THE PARLIMENT PAGES

APRIL, 2012

BLIND AS A BAT –

Over the past 45 days, I have spent an extensive amount of time talking with business owners from all around the country. Many were in our industry, some were in related industries, while others came from a totally different direction. The purpose of these calls was just to try to get a pulse on expectations for the coming year.

In all of my years of talking with business owners, I have never received responses that were so consistent. I estimate that I talked with over 60 business owners and it seems that everyone was reading off of the same script. The conversations all started with a statement that 2011 was an ok year. There was a fair amount of certainty that the first quarter of 2012 was also going to be ok. After a pause, they then went on to say that they thought the balance of 2012 was also going to be ok. At that time, I also asked if they had a basis for their predictions for the rest of 2012. There were a few comments that there were specific projects bubbling up, but by and large, it was just a “feeling.”

As we would talk further, I would discover that the feeling was pretty much based on a couple of things. First, there was the belief that things just had to get better. It has been so bad for so long that it is time for a recovery. As the conversations progressed, it became apparent that the “feeling” of things getting better was really more of a hope. More often than I cared to count, the conversations almost always wrapped up with a statement that they hoped things would get better because they just didn’t know how much longer they could emotionally and financially hold out.

As I started to dissect these responses, I began to realize that much of the emotional turmoil came from an overwhelming sense of uncertainty and unpredictability. We are deluged daily with conflicting financial stories, misleading and distorted government statistics, political uncertainty, and growing worldwide economic issues. The combination of these factors has left company owners sitting in a chair that has no predictable vision of the future.

An airline pilot will use sophisticated instruments to guide him through impenetrable darkness and bad weather. Take away those instruments and disaster awaits. In business, our instruments either don’t exist anymore or are malfunctioning. Flying blind as a bat is not the safest way to reach a destination. It results in a lot of guesswork and a blind faith.

VARIABLE COST MANAGEMENT –

The problem with an unpredictable future is the suddeness that we can be hit with a major change. That change could be a radical uptick in business or it could be a dreaded business slump. No matter how savvy we are, we have learned over the past four years that the market conditions will affect our revenues more than any combination of actions we can take. If the market drops 70%, it is virtually impossible to grow sales. Those of you who successfully weathered this past downturn will realize that your success came from a combination of grabbing market share while at the same time reducing the cost structures of your company. Unfortunately, too many were too late in cutting costs and sustained unrecovered losses until the expenses were brought into line. The effect of this delay put many companies out of business and deteriorated the balance sheets even more.

So, here we are today, the beginning of the second quarter of 2012, and no one seems to know if business is going to go up, go down or stagnate at existing levels. To help overcome this uncertainty, more and and more company owners are moving towards variable cost management.

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Variable cost management is quite simply the restructuring as many of your expenses as possible to a variable, based upon sales, production or other measurements. Examples could be a higher variable sales commission replacing a base salary. Some companies have sold off vehicles and are renting rolling stock only as they need it, paying for miles driven instead of a monthly payment to the bank. Salaried yard workers are converting to hourly pay and are only punched in when there is work to do. We have seen building leases restructured with rent based wholly or partially as a percentage of revenues. The list goes on with some unbelievably creative thinking. The closer your expense structure is to a variable model, the quicker your expenses will automatically adjust to changing market conditions.

In addition to managing the profit and loss through variable cost management, companies today are also able to variably manage their balance sheet, i.e. assets and liabilities. Lines of credit are designed to only borrow when you need the funds. If you are not on a bank “zero balance sweep account ,” you will be paying interest on funds sitting idly in your bank account. Today is a great time to work harder with your vendors to insure quicker delivery and better inventory management. You can sacrifice a little margin by purchasing smaller quantities with more frequent deliveries. Such a strategy will free up cash, space, labor and minimize inventory loss.

The result of this is a more nimble and agile company that can quickly scale up or down as the uncertainties of the market continue.

COULD THIS BE THE END FOR SOME? –

Over the past couple of years we have continued to talk about the consolidation taking place at all levels of the distribution chain. Our predictions rang true as every week, news of a combination or closing hit the press. However, we believe 2012 is going to see an acceleration of failures and combinations. Weak balance sheets combined with a continued depressed demand has resulted in many companies reaching the end of the rope. The remaining strong will accelerate their acquisitions of the weak and the weak who are not attractive enough to be bought will fall by the wayside.

As we have stated repeatedly, this consolidation is always an opportunity for the well managed companies to step into a situation where they can pick up market share and assets at bargain basement prices. Keep your eyes open for those bargain basement opportunities.

THE BIGGER THEY ARE THE HARDER THEY FALL –

Over the past 40 years of business experience, I have come to recognize the cycles of mergers and acquisitions. Most of these types of transactions take place at an economic peak. This will always result in balance sheets bloated with overvalued assets and crippling levels of debt. As the market turns down, these highly overleveraged companies fail. Our industry is one of the best examples of that as we have seen many of the national chains suffer beyond redemption. More of this will occur in 2012 as investors and banks are exhausted by the protracted recovery and will be throwing in the towel. The result will be a combination of more big failures while yet others will continue to scale back operations.

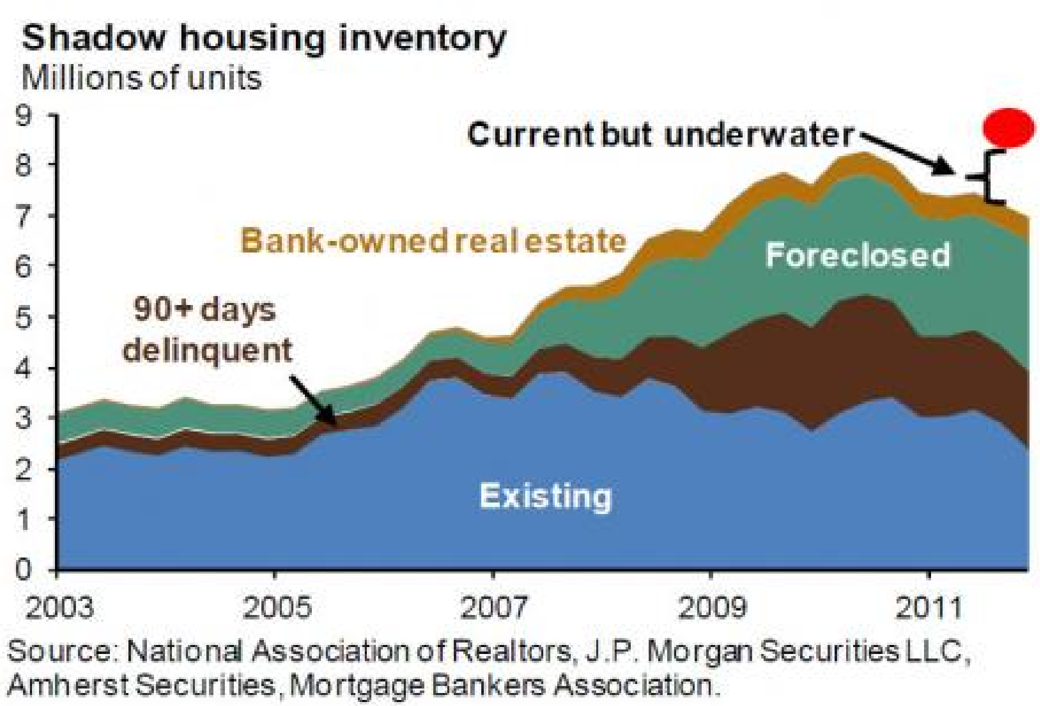
Again, this is a wonderful opportunity for the local dealer to gain back that market share. Locally owned businesses will always be more agile and responsive and can find and capitalize on those opportunities.

<u>THE REAL STORY ON FORECLOSURERS –</u>

There can't be any doubt in any of our minds that foreclosurers have had a significant impact on our business. For most of you, this has been a huge negative event. Contractors are understandably unwilling to begin any speculative construction when neighborhood after neighborhood are filled with forclosed properties selling for a fraction of the cost of a new construction. Some of you have taken advantage of the situation and have designed a piece of your business to deal with the construction issues surrounding foreclosurers. However, no matter which side you come down on, understanding the future of these foreclosure events is critical in our planning.

I am sure many of you have heard of the "robo signing" scandals that have given the banks such heartburn over the past 12 months. Simply put, these were mortgage contracts that had questionable enforceability. Because these mortgages had a cloud hanging over them, banks were hesitant to start the foreclosure process because of the fear that they might not be successful. As a result, a huge number of really delinquent accounts were not thrown into the foreclosure column.

The graph below paints a very ugly scenario from numerous angles. First, the total of 90 day delinquent mortgages and foreclosed property is more than double the total amount of new inventory. This is an astounding number that has no historic precedence. Next, the rapid growth of the 90+ day delinquent is equally frightening. With no real signs of rapid economic recovery in sight, it can be assumed that a large part of that deliquent number will be converted to foreclosed property. Until 2007, all numbers seemed to track along fairly consistently. Clearly, and no surprise, since 2007, the game has changed signficantly. As the banks get back to foreclosure policies more consistent with historical trends, the sudden influx of inventory could become very depressing to home valuations and available inventories of new homes. We believe this will all play out over the next six months or so.



As long as these massive numbers of foreclosurers are sitting in the market place, it is hard to imagine that any type of sustained housing recovery can occur in the near future.

THE BLAST –

Almost a year ago, I wrote that I was splitting the Parliment Pages into two different publications. The first, which is this one, was going to be more dedicated to reporting the specifics within our industry. We would address the industry trends, economic factors that relate directly to the industry, and management leadership issues which are key to our businesses. The other publication, which is titled "***The Blast,***" is a broader look at the geopolitical, economic, and cultural issues that are impacting our country. That publication is more of a personal commentary and definitely has a conservative slant. This monthly publication just released its ninth issue and the response from the readers has been very positive. We started out with just a couple dozen readers and our distribution list is now approaching 1,000. My goal for this publication is to provide a simple presentation of some of the very complex and interwoven events that are taking place both here and abroad. If you are not receiving this new publication and would like to do so, please send an email to: jbleech@no-excuses.com We will put you on this list. If you would like to get caught up on the past issues, just mention that in your email and I will forward them on to you.

GASOLINE PRICES –

We have all seen the recent increases in the price of gasoline. Today, I filled my tank, paid almost $4 per gallon and had a total bill of $85 for enough gas to get me by for a couple of days. Both political parties are pointing fingers. Some fingers are leveled at Iran, while others are leveled at the failure to approve pipelines, and yet many are blaming the paralyzing impact of regulation on our own production. These are all valid and make for good political commentary. However, the single biggest reason for high fuel costs is quite simply the devaluation of the dollar.

Let me give you an example. In 400 BC, during the reign of King Nebuchadnezzar, an ounce of gold bought 350 loaves of bread. Today, an ounce of gold still buys 350 loaves of bread. That would lead one to conclude that the value of gold has not changed in almost 2500 years. What has changed, however, is the number of dollars that it now takes to buy an ounce of gold. When Nixon took us off the gold standard in 1971, you forked over $35 per ounce. Now you have to dig into your pockets and shell out over $1,600 to buy just one ounce.The common mistake is assuming gold has risen in value, when this illustrates that gold has remained constant. It is the steady and continual erosion of the dollar that has caused gasoline and other commodities to rise in price.

We can increase supplies with more drilling and better pipelines. We can all begin to drive our cars pedaling our feet like Fred Flintstone and bypass the gas station altogether. We can power our air conditioning and refrigerators with solar power. We can convert our power plants to natural gas. But none of these will fix the basic problem of the erosion of the dollar. Until the erosion of the dollar stops, inflation will continue.

BEWARE OF INFLATION ELSEWHERE –

This same erosion of the dollar will impact many other items in our lives as well. Hardest hit will be commodities that primarily come from an overseas destination. We are already seeing huge increases in various foodstuffs, cotton, and rare earth minerals. In construction, it has only been a depressed construction climate that has kept steel prices from skyrocketing. When we experience a legitimate and sustained increase in construction, you can expect many products to inflate faster than you have ever imagined.

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