

THE PARLIMENT PAGES

April, 2005

ECONOMIC AND MARKET NEWS

Overall Economic News – On a recent vacation trip to the Caribbean, I had the experience of following a fully loaded redi-mix truck up a very steep hill. The truck was groaning along at about 3/4 Mile per Hour. As I was crawling along behind that truck it suddenly dawned on me that there was less than 1 Mile per Hour separating me from going up the hill and from being squashed.

I think the same can be said about our economy right now. Nationally, we are in a very precarious economic position. The difference between economic prosperity and a slowdown is about the same as me and the concrete truck. The real question we continually struggle with is how will our economic area stack up against this rather shaky broad economic overlook. The projected soft landing has hit the rest of the country. As we predicted several months ago, housing starts have flattened around the country. We expected this and we also predicted that this slowdown would not be indicative of Florida/Georgia. The good news is that our predictions have been right on target again. Housing starts in our market, which we track county by county, month by month have continued to rise. (For those of you familiar with this newsletter, you may recall that we traditionally dedicate the back page to a county by county analysis of housing permits. However, due to some type of glitch, a large number of counties have not reported results for the past several months. Therefore, we have chosen not to publish that data until the glitch is worked out. We hope to have the quarterly statistical report again in next quarter's newsletter. If you would like specific county information that is relevant to your business, please give us a call and we can provide you with the data.)

The facts are impressive. Florida is gaining 1,000 net new people EVERY DAY. Of the fastest growing counties in the country, 14 of the top 50 are in Florida. Think of the impact that has on housing demand. Over the past 5 years, the SE USA economy, if valued by itself, would be the fourth largest economy in the world. And during that period it grew faster than any other economy in the world. Whereas in the past couple of years, this growth was fueled by tax credits and interest rates, the growth now is far more broad based and is driven primarily by job growth therefore making the growth more sustainable.

Let's look at some objective analysis. It appears that housing starts for our entire market area are up over 10% from this time last year. This is consistent with our past predictions and tracks perfectly with what all of our economic sources foresee. Last year there were 165,000 new housing permits in Florida. The projection for 2005 is 187,000. Total spending will be even higher as hurricane damage expenditures kick in.

So once again, it looks like we will continue this upward business cycle. How long will it last? We have had several discussions with some of the best economic minds in the country. There seems to be a consensus that this cycle will improve somewhat in 2006 and then will remain strong through at least 2011. At that point, they see a gradual retrenchment that will leave us in a nominal growth mode. Think about the implications of these predictions. First, we will continue with this unbelievable market at least through the next 12 months and then it will get better for the next 4 – 5 years. On top of that good news, when it does slow down, we will still be cooking at a rate that is incredibly profitable.

Bottom line, don't hesitate to invest in your business. Whether it is capital expenditures, property improvements, new equipment, more sales people, new showroom, this is the time to do it. Don't be cautious. Carpe diem – seize the moment.

Interest rates – Most economic forecasts are showing a gradual increase in short-term rates. The expected increase is about 2% over the next 12 months. Since this will be gradual, there is little fear that these increases will cause any negative repercussions in our economy. Oddly, it seems that the long-term rates have anticipated these increases already and mortgage rates are not expected to rise more than 1% over the next 12 months. Again, great news for our businesses.

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

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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.

Specific market information – As we suggested, there is no doubt that building officials are stepping up the code enforcement. The prospect of another hurricane season like 2004 has put enough fear into the officials that they are demanding better compliance.

We are also noticing another potential trend. It is too early to make any firm predictions, but there is some real good market indication that the interest in stucco houses may be diminishing. We think it may be a combination of water saturation problems and atheistic demands. More on that later.

EMPLOYEE COMPENSATION

About to become a bigger issue – One of the leading economic indicators we always watch is the use of temporary help. When temp help increases that is generally a warning sign that the job market is going to heat up. This has happened off and on for the past couple of years, but oddly enough, the increase in the job market seemed to be having very little, if any impact, on the wage scales. In fact, despite job growth, wages remained flat. Well those days appear to be over. *The increase in temp workers has been dramatic and with that increase in demand, we are seeing wage escalation that has not really existed for at least 5 years.*

As we travel the area, talking with our customers, we find that a consistent topic of conversation is employee compensation. At more dinner tables than I can remember, I have had people like you say, “How do you pay your people.” The ensuing conversation has left me with the following conclusions:

- No one does it the same way
- It is inconsistent within the company itself
- It is never addressed until it is too late
- There is never an overall philosophy and plan
- Compensation changes are executed horribly
- It scares the *^%*&^* out of us

The change in the job market and the sudden pressure on wages is about to make compensation a major talk of discussion in most companies. Please don't react to this but get ahead of the curve and start planning now.

How do you design a compensation program - One of the reasons most compensation programs fail is because there is no coherent philosophy in place that helps guide the design. Ask yourself the following questions:

1. In what range do we want to compensate our employees compared to the rest of industry?
High Medium Low
2. What percentage of our compensation do we want to be individual incentives?
3. Do we want our compensation to reflect overall company performance?
4. Do we want to reward seniority or performance and how should a program handle the difference and conflicts between the two?
5. Do I want to compensate based on job categories?
6. Do I want to be consistent?

I suggest that you decide philosophically the answer to each of these questions prior to designing your plan.

As to the actual design, there is not a single design that is always correct. Each company has different needs and different goals. However, as you work the design, you may want to continually ask the following:

- What behaviors am I trying to either change or incent?
- How complex is this design?
- Is it too complex to be readily understood?
- Does the design cause people to only focus on making personal income at the risk of hurting the company in a bigger area? (Example – You are trying to move some old inventory and the

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only way it will move is to sell it below cost. However, you pay people based on the profit of the sale. Therefore there will be no commission and hence no incentive to sell it.)

- How easy will it be to change this program in the future?

Other plan design issues - Many comp plans become annuity programs after a while. For example, if you are trying to design a comp plan to incent your salespeople to bring in new business, you must be careful how you compensate them on existing business. For example if you pay 30% of gross profit for all sales, why should a salesperson work new business when his existing business pays the same amount. DO NOT EVER ALLOW COMPENSATION TO BECOME AN ENTITLED ANNUITY.

Another issue that many of us have faced is the forklift driver who has worked for us for 27 years. Modest increases every year for 27 years have now made the employee grossly overpaid for his job description. We have all heard the story of the secretary who worked for 30 years for the same boss. The boss retired and his replacement could not justify keeping the secretary at the inflated salary. Net results, hard feelings and bad blood from every one involved. DESIGN A PLAN TO GUARD AGAINST SALARY CREEP.

Bonuses - We could write 10 full length books on bonuses and still not cover everything. However, despite all of those words, I believe that 90% of the bonus programs out there just plain don't work. They don't work because of two primary elements: the ultimate sense of bonus entitlement; and the complexity of designing a program that will last over time. After all, a company may have certain objectives at the beginning of the year but because of market or economic changes, those objectives may change radically later in the year. And those new objectives may be diametrically opposed to the bonus plan design.

What's the answer? There is no easy answer. If there was, a book would have been written, would be a 50 year best seller and the author would be on a beach sipping rum runners. However, I have believed and practiced for many years in a bonus program that is a combination of objectively and subjectively

The objective part is determined by formula. Whether it is a percentage of sales, departmental income or company income, there is a specific method for calculating the total bonus money to be paid. I believe that there should also be a formula to determine how 50% - 75% of that bonus should be distributed to the individuals. I believe the balance of 25% - 50% should be paid based on the discretionary decision of the overall boss man.

Invariably, people will squawk at discretionary bonuses claiming all sorts of inconsistencies. However, I have found that the biggest reason that supervisors balk at it is because they don't want to make the hard decisions. All of us have companies that are sized so that we or our direct reports know virtually every employee in the company. We know intuitively who is doing the good job. We just need the courage to look everyone in the eyes and tell the truth.

How to change a plan – Once the design is complete, I suggest communicating the comp plan with examples. I suggest that you do so well in advance of the effective date. For changes in sales comp, I would suggest a 4 – 6 month advance notice. For other departments, I would suggest a minimum of 30 – 45 days. Give your employees a chance to get comfortable with the plan. Give them the opportunity to make some calculations. And above all else, never ever change a plan and make its effective date retro active to a prior date.

PRODUCT NEWS

There is a lot happening in the market place.

Rebar - We are getting hit with another price increase in rebar. It looks like the increase will settle in around 5% and will be effective May 1. There has been some speculation as to whether the increase will hold and as the date gets closer we feel more confident in predicting that rebar will in fact rise 5% on May 1. It is difficult to make sense of what is going on in the market without really understanding all of the factors. The Port of Jacksonville is loaded with tens of thousands of tons of imported bar that landed last fall. It came in at high prices and the brokers have been unable to move it because of the price stability over the past 6 months. Now, you would think that with prices going up, that bar would start to move out of inventory. However, it has been sitting unprotected in a salt-water environment for 6 months and is in really ratty shape. So the brokers are in the old proverbial situation of "damned if we do and damned if we don't." To sell it now, they would take huge losses. To wait until the prices go up will cause additional storage charges and further deterioration of the product. Bottom line, be wary of the vendor offering cheap rebar. You may be receiving nothing more than a load of iron oxide dust. Be careful. If it sounds too good to be true, it will be.

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NP 1 and SL 1 – Being in the distribution business, we are like kids in the candy store when it comes to new products. However, our latest acquisition is clearly the one that has created the most excitement not just with us but with our customers as well. The product is manufactured by Degussa Building Systems and has an international reputation as being the leader in premium single component, non-sag polyurethane sealant. It is known for its easy gun and tool applications and its adhesion to all types of surfaces. This is another branded product that should help you gain competitive advantage.

Sharkskin - We have also picked up the Sharkskin product which is a roof underlayment. There has been considerable demand for this product because of its ability to stay on the roof without immediate application of shingles. With the shingle shortage we are hearing of more and more contractors who need this type of underlayment. Speaking of roofing – there is still an acute shortage of roofing products. We are doing our utmost best to buy and stock as much of these as we can.

Underlayment products - Speaking underlayment, we also have the Fiberock and Durock underlayments from USG. Again, these are nationally branded products with incredible name recognition. These products are utilized in flooring and all types of tile applications. They are easy to work with and have solved many of the engineering problems that have limited other underlayments. As well as the backing itself, we also are stocking a full range of the installation compounds. *Don't let that tile guy down the street take that business from you.*

SUCCESS DRIVERS

Within the past couple of months, we at Parliment added yet another tractor and trailer to our fleet, another forklift and 4 new employees. In the 2 ½ years that we have been in business, it has been a rocket ship ride. We started from scratch and are presently doing 250% of our most optimistic projections. The frenetic pace that comes with that type of growth sometimes keeps us from reflecting on what made us successful. However, we realized how important it is to recognize these “success drivers” to ensure that we continue them into the future.

What did we find from this reflective work? *Clearly our success comes from the execution of our brand, “You Can Rely On Us.”* While this statement sounds so simple, it really is very profound when it comes to the specific implementation. Upon study we found that this reliability factor touched virtually every aspect of our business. It starts with our salespeople and how they deal with you. It continues with our inside support people. Our warehouse, order entry and order fulfillment must execute perfectly. Our truck drivers must deliver the right product to you on time. Our paper work and billing must be complete and timely. And we must always be here to help you with that nagging problem. In short, *we have found that we must be reliable at every single “touch point” in the company.* While we do not always execute perfectly, let there be no doubt that our goal is 100% perfection. This is what we have identified as our success driver and that driver has given us the greatest amount of differentiation in the market place.

Have you done the same in your business?

1. Do you know your brand?
2. Do you really have an understanding of how you are truly different from your competitors?
3. Have you identified the myriad of success drivers that have put you where you are today?

We have found two consistencies with many of our customers. First, they have a specific model of doing business but it is so intuitive that they have never really defined it. If you don't believe me, ask your employees those 3 questions. You will probably find that most can't answer any of those questions. Because you have not defined it and communicated it to your employees, you may find that you will inadvertently wander off the path and before long will find yourself knee deep in the briars.

The other thing we have noticed is that very few of our customers do a good job of externally communicating to their customers what their brand is. Please be careful. The big national companies spend hundreds of millions of dollars articulating their brand. They *are spending that money for a reason: it works.*

While I am not suggesting that you have to spend big bucks, at least start the process of understanding the unique brand of your company. Once you understand it, you can keep your eye on it, keep your employees focused on it, and actively promote the benefits of that brand to your customers.

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