

THE PARLIMENT PAGES

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WHAT IS GOING ON THIS MARKET PLACE –

I remember last year when I visited my physician for my annual check-up. At the conclusion, he pronounced me in perfect health. "However," he said as I was about to leave, "That doesn't mean that you won't catch a cold or the flu sometime."

That, I believe, is where we are with our industry. We have stated all along that we believed that housing would increase a minimum of 5% - 7% for an indefinite period of time. Those of you who have read this newsletter are probably laughing at the egg that I have all over my face. However, I have scraped the egg off and I still stand behind that basic projection, with one small caveat.

What I didn't consider, nor did few others, was the impact that speculator sales would have on the market. It turns out that the entire amount of increase in sales from 2004 to 2005 was due to speculator involvement in the market. How do we know? Well the economists are just now realizing (duh) that home ownership percentages have stayed the same for the past 7 years. That means that, aside from basic population growth, any increases in sales were due to second home or speculation sales.

So here is the caveat. We believe very strongly that we will continue to see an increase in the housing industry in that 5% - 7% range. However, that will not be an increase based on 2005 numbers. Remember those numbers were exaggerated by the speculator problem. No, instead the smart baseline will be 2004 results.

When will this growth begin? The compounded problem is that the increase will not happen immediately. There is a huge amount of unsold inventory in the market. Some of it is completed and some of it is in progress and has yet to hit the market. So, the first thing that must happen is the sale of this excess inventory. Once the inventory is sold, we will see the market get back to the 5% - 7% growth based on the 2004 baseline. When will that happen?

In talking with numerous builders we are finding an interesting tale to tell. All of the builders are reporting that home buyer traffic is at, or exceeding, levels of a year ago. The problem is that the builders are not able to create any sense of urgency to turn the "lookers" into "buyers." Why is that? It seems that the buying public is smelling blood in the water. They believe that if they hold off on their decision to buy, they will see substantial price decreases and incentives from desperate builders. (Remember, it was not too long ago that the car companies started this thought process by offering unprecedented rebates and financing options.) At some time either the builders will discount or the buyers will give up and start signing on the dotted line. That game can't go on for long.

Every indication is that with the huge inventory overhang and the reluctance of the buyers, excess inventories will remain until mid 2007. So tighten your belts and prepare for some slow times. However, don't pull the sign down and move to Costa Rica. We are in a temporary situation that will reverse before we know it.

So, yes, we have a case of the sniffles and for some of us, we have a fever and nausea. But you will get back to health. This is only an event caused by a lot of speculator greed. It is not a trend.

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WHAT TO DO ABOUT IT –

We are very certain of the right strategy. But before launching into that, let's go back and review a couple of basics. First, a rule that we have always followed is: "*A little bit of prosperity creates a lot of overhead.*" Let's face it, we in this industry, have had a lot of prosperity over the past few years. Growth and the frenetic pace we have lived, have, undoubtedly, created some bloat in our companies. That *bloat should and must be eliminated right now. The real questions is where is the bloat? The bloat is not where you think it is.*

A military strategist will tell you that "when ambushed, you must attack." This is so counter-intuitive that lieutenants train attacking towards the ambush over and over. The natural reaction is to hunker down, hide and make yourself as small a target as possible.

The strategies in handling business slowdowns are also counter-intuitive. The natural reaction in a period of slowdown is to hunker down and cut the sales force, marketing and training dollars. Is this the right strategy? *Growth can come from only two areas: market expansion or market share.* You cannot control market expansion or contraction, but you can control market share.

As business slows down, cash has a tendency to build because you are no longer funding expanding inventories and accounts receivable. *This is a great opportunity to invest that cash into gaining market share.* Market share gained today will yield exponential results in the future as the market expands. So we believe that now is the time to invest some of that building cash flow into the sales force, marketing and training. This is the time to scout out additional product lines. This is the time to work with your operations people and tune-up your systems, clean the warehouse, do the minor remodeling that you know you need. This is the time to sit with your customers and jointly plan on how things can be different when the recovery begins. *There are countless examples of companies who timed market changes, attacked the slowdown and got wealthy by taking advantage of the shirkers who crawled away and did nothing but wring their hands and duck their heads.*

Yes, you have bloat. But the bloat is not the muscle that you will need to grow your business. Review your P/L very closely. Compare every line item expense to 2004. You will be surprised at how some innocuous expenses have crept in. Those are the expenses that need to be eliminated.

On the balance sheet side of your business, *watch your accounts receivable very closely.* Customers who used future jobs to pay for previous expenses are suddenly going to be squeezed. Watch the collections, analyze, where possible, the source of the money and pay particular attention to the reality of future business with that customer. Talk to your bank and let them know that you are in control of the future. Show them the changes you are making and explain your reasoning for your actions. Bankers are really pretty good guys as long as they are not surprised. Don't hide from them, because they will find you.

CONCLUSION –

We are in a period of correction. We are not in a downward spiral. The fundamentals of housing remain strong. We have excess inventories that will be sold off and building will resume at a great pace. There is plenty of money that will be made in our industry. *Long-term outlooks have never been better.* The National Association of Home Builders recently released their projections. Please read the following excerpt:

"...but the number of homes constructed over the long-term – the focus of this report – will depend less on interest rates than on demographic trends and on the utilization of the existing housing stock. Those factors are likely to lead to production levels over the next decade exceeding the average during the last decade. Indeed, *the number of new conventional houses built during the decade from 2006 to 2015 will exceed the number produced in any previous decade.*

Considering the larger average size and more extensive equipment that will characterize the typical home built during the coming decade, the real value of residential construction during the next ten years will exceed previous decades by an even wider margin."

So, maybe the next couple of months may be a little skinny, but long-term profits will be there for those who manage their businesses correctly and avoid knee jerk reactions. *Don't cut muscle, build it.*

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WATCH FOR SOME ALARMING HEADLINES WITHIN THE NEXT 60 DAYS –

Within the next couple of weeks, the government will release their statistics on the value of residential properties being sold. These statistics will be viewed by the press and will result in the following headline: "Real Estate Property Values Plummet!!!!!" Don't be alarmed. This misinterpretation will come from how the statistics are calculated. There is an incredible disproportionate share of entry-level, low-dollar homes being sold. This, along with various incentive packages, will skew the average prices and it will look on the surface as if the median price homes are falling in value. It is not the case. Ask anyone who has their house for sale if they are selling it for less than they purchased it. No one is and no one will have to. Not in our market or even in the over inflated markets.

Unfortunately this headline will be another headache and will add to the reluctance of the home buyer.

INTEREST RATES –

We have hit close to the peak in both short and long-term rates. The Fed is worried enough about the economy that we think we will see very few, if any, further increases in the short term rate. Long-term mortgage rates are even down from last year and the competition for fewer mortgages will likely add pressure for more downward movement. So barring a sudden unexpected bump in inflation, don't worry about interest rates adding a further burden to our businesses.

OVERALL ECONOMIC SITUATION –

When recently asked about the worst news, the Fed Reserve Chairman said, "The worst news is the housing collapse." When asked for the best news, he replied, "The best news is the housing collapse." Just like the dot bomb days of a few years ago, housing had to correct. Keeping the balance between a correction and a collapse is what is keeping Bernake up at night. This focus on housing is particularly interesting when you consider that housing and the related consumer spending that comes with new construction, only accounts for about 10% of the overall economic performance of this country. Interestingly enough, that 10% has remained constant for many years. Therefore, whatever happens in housing, whether it is boom or bust, is not going to drive the economy. Consumer spending always has and always will be the biggest driver to our economy. However, the Fed and Bernake are very sensitive to public opinion and therefore housing has garnered more attention than is probably deserved. That is good news for our industry because we are in the spotlight enough to ensure that we will not get lost in the shuffle.

NOTEWORTHY BUMPER STICKER –

"Be thankful that we are not getting all of the government that we are paying for."

SALES BOOT CAMP –

Our first sales boot camp was a great success. We had 21 people attending and all felt that they left with some good practical knowledge to help sell in this difficult market. Remember, if you are interested in having us come in and do some sales training for your company, just give us a call. We intend to schedule another boot camp in the near future so watch your mail closely for the flyer. The last one filled up quickly and we hate to have people on a waiting list.

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OWNER'S BOOT CAMP –

Because of the popularity and success of the sales boot camp and in responding to so many questions that we get from owners, CEOs and Presidents, we have decided to have a special program designed only for the top decision maker in the company. This will be a one day intensive session that will discuss the following:

- How to recruit and hire the best workforce
- Compensation strategies
- Sales management
- Building a cohesive team
- Financial management
- How to develop and administer a clear and concise business plan

The date of the session will be Thursday, December 14. Attendance will be limited to the first 20, so please pick up the phone and call 866-387-7601 to make your reservation. Remember, you must be the owner, President, or manager of your organization to attend.

PROUCT NEWS –

As predicted last quarter, we did see a run-up in prices on several major product lines. In some cases the price increases exceeded 15% which just defies logic in view of the market. But remember, we said much of that increase was due to the increase in commercial construction. Commercial construction continues to increase and is projected to remain strong for at least another 2 years. The demand from that sector combined with the softness in the residential side should result in fairly stable pricing for some time. Therefore, don't expect any drastic price increases anytime soon, but instead plan for a relatively stable price structure.

NEW PRODUCTS –

Last quarter we told you about the OSI product. We continue to add OSI products to our inventory and now stock almost the entire line of that well branded and well recognized product. Branded products typically sell better and usually command higher margins. Look at your caulking and adhesives shelves and see if it wouldn't make more sense to have one brand that will be recognized by all of your customers.

OLD PRODUCTS TAKING OFF –

Two of our recent addition products have become major successes in the market place. ProCell decking is a product that finally does what composite decking was supposed to do but never did. ProCell is a product that truthfully doesn't stain, doesn't warp, doesn't scratch, doesn't crack, stays cool to the touch, and can be installed with fewer labor dollars. Consumers love it and are starting to ask for it. Don't be one that doesn't have it on display.

Through a huge educational process, Weslock has finally gained a firm foothold with many builders. Builders are reporting to us that the all-steel construction provides a lock far superior to the market leader and equal to, if not better, than the other high quality products. And the price point allows them to deliver this top quality product for a cost substantially less than the other top quality products.

Good rule of thumb to follow in sales: The higher the quality, the higher the price, the higher the margin percentages and the more gross profit dollars delivered into your business. Don't ever pass up the opportunity to upsell your customer.