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Business Briefing

What's Happening in the Business World?

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This month *Business Briefing* reports a flurry of business and economic stories that will impact your customer base in the wood products industry...

Ocean Shipping Rates Rise; Port Congestion Eases

The cost of importing from Asian sources is going up. Increases scheduled for May 1 include:

+$285 on 40-foot containers to the U.S. West Coast.
+$430 on 40-foot containers to the U.S. East Coast via the Panama Canal.
+$400 peak season surcharge for containers shipped from June 15 through November 30.

These charges result in an 11% to 12% increase over prior costs not including the peak season surcharge. The average cost of a container is now about $2,800 to the West Coast and $3,900 to the East Coast, again excluding the peak season surcharge.

In the face of higher oil prices, experts attribute these relatively small rate increases to the increase in container ship capacity due to a wave of shipbuilding.

In the meantime, lower ship calls and cargo volumes at the huge port complex at Los Angeles-Long Beach, CA, have resulted in less congestion. Vessels are moving quickly into assigned berths without delay. Diversions of vessels to Seattle, Tacoma, and Oakland contributed to this situation.

Business Must Be Good...

One thing is certain about taxes. Businesses and people pay taxes on income that is earned, not on money they think will be received.

High tax receipts, therefore, indicate that business is good...

1. April tax receipts in Washington exceeded spending by $58 billion this year vs. only $17.6 billion last year.
2. The total Federal budget deficit for the first seven months of this fiscal year was $237 billion, down from $283 billion last year.
3. Federal tax receipts were up 13.7% in the first seven months - Individual tax receipts were up 16%; corporate taxes, a staggering 47.8%.

How then can the U.S. GDP only be 3% to 4% higher?

Chinese Revaluation: In Time...

U.S. Senators, Cabinet officials, and leading business groups are increasing calls for the Chinese to revalue their currency. A recent issue of *Forbes* contained these interesting words on this subject...

> *China's official exchange rate is about three Yuan to the dollar, but what if Peking lets the Yuan float freely? That might just happen, says Yin Yi, head of China's Printing & Mint Bureau. What will it take? "Economic development," he replies. "Up to now we didn't consider it, but that is a question we do need to study." Peking may allow only 10% or 20% flexibility, not a freely-floating currency in the Western sense, warns one outside observer. But any flexibility would mean a devalued Yuan and a potential boost to Chinese exports. Chinese officials have been denying rumors that they plan to remove the Yuan's link to the dollar.*

This quote was taken from the November 18, 1985 issue of Forbes! Seems the Oriental mind moves to a different drum beat than does ours.

Oil: From Whence It Comes

The average American, indeed most of the world, believes that the U.S. is totally dependent on Middle Eastern oil and, therefore, subject to blackmail of the highest order and ill-taken foreign policy decisions.

The facts are otherwise. First, the largest supplier of crude oil to the U.S. is our neighbor, Canada. Second, Saudi Arabia supplies only 1.5 million barrels of crude daily out of a total consumption of 20 million barrels.

Furthermore, the world is not running out of oil. Petro-pessimists insist that a fixed amount of oil is in the ground, we have found it all, and the world is running down its stock of "found" oil. But a recent issue of *The Economist* pointed out that innovation and technology have always resulted in more oil.

Estimates of the ultimate recoverable amount of oil have indeed consistently grown over the past few decades. Since 1971 over 1,500 billion barrels have been added to reserves while under 800 million barrels were consumed. On that basis the world is running into oil, not out of it.

This growth in reserves is resulting from technological advances. Not too long ago the average recovery rate from an oil field was 20%. Today that rate is 35%. That leaves nearly two-thirds of the known oil under ground available for tomorrow's innovations in recovery.

What's needed is more capital investment in research, the development of killer applications that will raise more oil from the ground. And more capital is what higher oil prices are providing. Exxon Mobil alone recently earned nearly $8 billion in a single quarter.

Economic Factoid
The median price of existing homes in the U.S. rose by 15.1% during the last twelve months. In

the last five years average property values have risen 50%. Home equity now represents 38% of the average household's net worth vs. 27% in 2000. More worrying, a National Association of Realtors survey found that 23% of all homes purchased in 2004 were for investment and another 13% were vacation homes. Sound a little like stock market speculation during the dot.com boom in the late 1990's.

Sector Report

Kitchen Cabinets
Cabinet sales rose 13.6% in April vs. the same month in 2004 according to the KCMA's Trend of Business Survey. For the first four months of 2005 sales were up 14.1%.

Down at the company level...

- **Masco -** manufacturer of Merillat, KraftMaid, and Mills Pride cabinets - reported a 7.5% increase in cabinet sales in their 1Q2005. At 14.8% of sales, operating profit in their cabinet segment grew by 13.8%. Installation services also showed strong growth with a 10% rise in sales. Management reported that sales to homebuilders were more robust than to the consumer, DIY channel. Weakening DIY sales may indicate a softening in the important remodeling sector.

Home Furniture
Retail sales of home furniture were up 7.8% in 2004. Domestically-made wood furniture shipments also grew by 4.2%, the first gain in that category since 2000. Imports continued their strong showing with 2004 growth of 13.6% from all source countries combined. Chinese-made shipments of wood furniture to the U.S. were up 16.3%.

While 2004 was a good year for U.S. producers, a little reality must be poured over any optimism. During the last ten years shipments by domestic producers grew by 15.7%. By comparison imports increased by nearly 270%, and shipments from China jumped an amazing 1,630%.

Chinese furniture makers continue to expand. On a China trip Business Briefing visited two new factories of over one million square feet. If the Chinese industry operated their plants efficiently, no need would remain for furniture plants anywhere in the rest of the world.

The Chinese industry is dealing with the fallout from the recently-assessed anti-dumping duties on wood bedroom products. According to Samuel Kuo, chairman of Lacquer Craft, the larger producers who received duties of 6.65% or less will remain viable sources for wood bedroom. Those companies assessed at higher rates are shifting to other product categories. Kuo's company has ownership stakes in Universal and Legacy Classic, two U.S. brand names well known to retailers. Vertical integration via the acquisition of U.S. distribution and retail stores is seen as a natural move for large Chinese producers.

Not surprisingly, a new wave of plant closures has begun:

- **Sligh Furniture**, the 125 year-old producer, is closing its Holland, MI, plant and moving to import its entire line. The closure will idle 75 workers. The company closed its Zeeland, MI, plant in 2002. Source countries for their products are Mexico, the Philippines, China, and Indonesia.

- **Alan White Furniture**, the Stamps, AR, upholstery maker, is ceasing operations in June at its 225,000 ft2 plant. Production from this plant is moving to its Shannon, MS, and Sulligent, AL, plants. About 300 workers will be laid off.
- Canadian producers are also feeling the brunt of low-cost imports - **Durham Furniture** is shuttering its state-of-the-art plant in Chesley, Ontario. The company invested C$38 million in the 147,000 ft2 operation. **Palliser** of Winnipeg is closing one of its leather upholstery plants citing the 30% appreciation of the Canadian dollar and competition from Asia. Concurrently the company announced the building of a new leather facility in Mexico. The Mexican plant will service the U.S. market as well as supply cut-and-sewn covers to the remaining Canadian leather factories. Casual dining and bedroom maker **Dinec** is closing its Louiseville, Quebec, plant and moving all operations to its Trois-Rivieres operation. Since its founding Dinec has combined customization and fast delivery as a strategy for competing with low-cost imports.

In spite of these closures, global capacity remains high.

On the brighter side, furniture maker **University Loft** has acquired the former Universal Furniture plant in Morristown, TN, from Masco. The 635,000 ft2 plant will enable consolidation of five facilities. The company produces upholstery for the youth, institutional, and contract markets.

Financial results for U. S. furniture makers include...

- **Hooker Furniture** reported a 2.7% decline in net income despite a 2.9% increase in 1Q2005 sales. Management attributed the lower income to higher selling and administrative expenses including improvements to its High Point, NC, showroom and charges related to the closure of its Maiden, NC, plant in the fall of 2004. Shipments of U.S.-made products declined 22.4% vs. the same quarter last year. Discounting of slower selling domestic goods also negatively impacted net income.
- **Ethan Allen** announced a 5.5% decline in its 3Q2005 sales. This performance resulted from a same-store decline of 5.5% at company-owned stores and 5.6% in wholesale activity. The company owns 127 stores out of a total of 313 retail stores. The average sales of company-owned stores is $4.7 million, up from $2.5 million in 1996. At the same time, however, corporate operating margin has fallen from 17.6% to 14.7%.
- **Furniture Brands International** reported 1Q2005 sales down 5.3%. Operating profit fell by 26.8% to 6.6% of sales. Management cited a weak retail environment and raw material inflation for its poor performance. The company also consolidated three of its high-end companies - Henredon, Drexel Heritage, and Maitland Smith, into a new operating unit in a move to reduce redundant back office operations.
- Casegoods producer **Stanley Furniture** reported 1Q2005 sales of $83 million, up 16% over the same period last year. Gross margin also rose to 24.7% resulting in an operating margin of 11.3%. Analysts see the company gaining market share in the independent retail channel as other producers like Furniture Brands move to more dedicated distribution strategies.
- **Chromcraft** announced a 51.1% jump in its 1Q2005 profits in spite of a sales decline from $46.5 million to $44.7 million. Gross margin was 23.6% while operating margin increased to 8.4%.
- RTA furniture maker **O'Sullivan** reported a 6.4% decline in 3Q2005 sales. This decrease resulted in a net loss of $13.2 million for the quarter. Net losses for the year total $33.9 million.

Office Furniture

BIFMA reported that March orders increased by 12% year and shipments grew 14%. This performance substantiates the opinion of many industry observers and analysts that contract furniture is experiencing a solid rebound.

Producer level reports support this conclusion...

- **HNI** announced sales growth of 18% in its office furniture segment.
- **Knoll** reported year-over-year quarterly sales up 17%.
- **Steelcase** announced a 23% increase in its 4Q2004 sales. Gross margin was 27.7%. However higher-than-expected operating costs resulted in a 0.7% operating margin. Management cited that its move to lean production techniques required more time than expected.

Wood Flooring

March 2005 shipments of strip flooring declined 11% over the same month in 2004. For the first three months of 2005, shipments are down 6%. As predicted in the April Business Briefing, the flood of flooring imports is adversely impacting domestic producers. Strong consumer demand in the U.S. will not absorb the worldwide capacity of flooring manufacturers.