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### Business Briefing

#### How Loud Will The Bubble Pop?

By Art Raymond, [araymond@raymondnet.com](mailto:araymond@raymondnet.com)

Prognosticators cannot reach consensus on the fate of the five-year U.S. housing boom. Will it explode as investors and lenders rush for the door? Or will population demographics keep demand for homes perking along? Will it be a soft landing or a crash?

The argument focuses on a number of critical factors - some positive, some negative...

- + Mortgage rates remain historically low.
- + Bankers are offering creative mortgage products like interest-only loans and 40-year terms.
- The disparity between incomes and home prices is at its highest level in 25 years. The National Association of Realtor's Affordability Index is at its lowest level since 1991. In some areas, like New York City and San Diego the Index has dropped to levels not seen since the early 80's.
- The percentage of households living in their own home is at near-record levels.



Even the most recent news is giving mixed signals. While sales of existing homes hit a 21-month low in December, new home sales rose by 2.9%, but monthly numbers are notoriously volatile.

One longer term fact remains positive. Between now and 2025, the U.S. population will grow by 70 million, the equivalent of California, Florida, and New York combined. To accommodate this growth, 100 billion square feet must be constructed. That equals a lot of houses, wood floors, kitchen cabinets, doors and windows.

The remodeling of existing homes will continue to support usage of these products. According to *K+BB*, a leading kitchen and bath publication, 2006 looks like a strong year for remodeling in these two critical rooms. Their survey forecasts:

- ✦ Kitchen remodeling jobs up nearly 10% with spending rising by 20.8%.
- ✦ Bath remodeling jobs up 7.3% and spending up 12.5%.

The forecast predicts a total of 6.06 million kitchen jobs worth nearly \$80 billion. By comparison, new homes will account for only 1.94 million kitchens. More than 40% of these jobs will be valued at \$40,000 or more.

Bath remodeling jobs will total 8.96 million at a value of \$36.95 billion. New home construction will add another 3.92 million bathrooms. Nearly 48% of the remodeled baths will cost over \$11,000.

*Bottom Line:* Secondary wood products have benefited from housing's five-year run.

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Keep your eyes on the housing numbers.

### Manufacturers Focus On Cost Reduction, New Products & New Markets

In *Managing Automation's* latest survey, cost reduction repeated as the highest ranking business priority of its readers. In this year's poll 61% of all respondents selected cost reduction from a menu of eight priorities vs. 60% in the 2005 survey. The cost disadvantage that U.S. manufacturers face shows no signs of lessening. Continually rising health care and energy costs are adding to the 22% disadvantage vs. foreign producers reported by the National Association of Manufacturers.

Closely behind the cost reduction focus in the survey came two related priorities: new markets and new products. Over 40% of respondents indicated the need for new, fast product introductions and new markets for existing products as keys to their business success.

In their quest for these objectives, readers indicated a willingness to spend on information technology tools. This spending will be aimed at improving agility, i.e. the ability to respond to customer demands. Agility includes a diversity of activities: understanding demand signals, designing products, managing the supply chain, and allocating labor and other resources.

Unstated in the *MA* survey, yet clearly understood in the pursuit for agility is the need for fast customization. The ability to fulfill demand for customized products in less than four weeks is one competitive advantage the Chinese and other foreign competitors cannot capture. You can bet that prospective buyers of woodworking equipment are seeking that kind of agility more than ever.

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### Economic Factoid

Keep your eyes on demographics as an indicator of economic fortunes. Later this year the U.S. population will reach 300 million. A new baby is born here every eight seconds. Someone dies every 12 seconds. An immigrant moves here every 31 seconds. The net result - our population grows by one every 14 seconds. Metaphorically speaking, the 300 millionth American will be of Mexican-Latino extraction born in Los Angeles County of Spanish-speaking parents.

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## Sector Report

### Kitchen Cabinets

Cabinet sales rose 13% in December versus the same month in 2004, according to the KCMA's Trend of Business Survey. For the full year (2005) sales were up 13.3%. This increase covered all product categories: custom sales were up 9.7% for the year; semi-custom, up 14.6%; and stock, up 12.9%.

### Home Furniture

Strong retail furniture sales are seen in 2006 and beyond...

Jerry Epperson, of investment banking firm Mann, Armistead & Epperson, is forecasting 2006 retail sales of \$82.9 billion, up 6.5% over 2005. Last year's retail sales grew by only 3.1% over 2004. One bright spot in 2005 was a 7% rise in manufacturers' shipments of wood and upholstered furniture. Epperson is concerned about declining furniture retail margins which have fallen to 36.5% from the peak of 42.9% achieved in 2001. His forecast for 2006 shows imports accounting for 56% of all wood furniture sales and 20% of upholstery sales.

*Furniture Today* is predicting a 23% increase in furniture and bedding sales by 2010. Their forecasters noted that Baby Boomers will be moving into their peak earning

years while their children, Generation Y echo boomers, are entering their household formation years. Spending in the Southwest and South is expected to outpace furniture sales in other regions of the U.S.

Meanwhile, problems continue for Canadian producers...

Retailer, importers, and producers continue their debate over the producers' petition for safeguard tariffs on Chinese furniture imports. These arguments are reminiscent of the Furniture Civil War between U.S. producers and retailers over anti-dumping tariffs on Chinese wood bedroom exports. Canadian producers contend that the furniture manufacturing industry there is at risk. Importers and retailers claim that such a tariff will result in higher retail prices and declining sales.

Canadian producers are indeed suffering...

**Dinec**, a Quebec-based casual dining specialist, has sought bankruptcy protection under Canada's version of a Chapter 11 filing. Company management is seeking time to restructure and refinance the business while continuing operations. Their plans call for the idling of 65 production and administrative staff .

**Shermag** continues to restructure its production capacity in the face of Chinese competition. The company announced the closure of its Lac-Megantic sawmill with the elimination of 48 jobs. Also its Saint-Leonard, Quebec, upholstery plant will be closed affecting 70 workers. Production from that plant will be transferred to its Jaymar facility.

At the same time, China's furniture industry continues to expand. **DeCoro**, an Italian-owned leather upholstery producer, announced a 1.75 million square feet expansion to its Shenzhen plant. The new plant will produce upholstery and case goods, employ 5,500 workers in 3.75 million ft<sup>2</sup>, and produce 70 to 90 containers of furniture per day. **AICO** has announced the addition of three new plants to its supply base in China. These plants, scheduled to open during 2006, will produce casegoods, office furniture, and upholstery.

**Kasen International Holdings**, another Chinese upholstery maker, recently completed a \$64.5 million initial public offering. The company produces for a number of U.S. firms including La-Z-Boy, Rooms To Go, and Furniture Brands in plants totaling 13.9 million square feet.

News among U.S. furniture producers remains mixed...

- ✧ Casegoods producer **Hooker Furniture** reported a 1.4% decline in its FY2005 sales to \$341 million. Management blamed a 25% decline in shipments of its domestically-produced wood furniture. Meanwhile, sales of imported wood products increased by 8.8% to \$202 million. Its Bradington-Young upholstery unit saw sales grow by 8.6%. Net income declined by 35% over 2004.
- ✧ Led by its retail stores, **Bassett Furniture** reported 4th quarter 2005 sales up 10.6% over last year. Earnings for the period declined by 21% owing to restructuring charges associated with the closure of its Mt. Airy, NC, plant . For fiscal year 2005, sales rose 6.2% to \$335 million paced by an 18% gain to its BFD retail stores. The company now supplies 132 stores, 27 of which are company-owned. Fifteen new stores will open in 2006.
- ✧ **Furniture Brands** reported fourth quarter 2005 sales of \$593 million, down 1.4% from the same quarter last year. Sales were flat at its Lane and HDM divisions. Revenues increased at Thomasville while its Broyhill operation continues to struggle. Profits continue to be impacted by charges for plant closures. The HDM division is closing its Drexel Heritage case goods plant in Hildebran, NC. Production will be shifted to a nearby Henredon facility. The Hildebran plant, the division's only remaining case goods operation, employed

218 workers.

- ✂ **Ethan Allen** reported 2nd quarter 2006 sales up 12.5% with net income rising by 13.4%. Management attributed part of this growth to its initiatives aimed at reducing customer delivery time.
- ✂ Casegoods producer **Stanley Furniture** completed their 4th quarter 2005 with sales falling by 2.2%. In spite of this decline operating margin improved from 11.3% to 11.4%.
- ✂ **Vaughan Furniture** announced the closing of its E.C. Dodson plant in Galax, VA. The closure will affect about 200 employees beginning in early March. The company now operates one casegoods plant with 300,000 square feet and 365 workers. At its peak, Vaughan employed 1,500 production workers in 1.5 million square feet of plant space.
- ✂ **Nichols & Stone**, founded in 1857 and one of the oldest furniture makers in the U.S., announced the closing of its Rural Hall, NC, plant. This plant produced bedroom furniture and employed 82 workers.

### Office Furniture

BIFMA reported that December orders increased by 11% and shipments grew 14% vs. the same month in 2004. On a trailing twelve-month basis, orders grew 11.4% to \$10.15 billion. Likewise, shipments jumped by 11.4% during the same period. At \$10.07 billion, annual shipments are now about 19% higher than the market bottom of \$8.47 billion in November 2003. Analysts opine that the industry is now a picture of good health. Yet the annual shipment rate remains about 25% below the industry's peak performance in January 2001.

BIFMA's updated 2006 forecast shows shipment growth projected at 7%.

- ✂ **Steelcase** reported 3Q2006 sales up by 11.4% compared to the same period last year. North American sales rose by 17.4%. Gross margin also improved to 30.6% benefiting from higher capacity utilization and cost controls. Management is calling for a 4 to 8% sales increase in the 4Q.
- ✂ **Herman Miller** saw its 2nd quarter 2006 sales rise by 19% to \$438 million. Gross margin was 32.8%, slightly above the same period in FY2005. Guidance for 3Q calls for a 7 to 13% sales increase.

### Wood Flooring

November 2005 shipments of strip flooring declined by 6% vs. October but rose by 8% compared with the same month in 2004. For the first eleven months of 2005, shipments are up 2%.

#### ✂ Non-Residential Construction

*Building Design & Construction's* 2006 Construction Forecast is calling for a strong year in non-residential construction. The drivers of this growth are accumulated increases in office employment, retail spending, and manufacturing. Vacancy rates are declining, and rents are slowly rising, thus investment returns are sufficient to obtain financing for project starts. Leading segments in their forecast include office (+17.7%), lodging (14.7%), education (14%), and healthcare (12.5%).

In the face of the supposed death of manufacturing in the U.S., spending on factory construction jumped by 20.4% in 2005 and is projected to grow by 10% annually through 2007. Manufacturing capacity utilization is currently 80%, a level at which investment normally accelerates, and is expected to move to 82% by 2007.

While many labor-intensive industries are abandoning their U.S. operations, other manufacturers continue investing in new plants, products, and processes. These new plants contain a fair amount of doors, windows, office furniture, casework, and other secondary wood products.