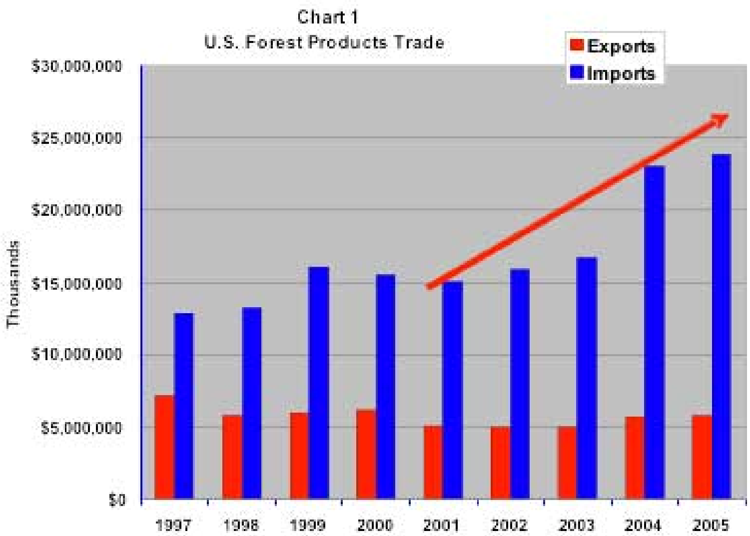
Business Briefing

Beyond The Furniture Deficit

By Art Raymond, araymond@raymondnet.com

Everyone knows about the import tidal wave of wood furniture that has swept away most of the U.S. furniture manufacturing industry. At last count, over 250 plants have been shuttered with the loss of over 60,000 jobs since January 2000.

But, given the vast forest resources in the U.S., what about the foreign trade status of other wood and forest products? By and large, with few exceptions, the U.S. imports far more wood and forest products than we export. Chart 1 shows the dollar value of wood and forest products exports and imports, excluding furniture and cabinets since 1996.



These data include important product categories such as logs; lumber; veneers; panel boards like MDF, particleboard, and OSB; moulding; flooring; windows and doors; poles; and ties. In 1997, the forest products trade deficit was $5.67 billion. Last year, the deficit rose to $18 billion. Exports, nearly $7.2 billion in 1997, fell to $4.96 billion in 2002, before rising steadily to $5.85 billion last year. Interestingly, this three-year recovery involved all of the product categories with the exception of pulpwood, hardwood chips, OSB, particleboard and hardwood moulding. Leading export categories included logs and hardwood lumber – products that have low labor contents.

Let's look at the trade situation in some important hardwood sectors:

- **Logs** – Last year, the U.S. exported $582 million of hardwood logs versus $307 million in 1997. Canada purchased about 35% of these logs with nearly 20% going to China. Imports of hardwood logs totaled only $39 million last year, resulting in a $543 million surplus, up from $280 million in 1997.

- **Lumber** – U.S. sawmills and yards shipped nearly $1.48 billion of hardwood lumber to markets around the world in 2005. Imports totaled $720.9 million creating a $758 million surplus. This surplus has declined from $1.08 billion in 1997 as the lumber supply from the world's forests has grown. These competitors generally have low cost labor leaving U.S. mills as relatively high cost producers. Canada, who purchases nearly 28% of our hardwood exports, is the number one destination with China ranking number two at 13%.

- **Flooring** – The U.S. housing boom has fueled record production of hardwood flooring by U.S. mills. This demand has also attracted competition from around the world. 2005 imports of flooring totaled $415 million, up from $76 million in 1997. China has captured 35% of this import total and has grown their share from $5.7 million in 1997 to $148 million in 2005. Much of this growth has come at the expense of Canada who has seen its share drop from 18% in 2003 to 4% last year. Canada is now suffering from an onslaught of Chinese competition across the wood products spectrum as their currency strengthens.

- **Moulding** – Import growth in this category declined from 41% in 2004 to 4.5% last year. Yet with U.S. exports at $20 million, the moulding deficit was $312 million. Like flooring, the moulding market has seen China capture nearly 31% of all imports, with Canada dropping from 37% in 2004 to 29% last year.

What about higher labor content products?

- **Windows & Doors** – The trade deficit in this sector has grown from $470 million in 1997 to $2.25 billion last year. Canada provides 68% of the $2.57 billion of imports while China trails with only 7.4%. Their geographic proximity, as well as ample forest resources, has clearly provided the Canadians an advantage in this product category.

- **Kitchen Cabinets** – U.S. cabinet makers have thus far held foreign competition out of their market space. Imports total only $897 million in an $18 billion industry. The trade balance, however, is negative as cabinet exports only total $60 million. As with many value-added products, the Canadians shipped $543 million of cabinets to the U.S. and now have 68% of U.S. imports. Interestingly, however, their share has dropped from 88-89% in the late 90's as the Chinese entered the market. In 2005, China's cabinetmakers shipped $144 million of their products to U.S. buyers and captured 18% of the import volume. Anecdotal evidence abounds that more, lower-priced cabinets and vanities are being imported. U.S. cabinet companies are also increasing their use of imported components. Cabinets built from these parts are often marked "Assembled in the U.S.A." and found at your local "big box" home improvement retailer. Trade data do not allow an accurate assessment of cabinet part imports, as these purchases are classified as Furniture Parts. This category has increased from $302 million to $897 million since 1997. With the concurrent decline of the U.S. wood furniture industry, one can easily conclude that many of the part imports are cabinet doors, drawer fronts, and face frame material.

The largest share of the forest and wood products trade deficit belongs to Canada. Shipments of Canadian products accounted for $12.26 billion or 68% of our 2005 deficit. Nearly 53% of their trade surplus comes from softwood lumber sales, much of which followed the decimation of the lumber industry in the U.S. Pacific Northwest during the 90's.

China's share of our deficit comes to 10.3% or $1.85 billion (not including wood furniture). Chinese shipments have grown from $340 million in 1997 to $2.32 billion last year.

Mexico, well positioned by geography and NAFTA, has seen its exports to the U.S. decline from nearly $440 million in 1997 to $339 million last year. As a result, the U.S. is now running a trade surplus with Mexico in forest and wood products (not including furniture).

Bottom Line: The trend is clear. Many countries with low labor costs and access to competitively-priced wood have grown their shipments to the U.S. market by 86% since 1997. Add wood furniture into this equation, and the results worsen. The only products with a trade surplus are hardwood logs and lumber, and the lumber surplus is declining. Keep your eyes on the trade situation in the cabinet sector for signs of strengthening imports of parts and assembled units.

Economic Factoid

According to insurance consultants Tillinghast, the cost of the U.S. tort system is $260 billion, about equal to the annual sales of Wal-Mart and 2.25% of gross domestic product. For every man, woman and child, the cost of compensating the injured and wronged runs $900. The Council of Economic Advisors claims that the U.S. system is the most expensive in the world, running more than

---

Sector Report

Kitchen Cabinets

Cabinet sales rose 17.2% in February versus the same month in 2005 according to the KCMA's Trend of Business Survey. For the year to date, sales were up 14.5%. This increase covered all product categories: custom sales were up 17.8% for the year; semi-custom, up 13.5%; and stock, up 14.8%.

At the producers…

- **Masco** reported cabinet sales of $842 million in its Q42005, up 5.5% over the same period last year. Operating margin was 15.2%, down from 18.4% last year owing to energy costs and currency exposure at its European operations. Sales of lower-priced ready-to-assemble cabinets declined. Analysts attributed this weakness to the impact of higher interest and energy costs on lower income buyers. Can this downtick at the largest U.S. cabinetmaker portend a trend in this critical industry sector?

- **American Woodmark**, the third largest U.S. cabinetmaker, reported Q32006 sales of $191 million, up 4.3% year-over-year. Gross margin fell from 18.8% to 17.5%, and operating margin dropped to 5% from 6.3%. The company is exiting $90 million of lower-margin sales sold primarily through Lowe's, the big box retailer.

Home Furniture

More Anti-Dumping News…
The Canadian International Trade Tribunal (CITT) will not investigate anti-dumping charges brought by that country's furniture makers against China without further information. Last October, the Canadian Council of Furniture Manufacturers requested that safeguard measures be implemented for three years to give the industry time to adjust to increased competition. The CITT indicated that insufficient information was provided to support the claim of market disruption.

Furniture makers in Germany and Italy are preparing to file anti-dumping complaints with the European Commission accusing China of selling upholstered products at unfairly low prices. The two countries account for over half of the EU's furniture production. Retailers that rely on cheaper Asian imports are expected to fight this filing.

U.S. companies that filed an anti-dumping claim against Chinese wood bedroom producers were awarded $144,159 in February as their share of the $116 million of import duties collected through October 2005. The 24 U.S. furniture producers also sought a further investigation of 56 Chinese companies that they claim are selling goods below cost. Additionally, the Department of Commerce is conducting an administrative review of the earlier anti-dumping duties.

And finally, Congress has repealed the Byrd Amendment that distributed import duties collected as a result of anti-dumping actions to the U.S. manufacturers who supported the imposition of the tariffs. Since its inception in 2000, this law has paid out over $1.26 billion to companies in various industries claiming to be hurt by low-cost imports. Payments will end on October 1, 2007.

Ashley No. 1…
*Furniture Today*reported that **Ashley Furniture**, the integrated manufacturer/ importer/ retailer based in Arcadia, WI, is now the No. 1 furniture company in the U.S. The company's $2.72 billion in 2005 sales edged out formerly number one Furniture Brands International, whose sales declined 2.4% last year.

News among U.S. furniture producers remains mixed…

- **Prestige Wood Products** has acquired casegoods maker **Eagle Industries** of Bowling Green, KY. Prestige is a just-in-time supplier of wood products and Eagle's top materials vendor.

- **Broyhill Furniture** announced the closing of its Marion, NC, frame plant. The plant will cease operations in late May, and the 187,288 ft2 factory will be sold. The closure will affect 72 workers. The company blamed the shutdown on the impact of globalization and a shift of frame making to the upholstery plants. Broyhill's parent, **Furniture Brands International**, has directed an increase in imports.

- New company **Linwood Furniture** has acquired Lexington Furniture's Plant No. 2 in Lexington, NC. One of Linwood's owners is artist Bob Timberlake whose licensed furniture line was made by Lexington at Plant No. 2 prior to its close in December 2005. The new owners will invest more than $5 million in the 550,000 square foot plant. At its peak, the plant employed 550 workers and produced $60 million.

- **Bassett Furniture** announced that its sales rose 7.1% in 1Q2006, but net income fell by 2.3%. Management attributed the decline in profits to higher operating expenses at its company-owned retail stores. Shipments to the Bassett Furniture Direct stores now represent 70% of total company sales. The retail operation currently has 133 stores of which the company owns 27. A new team has been formed to manage these stores. The company plans to open 12 to 14 new stores by November.

- **O'Sullivan Industries**, which has been operating under Chapter 11 bankruptcy protection since last October, has filed a reorganization plan. Under the plan, the company will emerge from bankruptcy in a few months with much of its current debt converted to equity.

- **Chromcraft Revington** said that its 4Q2005 sales fell by 2.3% and earnings by 21%. For the full year, sales were down 1.6% to $169..6 million. Strong cash flow, however, enabled the company to pay off its bank debt. Management is now focused on revitalizing its brands – Peters-Revington, Chromcraft, Cochrane, Sumter Cabinet, and Silver.

- **La-Z-Boy** announced that its 3Q2006 sales declined 0.9% to $502 million. Net income also fell by 5.6%. Its company-owned retail stores reported that sales increased by 29.6%. However much of that growth was attributable to acquisition of several stores. The company operates 64 of the 335 Furniture Gallery stores. While the company is increasing its use of cut-and-sewn covers from China, CEO Kurt Darrow indicates that American upholstery production is not going the way of wood furniture. He attributed the ability to provide customization and fast delivery at competitive prices as the industry's defense against foreign sources.

- **Harden Manufacturing** of Haleyville, AL, has sold a majority ownership stake to Linsalata Capital Partners, a private equity firm based in Cleveland, OH. The company, founded in 1972, is a manufacturer of promotional and mid-priced bedroom, dining room, and home entertainment furniture.

- **Shermag,** Quebec-based manufacturer and importer, announced a net loss of C$4.3 million for its 3Q2006. Revenues were down by 31.9% versus the same period a year ago. For nine months, sales declined 15.1%. The company has closed several manufacturing facilities in an effort to balance capacity with demand. Its U.S. exports fell nearly 35% due to the stronger Canadian dollar.

- **Stanley Furniture** reported a decline in its 4Q2005 sales, but a 9.1% increase for the full fiscal year. Earnings were up 11.7% for the year. The company is forecasting 2006 sales of $340 to $350 million

Office Furniture

BIFMA reported that February orders increased by 10% and shipments grew 9% versus the same month in 2005. On a trailing twelve-month basis, orders grew 11% to $10.3 billion. Likewise, shipments jumped by 11.3% during the same period. At $10.2 billion, annual shipments are now about 21% higher than the market bottom of $8.47 billion in November 2003. Analysts expect some leveling off from the strong results experienced in late 2005 with growth rates moderating to 4.5%.

- **Steelcase** reported 4Q2006 sales up by 7% compared to the same period last year. North American sales rose by 9.8% while international revenues grew by 6.2%. Gross margin also improved to 29.7%; operating profit, to 3.2%. Management is calling for a 7 to 11% sales increase in the 1Q2007. Total manufacturing space is scheduled to drop from five million square feet from 14 million as a result of implementing lean production techniques.

- **Herman Miller** saw its 3Q2006 sales rise by 10.9% to $424 million. Gross margin was 32.5%, slightly above the same period in FY2005. Orders and backlog improved significantly year over year, with order up 16.6% and backlog 11.9%. Operating margin also grew to 8.7% from 7.6%.

Wood Flooring

February 2006 shipments of strip flooring rose by 9% compared with the same month in 2005. Year to date, the industry has shipped 7% more flooring than in the first two months of 2005.