

# THE PARLIMENT PAGES

July, 2005

## ECONOMIC AND MARKET NEWS

**Overall Economic News** – Last month I was in Syracuse, New York giving a presentation to a group of business owners. Since Syracuse is not a great hub of travel with continuous flights out, I finished my program and found that I had a little over 4 hours to kill before my flight left. Knowing that the Syracuse airport was not going to be a fascinating place to spend 4 hours, I conducted myself on a tour of the greater Syracuse area. I drove North, South, East, and West. Got lost and traveled in a couple of circles. However, what I remember the most, is that in the 3 ½ hours that I drove around, I did not see a single new house being built. Not one.

In our part of the country, it is impossible to drive 3 ½ minutes without seeing new home construction. What a stark difference and what a statement about our overall economy.

This was brought to light even further as I studied the numerous economic reports that we get. As has been projected for well over 18 months, the national economy is truly in a slow-down mode. Nationally, the economy is experiencing the projected “soft landing.” We, in the South, have been oblivious to it because we have been blowing and going for so long and have seen no slow down whatsoever. However, some of the effects of this soft landing elsewhere are starting to creep into our localized economy. One would think that this slow down would translate into a slowing of demand for our product. However, this is not how this soft landing has manifested itself.

Instead, demand remains strong in our market. However, the shrinking demand in other markets has led to a buildup of inventories by many of our suppliers. As the law of supply and demand works, we are seeing a softening of prices. While picking up a current price sheet makes this easy to see today, the question always remains, “What will happen in the future? Will prices continue to slide, firm-up or even rise?”

The same economic sources that we have used over and over to make our predictions have also come up with a firm prediction that the soft landing will end in the first quarter of 2006 and that the economy, nationally, will reheat to unprecedented levels by July of 2006. Most predictions show that the years 2006 to 2011 could be the strongest years in our economic history. In all likelihood, this will mean another round of escalating prices.

However we cannot ignore all of the questions surrounding sales demand. You cannot pick up any publication today without seeing talk of the “real estate bubble.” There seems to be universal agreement that we are in a bubble and it is a big one. The question that no one seems prepared to answer is “when will this bubble burst?” Again, I think we have nothing but good news on our front. As crazy as this sounds, we, in our market area, are lagging significantly behind other parts of the country in rising prices. While we have gone up about 15% per year for the past few years, other parts of Florida and other large metropolitan areas have risen at rates twice that. In addition much of the escalation is being driven by speculators who really have been limited in our market by smart builders who are not selling to anyone who is not going to live in the home. It is logical to assume that when the bubble bursts, it will be the other areas that are affected first and to a greater degree. Again, we should be isolated to a great extent from any burst.

Therefore our conclusive predictions are as follows:

1. Prices will moderate with some products experiencing a slight deflation between now and the end of the year.
2. Demand for the product will continue to increase at about 8% annualized through the summer of 2006 at which time we will probably see annualized increases at about 12% per year for the next 3 – 5 year period
3. Prices on products will escalate at a moderately significant rate beginning in the summer of 2006.
4. The opportunity to continue at the same or better profit levels will continue through 2010.

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## Parliment Steel Products, Inc. *You Can Rely On Us*

How certain are we of these predictions? As Ronald Reagan once said, "Please give me a one-armed economist." President Reagan was tired of hearing "on the other hand." For us, the "other hand" in all of this continues to be China. The largest producer of steel output for nine consecutive years has been China. They have over 800 iron and steel firms trying to meet the 20% + annual increases in their own domestic steel demand. The big question is, "Will this demand stay the same, decrease or increase?" In the past year there has been some decrease which has resulted in a stockpile of over 1.6 billion tons of steel sitting in China. If demand in China decreases further or lasts longer than projected, those tons could be dumped into the US with strong deflationary results. We believe that demand in China will increase internal consumption as they continue to get ready for the 2008 Olympics with a result that exports will not increase significantly over what they have been in the past couple of years. Therefore, we stick with the predictions listed above acknowledging, on the "other hand" that a big piece of that projection is based solely on what the government of China chooses to do with its economy.

**Interest rates** – Moderate increases in short-term rates are expected to continue through the 3<sup>rd</sup> quarter. Unless inflation raises its ugly head, there probably will be fewer increases beyond that. The differential between 15 year and 30 year mortgages will close until pricing becomes pretty much the same. This still remains to be one of the best times to take on debt. If you have been dragging your feet on any expansion plans, get off the pot and do it. Your grandchildren and their grandchildren will not be able to borrow money as cheaply as we can now.

**Fuel Prices** – Fuel prices have escalated even beyond our predictions. However, it appears there will be a small retrenchment in the near future to get us back to the \$2/gallon gas prices. Again, despite what you may read in the papers, we don't think you should plan on prices substantially below \$2 a gallon again. It is interesting that these prices really don't seem to be having much of an impact on the economy. Fuel and energy costs amount to about 3.1% of personal consumption expenditures. This is right in line with where it was 10 years ago. That shows how much our personal consumption income has increased.

**Single family housing permits** – The last page of this newsletter is dedicated to a statistical review of single family housing permits county by county. Last quarter several counties quit reporting, which threw off the statistical totals. This quarter, those same counties failed to report, so I just deleted them to maintain consistent comparisons. As can be seen from the numbers, things just seem to keep going up. We look at these statistics as a very accurate depiction of what is happening in the market place. If you ever have questions on any of this specific data, give us a call and we can tell you the source and where you can get better breakdowns of the information.

### **INDUSTRY CONSOLIDATION**

**A little history** – As cyclical as the sun and moon, so goes the merger and acquisition business. Fortunes are made, lives are changed forever, and mistakes are common place. After a rather dormant couple of years, it appears that the company buyers are back in the market place. The 90's were a period of unprecedented purchases. Most transactions were for unrealistic values that didn't pan out for the acquirers. These mistakes coupled with the downturn in the stock market stifled acquisition activity over the last 6 or 8 years. Now, low interest rates, good profits, and need for additional profit growth have put the buyers back into the market.

**Horizontal vs. Vertical** - There are two primary types of strategic acquisitions. A horizontal transaction would be a consolidation of competitors. Here numerous like businesses are put together to get better purchasing, technology and sales coverage. Vertical transactions are either upstream, where someone buys a supplier or downstream where someone buys a distribution channel.

Both of these types of acquisitions are happening in the market place today.

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**Why do acquisitions happen** – Companies acquire others to:

1. Gain market share
2. Acquire management or talented labor
3. Pick up specific customers
4. Gain cost savings through consolidated operations
5. Increase purchasing or selling power through economies of scale
6. Expand geographically
7. Gain access to certain products, technology or processes
8. Boost stagnate earnings.

**Merger vs. Acquisition** - First, understand that there is no such thing as a merger. All of these transactions end up being acquisitions regardless of how they are labeled. *And unless you are the acquirer, you will probably be the odd man out.* Statistically this is what you can count on. Within 3 years 92% of the employees of the acquired company will be gone. In 94% of the cases, the original owner will not stay beyond any transition period. And within 4 years, 85% of all acquisitions will fit one or more definitions of failure. It is tough to succeed in this business.

However, despite this, activity will pick up and we will see transactions consummated.

**What will be the effect on us** – *Because of the high failure rate of acquisitions, in most industries there is hardly ever much long-term effect of consolidation on the good operators.* Sure consolidation may increase competition, shrink some profit margins and force higher levels of professional management. Short-term there will be a lot of hand wringing, complaining and using that as a rationalization for all sorts of bad things. But the good operators will cope with that and will become better in the future. We all must realize that good competition is always good for the industry over the long-haul. Good competition takes the apathy and comfort out of our lives and forces us to new levels.

So if you start to hear about some acquisition transaction down the block, don't panic. *Focus on what you do the best and ride out the storm.*

**PRODUCT NEWS**

**Weslock** – We have now stocked the Weslock product for a long enough time for the product to cycle through to the end user. The reports we are getting back are incredibly positive. We are hearing both directly from our customer, and indirectly from some builders as well as home owners, that the Weslock product is a clear winner over all the competition. Over and over we hear about the *styling, the quality and the pricing.* In addition, we consistently are beating the competition in the service area and keeping the flow of products happening when it needs to happen.

**Shakertown** - A couple of months ago we became a dealer for Shakertown cedar shingle siding and panels. While this is not a big product, we want you to know that we are stocking this. This is a specialty product that you will get asked for from time to time. Most of you, in the past, have turned this business and profit away. We are pleased we can now help you fill those orders.

**Rhino Deck** - We have added the cedar colors to all of the Rhino Deck composite decking product. With all of the continuing problems that we see with pressure treated woods, the Rhino Deck product continues to grow. If you do not have a display in a prominent place, again you could be losing big profit opportunities. If you need any help to better understand composite decking or need displays or sales aids, please let us know and we will fix you right up.

**Sales Meetings** - Ever feel that your sales meetings need to be spiced up in some way other than you throwing a temper tantrum? We can help relieve the repetitious nature of the sales meeting by helping with presentations. We can either do a short sales training program called, "When the Other Guy's Prices Is Lower," or we can do specific product training on any of the wide range of branded products that we stock. Just give us a call and we will be glad to help.

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