES, BANKING AND FUEL COSTS –

In every issue we address those major areas that are of concern to our industry. Let's take a look at 3 biggies.

Mortgage interest rates have moved up. We think they will continue to rise but not dramatically or too fast. By the end of the year, we should see them flatten out in the 6.5% range which, by historical standards, is still very low. Corporate rates, on the other hand, are sure to rise even more and will possibly hit double digits sometime in mid to late 2010. While the cost of money for mortgages and corporate lending will continue to be historically low, the bigger issue will remain to be the availability of credit.

The greed factor that we were counting on with the banks has not yet settled in. Never in my life have I imagined a more difficult banking environment. Put simply, the banks have lost and will continue to lose substantial amounts of money. Because of the lending leverage principle, as a bank loses money, it must either replace that loss with capital infusion or cut back on its loan portfolio. There are not a lot of investors lining up to invest in banks, so most banks are being forced to cut back their portfolios. Obviously, if they are trying to cut back, they have little or no appetite for adding loans.

This has resulted in the average business finding the bank unwilling to extend credit. They are reducing credit by changing terms, advance rates on collateral, and collateral eligibility rules. Bankers are so busy managing their troublesome loans and shrinking existing credits, that they are devoting few resources towards the acquisition of new business. Contrary to our prior predictions, we are now doubtful that is going to change before the end of the year. Scarce credit is going to be an anchor for small businesses.

Gasoline pump prices have moved up rather dramatically in the last 30 days. We have said all along that prices are a factor of the economy. The stronger the economy, the more the demand, the higher the price. As this phantom recovery starts to gain some momentum, be prepared for fuel costs to continue to inch up. As the dollar begins to lose more value, that upward movement may become more radical. As the economy slides backwards, you will see some retrenchment in prices but not much. Count on gasoline in the $3.50 range.

I QUIT!!!!

Every business owner has heard those words on many occasions. Sometimes, we thank our lucky stars and other times we groan as we see a great employee walk out the door. As we get ready to come out of the bomb shelters and get ready to get back in business, I have an interesting exercise for you to try. Take a list of every one of your employees and pretend that each of them walked into your office one day and said, "I quit." Would you inwardly smile or would you groan.

If you smile, it is probably because you don't really value that employee and realize that the company is better off with them gone. The provocative question that needs to be asked is, "If I wouldn't mind if that employee quit, why do I employ them now?"

This is an interesting exercise to go through to really evaluate who you want in your company going forward.

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EMAIL NEWSLETTER –

Many of our customers choose to receive this newsletter electronically so that they can pass it on to others more easily. We know of some customers that send as many as 50 copies of this to their friends and business associates. If you are interested in getting this by email, please call our office at 866-387-7601 or send an email to jbleech@no-excuses.com.