THE PARLIMENT PAGES

JULY, 2012

LET'S SIT ON THIS FENCE –

Throughout the day, my mind will continually be looking for subjects of interest for my various newsletter publications. I have to admit, it is becoming more and more difficult to find subject matter in our industry. We seem to be stuck on top of the fence and can't seem to even lean one way or the other let alone fall off.

The daily news releases will have a few minor glimpses of something positive followed by equally mundane releases of something negative. What happens one month will seem to reverse itself the next month. The "experts" can't seem to agree on much except that whatever is going to happen, will happen slowly. While throughout history, this has been the norm for many industries, it just is not a familiar pace in our industry, one that went through such dramatic times over the past decade.

During the boom years, I continued to caution our company personnel that, "a rising tide floats all ships." We should not confuse our success with our ability. As a wise stock investor once said, "Don't confuse a bull market with brains." So, with that being said, I am going to take a different approach on this newsletter with a slightly new angle to the same subject.

WHAT IS THE PARLIMENT PAGES? –

When we began this publication almost 10 years ago, Chuck Parliment and Jim Bleech determined that this would be an industry knowledge newsletter dedicated to better informing our friends and customers of future trends that we foresaw in the building supply industry. Unlike most newsletters, we steadfastly refused to use the publication as a promotion for our company. We reported statistics, product introductions, management and leadership tips and annually made our predictions on the state of the industry. Today, I am going to temporarily change this philosophy to illustrate a very important point.

I am going to brag about Parliment, but not to promote the Company, rather instead, to use it as an example of success in a challenging environment. Being somewhat contrarian in our attitudes, we easily embraced the concepts of expansion at the bottom and caution at the top.

PARLIMENT BUILDING PRODUCTS -

When the building crash of 2008 started to hit, Parliment, like everyone in the industry took a huge hit in sales and profits. Additionally, while sales were on the decline, aging of accounts receivable skyrocketed as our customers were struggling to meet their obligations. After the reality of the situation became apparent, the first inclination was to immediately tighten credit and institute a dramatic decrease in expenses. Across the board pay decreases took place and every expenditure was examined with a fine-toothed comb.

Some natural attritions took place as some sales people left for other opportunities and our inventories adjusted downward to the new level of demand. However, panic did not set in. Instead we realized that within this economic chaos lay an opportunity. Less nimble companies were slow to make changes and lacked the creativity to take advantage of the situation. It wasn't long before Parliment began adding sales people, looking for new products and actually increasing inventory levels to better accommodate the changing environment.

In Parliment's first annual planning meeting after the downturn, we focused the entire company on one simple strategic initiative – increase market share. We believed that if the situation persisted, market share was the best path to survival. We also believe that when housing rebounded, the growth of market share

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would have a compounding positive effect on our growth. With that simple strategic initiative, we were able to focus the entire company on capturing business from our competitors.

At a time when the industry seems to be languishing with little or no growth, Parliment is now racking up consistent growth in sales and profits. We know the "pie" has gotten smaller, but we also now realize that we have a much, much bigger slice of that pie.

I tell you this not to brag about success, but rather to point out that growth and profits are there, no matter what the overall market environment might be. We have talked about this stuff indirectly in many of our past issues (www.parlimentbuildingproducts.com). We have seen many of our friends fail, while, yet others have succeeded. The common denominator to all of the successes we see are:

1. Increase market share
2. Increase sales presence
3. Offer products and services that no one else does
4. Be creative
5. Provide positive inspirational leadership

SOUNDS GOOD, BUT HOW DO I MAKE IT HAPPEN? –

Everyone seems to have great ideas on how to run your company. It is amazing how tongue-tied they become when you ask for the specifics on how to implement those ideas. You may look at this list above and say, "yea, I should do that, but it is easier said than done." You are right, it is easy to expound on this. However, if you will read and follow the directions carefully, you can find the path to execution.

Ideas to accomplish the 5 items listed above will generally come through these thought provokers:

1. Internal process innovation by finding a better, cheaper or faster way of doing things
2. Product or service enhancement by moving your product or service from good to great
3. Breakthrough technology that allows you to leap-frog the industry norms.

At Parliment, we took each of our five keys to success and ran those through these three thought provokers. This exercise will start to define what needs to be executed. Good execution will then take place when you have a combination of the following:

- High level executive commitment
- A limited number of "doable" ideas that can produce immediate measurable results
- Contingency planning for everything that can go wrong
- Relentless and constant focus
- Celebration of successes

Quit letting the circumstance dictate your actions. Instead, understand that we are in an environment where the strong will not just survive, but will actually prosper. Make it happen.

INTEREST RATES –

Mortgage rates continue to fall and will continue at such historic lows for as far as the eye can see. The best bellweather of such rates is the 10-year Treasury Bond. To better appreciate why we think the low mortgage rates are going to continue, it is helpful to understand the Treasury Bond. The U.S. Treasury is presently needing to borrow about 40% of all of the money that it daily spends. In order to borrow that money, the Treasury must obviously have someone who will lend it. That someone is a combination of investment and commercial banks, personal investors, various international investment interests and, as a last resort, the Federal Reserve. Private investors, banks and international interest continue to buy the bonds because there are not a lot of attractive alternatives to park massive amounts of cash. However, where the bond offerings exceed their appetite, the Federal Reserve steps in and buys the bonds when no one else will. They do that to ensure the Treasury has enough money and to help create enough demand to keep interest rates low. After all, if no one will buy the bonds at the current rate of interest, it would force the Treasury to increase the interest rate to entice more buyers. If that were to happen, the Treasury would sustain additional expense and have to borrow yet more money. This upward spiral could quickly expand the budget deficit even beyond its unbelievably high levels of today.

For those reasons, we can expect the rates to remain low for quite some time as the Fed will continue to artificially intervene in what would otherwise be a free market. These low rates will continue to have a significant impact on housing affordability which will help prop up new home construction. While there are many negative economic consequences to the interventiuon, one of the positives will be low mortgage rates. Just imagine how tough things would be in our industry if mortgage rates were 10% or higher?

INFLATION VS. DEFLATION –

There is a lot of controversy over what will happen to our currency in the next couple of years. There are those that believe an impending economic downturn will result in a period of deflation similar to what gripped Japan for over a decade. A deflation would be caused by a downshift in demand for products forcing companies to continue to reduce prices to the level that will increase demand. We are seeing some signs of this within our industry. There has been very little price increases over the past couple of years throughout most of our product lines. We are now starting to see some decreases, especially in steel products. (More on the causes of that later.)

Deflation carries with it many negative consequences. First, buyers will tend to hold off on buying decisions based upon the belief that prices will be lower tomorrow. We have seen evidence of that in our industry as many retail buyers still believe that they can wait and housing prices will continue to decline. This hesitancy on the part of the buyer will have a spiraling downward effect as demand drops, so do the prices, which further validates the strategy of the buyer to wait. In addition as prices drop, so do the real dollar value of margins. As the real value of margins decrease, it becomes increasingly difficult to meet fixed expenses.

Inflation has its own set of problems. Runaway inflation is caused by a lack of confidence. Currency holds its value on the belief that it is stable and will preserve its purchasing power over time. However, if that belief is shaken, holders of the currency will spend their money as fast as possible hoping to accumlate tangible assets before the currency loses its value. This also has a sprialing effect that gains velocity of its own.

Neither of these can be looked upon as anything good. However, what is even worse is the uncertainty as to which will prevail. This uncertainty causes a clear case of paralysis where the buyer does nothing. An economy that is driven by 70% consumer spending simply cannot grow if the consumer is paralyzed.

PRODUCT PRICING –

For several issues we have been predicting a stable pricing environment. Overall, the industry had seemed to reach that point of equilibrium between supply and demand where pricing was relatively constant. We are starting to see some changes to that all important formula. On the supply side, scrap steel inventories have increased and therefore the pricing has become quite soft. As a primary material in many of the steel products used in our industry, this soft scrap steel pricing is resulting in a decreased selling price of the finished goods, primarily rebar.

Of even greater impact is the demand side. Worldwide demand for construction materials is down signficantly. Most apparent is the decrease in demand from the internal Chinese market. The Chinese economy has slowed dramatically from an average growth rate of around 15% to a little less than 8%. Of the 8% growth, most of that was government spending related, with very little growth on the consumer side. Here at home, approximately 72% of our economy is driven by consumer spending with the balance split between commercial and governmental. In China, consumer spending accounts for less than 30% of their economy. While data is difficult to fully interpret, it appears the Chinese consumer has stopped spending at the same time commercial enterprises are also cutting way back. This means that the vast Chinese home

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construction boom has come to a skidding halt resulting in a dramatic inventory increase of unsold building products. Furthermore, many of the producers are slow to act on this change and continue to manufacture despite bleak sales prospects. These products will ultimately leave Chinese soil and will end up in the international markets which will result in some price deflation.

Deflation can be a dangerous position for companies who have too much in inventory. This is the time for everyone in our industry to closely look at the distribution side and ensure that you have the right suppliers to provide you with the just-in-time product selection you need.

QUANTITATIVE EASING –

As consistent positive economic news continues to be elusive, there has been more and more talk about the Federal Reserve stepping up for another round of Quantitative Easing (QE). In short, QE is simply putting more money into our system through the creation of massive amounts of additional currency. In the past, these types of programs were designed to directly place the money into the economic system and would generally stimulate the economy and cause varying levels of inflation. However, QE has been used the last couple of times to help prop up the balance sheet of commerical banks in the hopes that a strong balance sheet would encourage bank lending. As I write this issue, there is a growing certainty that there will be another round of QE modeled after the last. Now there are two big problems with this approach.

In simple terms, I will illustrate the first fallacy of this program. To help give banks liquidity and to strengthen their balance sheets, the Federal Reserve would loan money to the banks at say 1% interest. The theory is that with this cheap money, the banks could then use their leveraging power to re-lend this money through either commerical or consumer debt. At prevailing rates, the banks should be able to lend that money at say a 4% rate thus yielding them a 3% profit (rates are for illustrative purposes only). However, the banks are still snake-bit over the credit worthiness of their loan applications and are wary of making loans that could go bad if the economy does not improve. So, instead of lending the money out and stimulating the economy, the banks will instead buy Treasury Bills at say 2%. While the profit spread is not as great, it is a secure investment so the banks will make a risk free spread. The more money that is pumped into the system, allows the banks to make more profits. Contrary to the political thinking, the banks would rather have the sure profit than the credit risk. Therefore, the QE money that is supposed to generate spending is really doing nothing more than enriching the bankers.

The second point I think is even more ominous. Let’s say the banks took this massive amount of QE stimulus and did, in fact, lend it out. While it would spur more spending, it would also cause more debt. And isn’t the amount of debt and leverage what got us into this whole mess in the first place? This is the real theoretical difference between the various economic philosophies. One believes economic recovery will come from government stimulated spending while the other feels recovery will come from austere spending and less debt leverage. It will be interesting to see how this plays out over the next couple of years.

THE BLAST –

The purpose of this newsletter is to address issues that are specific to the building supply industry. I also write another newsletter that better addresses the international and domestic economic issues along with some political and social commentary. The success of that newsletter has astounded me as there are currently over 1,000 readers of that monthly publication. We live in increasingly difficult and unpredictable economic times and I strive very hard to bring perspective to these conditions so that we may all best prepare ourselves. If you would like a free subscription to this monthly publication, simply send me an email at jbleech@no-excuses.com

NEW PRODUCT –

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