THE PARLIMENT PAGES

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TRADE WARS –

We are in the building supply business. One of our monthly measurements of sales is the amount of tons we ship out. We use this measurement as a throw-back to the days when the vast majority of our products were steel derivative items. It should be quite obvious that when Trump announced his steel tariffs, we all sat up straight and paid attention.

There was the normal political ground swell supporting the decision in some cases, but mostly objecting to such a "draconian" move. The liberal press saw this as another reason to attack Trump predicting everything from economic collapse to a nuclear exchange with China. It didn't take long for China to fire their return salvo and announce countervailing tariffs on a reported $100 billion in US goods. Again, the calamitous headlines appeared.

But let's pull back the covers and see what actually is taking place. First, it is important to understand the tariffs were placed on a very limited number of steel products. Next, we should also understand that over 30 countries were exempted from these tariffs meaning they could still send steel products into the US tariff free. And I think of equal importance, is the fact that American steel production is operating at pretty much full capacity and imports will be necessary to meet our day to day demands.

So, what is all of this really about? Whether you like him or not, you need to understand that Trump is one of the best negotiators on this planet. He has negotiated himself out of trouble. He has negotiated himself into incredible profits and he has now negotiated himself into one of the most powerful positions in the world.

How many of you know that the threatened Chinese tariffs do not take place until November 22(Thanksgiving Day)? How many of you know that the recently announced Chinese tariffs don't go into effect until November 23? Why would two countries announce such a drastic trade measure and delay implementation for over 6 months? Why would China's date be one day after the US implementation? Maybe, just maybe, there is another agenda at work.

China for years has been the international bad boy in foreign trade. US patent protection is virtually worthless in China. A unique and brilliant solution that may have taken years of thought and countless dollars to bring to conclusion can be knocked off by the Chinese overnight with no financial repercussions. Previous administrations were loath to even pretend this was happening as they were afraid of upsetting the Chinese. Chinese knockoffs have severely damaged many iconic US brands.

In addition, every company in China must be owned at least 51% by Chinese ownership. Therefore, any technology that is taken from the US and used in a China can ultimately be stolen by the Chinese ownership. With no patent protection, US companies who do business in China must just swallow the fact that their technologies and methodologies will be knocked off by the Chinese and probably result in direct competition.

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Virtually every company in China is financially supported by the Chinese government. In many cases, the government owns a substantial piece of the company while in other cases the Chinese central bank has funded and subsidized the company. Many Chinese companies are operating at losses, subsidized by the Chinese central bank, and selling goods internationally at less than cost.

All of these, plus many more, have added up to make China the bad boy in international trade. Their practices have to stop. It is that simple.

What better way to start negotiation other than to fire a big cannon across their bows. Get their attention in such a way that will bring them in good faith to the negotiation table. This is just the beginning and is so typical of Trump's negotiating strategy. Our bets are that tariffs will probably not be implemented unless these negotiations fail to gain concessions from the Chinese and they are forced to clean up their international trade practices.

THIS IS A FAMILIAR TUNE –

Just 5 or 6 months ago, that crazy "Rocket Man" leader of North Korea was making all sorts of threats against the free world. He beamed and bragged about how he was going to take on the US. He displayed his firepower with promises to not hold back.

Trump responded with a simple message. "You launch at us and your country will be turned to glass." It is amazing how "Rocket Man" has disappeared from the news and has even reached out to South Korea with several different agendas to ease off the tensions. This is just another example of the negotiation techniques that are so entrenched in Trump's thinking and actions.

While trying not to be political, intelligent people will look behind the headlines and will work harder at understanding the big picture.

WITH THAT BEING SAID –

Whether it is right or wrong, steel producers saw these headlines as an opportunity to grab some profits with immediate price increases. Fearing more increases, a hoarding mentality soon took over the market and steel rebar and many steel products began to fly off the shelves.

As a distributor, we cannot control the manufacturer's pricing. What we can do is keep our customers informed of price changes, inventories and pending allocations. Again, whether it is right or wrong, we see continued price increases over the short-term.

With the expansion of the economy, normal demand is outstripping supply and we are being faced with allocations on some of our products. I hate to make this a self-serving commentary, but this is where customer loyalty becomes so important. In the past month or so, we have had to turn down many sales from those that were not our regular customers to ensure that we had the inventory to meet our loyal customer's demands. Sometimes, you need to realize it is not always about price.

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WARREN BUFFET –

That is a name that is synonymous with sound business sense. You can't argue with the investment success Buffet and his people have had over the decades. They seem to have a genuine sense of where things are headed and position themselves there before the crowd.

In some ways, I look at the Buffet portfolio (Berkshire Hathaway) as an economic leading indicator. The very good news for our industry is that Buffet is very bullish on housing as evidence by the growth of housing (site contractors) and housing product related companies in his portfolio. In a recent statement, he again reinforced his position that he believes housing is a critical piece of the American economy and that it will continue its growth well into the future.

MILLENIALS ARE BACK –

After a long hiatus from the housing market, we are finding that that the millennial population is aging to the point where home ownership is becoming more important. There is a surge in entry level homes that is approaching unprecedented levels. This is great news for the housing industry as the inventories of these homes is also at record lows. Pent up demand combined with the low inventories are sure to lead to increased housing starts.

While this is great news, it is somewhat mitigated by the fact that upgrading from starter homes is still lagging behind expectations. Debt load from overhanging student loans is making a trade-up more difficult than in the past. In addition, the millennials don't have the same appetite for "big" that once dominated the housing upgrade phenomenon.

Thus, we will likely see a long-term increasing demand for starter homes and a softer market for the upgrade homes.

INTEREST RATES –

In the past couple of months, there has been a lot of hand-wringing as the housing industry experts hear of present and future interest rate hikes. There is no question that the cost of interest does have an impact on our industry. It undoubtedly limits the price a homeowner can afford. Higher interest costs will always result in a smaller property as that is the formula for mortgage qualification.

However, increasing rates does not stop buying. In fact, as rates go up, buying tends to increase as the buyers want to get in before rates go up again. Experts say that the resistance to a purchase because of a particular interest rate does not hit until rates are in the 7% range. Higher than that and buyers will defer purchase decisions. However, rates lower than that will impact the size of the sale but not the sale itself. Let's not fret about rates just yet.

INVENTORY AND TECHNOLOGY –

A number of years ago we were looking to purchase a company. This company specialized in hard-to-find items. The owner proudly showed us a recent sales slip where he sold one part for $5,000. His cost on that item was $123. As we looked unbelievingly at the transaction, he explained that he was the only one who had that part available. While other dealers could get it, it would take several months before the manufacturer could supply this long out-of-date item. The customer needed it now to avoid a shut-down on his project.

We all know stories like this. But this story, as ridiculous as it is, it brings to light one of the biggest challenges we face in managing our business. With the possible exception of real estate, our biggest investment is in our inventory. And with that investment comes the following questions:

- How much do I need
- When do I have too much
- When do I have too little
- How much can I charge for having availability and high fill rates
- When do I lose a customer because of a bad fill rate
- How do I balance inventory turnover with profit margin

A number of years ago, we developed an inventory management report that is called the Turn and Earn report. It is simply a calculation of the average gross margin of a particular product multiplied by the number of times that product will turn in inventory.

For instance, let's assume there is a product that we buy 6 at a time and we will sell all 6 in a 4-month period. That would equate to an inventory turn of 3 times. If we sold them all in a 3-month period the turn would be 4 times. Now let's look at our sales records and see that our average gross profit margin was 10% on that product. In our first example of a 3 times inventory turn our calculation would be 3 x the profit margin (10) for a factor of 30. In the second example, with a turn of 4 the factor would be 40. If it took us a full year to sell all of those products, the factor would be 10. Obviously, the bigger the factor, the better the turn/earn ratio.

We know we can't carry everything for every possible scenario and have to make decisions on what does sit in our inventory investment. Let's look at another example where we have a product that only turns 2 times in a year but carries a 40% profit margin. That would result in a turn/earn ratio of 80. On the surface, this would seem to indicate that you should only carry high profit margin items to get the highest ratio. This is exactly true except…

What if your customers are depending on you for high fill rates of the lower profit margin items? Do you risk losing a customer because of a low fill rate? There is no absolute answer. However, we hope that you will see that inventory management is a combination of analyzing:

- Fill rates
- Earn/turn ratios
- Total investment dollars
- Space
- Your brand equity

Most inventory management systems today have the supporting technologies that allow you to have the necessary data. It is up to you to interpret it and make your inventory decisions. Parliment sales people are excellent resources to discuss your inventory questions with. Our fill rates are the highest in our industry. We specialize in taking a large part of inventory management off your plate and putting it on ours.

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