

Business Briefing

Rising Productivity - The Key to Prosperity

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In the first quarter of 2006, the manufacturing sector turned in another great productivity performance. Output per hour, the standard measure of labor productivity, rose by 3.8%, as the result of a 6% gain in output with only 2.1% more labor hours expended. Unit labor costs dropped 1.9% in spite of a relatively tight labor market.

In the last 20 years, manufacturing productivity has doubled. Since 1997, manufacturing productivity has averaged a 4.6% gain annually.

When productivity rises, businesses can afford to pay higher wage rates. More importantly, workers can be released to perform more value-producing tasks. The increased profits that result mean more money for investment in productive equipment.

Managers' efforts to raise labor productivity also bring secondary benefits, like lower inventories and quicker throughput. Companies that increase their labor output per hour do so by eliminating wasted effort. These restructured organizations are, as a result, more competitive.

For that reason, the U.S. remains the world's leading producer of manufactured goods. Our manufacturing sector alone would be the seventh largest economy in the world. Total U.S. manufacturing output has risen by 10% since 2002.

These gains have come at a price. Over the past 15 years, the U.S. has shed over three million manufacturing jobs. Many blame this decline on globalization. But a study by the Federal Reserve Bank found that the real culprit is *labor-saving technological progress* ie, better machines, better information systems, and smarter process designs. Put simply, capital investment has simultaneously taken labor out of our factories and increased output.

One wood products industry sector that has benefited from increased investment is cabinet manufacturing. From 1997 to 2004, cabinetmakers spent \$2.9 billion on new plant and equipment. In 1997 annual shipments per production worker totaled just over \$113,000. By 2004, that metric jumped to over \$161,000, a 42% gain.

At the same time, the industry reduced delivery times and improved their product offerings with more customization opportunities for the consumer.

Kitchen Cabinet Industry Productivity

Year	Annual Sales	Production Workers	Output Per Worker
1997	\$9.029 billion	79,704	\$113,280
2004	17.212 billion	106,416	161,740

Cabinetmakers as whole nearly doubled sales with only 26,712 new workers. If productivity had remained at the 1997 level, the industry would have required 45,500 more workers in 2004. That's real improvement. And thus far, this industry has strongly defended its turf against foreign competitors.

Remember, too, that those 45,000 people found jobs. Unemployment ran 4.6% in May vs. 5.1% in 2005.

Bottom Line: Put simply, doing more with less is the driver of the miracle that is the U.S. economy. The relative share of manufacturing employment has fallen steadily in the U.S. for at least 50 years. That decline has coincided with a remarkable rise in our standard of living based primarily on new technologies. Machinery makers, keep the new gear coming...

Economic Factoid

The same statistical analysis by the Federal Reserve Bank that identified the role of technology in lower manufacturing employment also highlighted the impact of taxes. The recent economic performance of Ireland proves that linkage again. In the late 1980's the tax rate on Irish corporations was cut to 12.5% - the lowest in the developed world. The boom that has followed drove Ireland's unemployment rate from 18% to 4.2%. Compare that with Germany's rate of 11.7%. Per capita GDP at \$41,000 is second only to Luxembourg in the European Union.

Sector Report

Kitchen Cabinets

Cabinet sales rose 6.1% in April versus the same month in 2005, according to the KCMA's Trend of Business Survey. For the year to date, sales were up 13%. April saw custom sales rise by 4.2%; semi-custom, 7.1%; and stock, 5.5%.

At the producers...

Masco reported cabinet sales of \$852 million in its Q12006, up 8.8% over the same period last year. Operating margin was 14.2%, down from 14.8% last year owing to higher energy and particleboard costs. The company is increasing cabinet prices to offset this margin decline. Meanwhile, two assembly lines have been installed in temporary quarters as the company's Merillat division awaits completion of its 350,000 ft.

Home Furniture

Imports Continue Double-Digit Growth

2005 furniture imports surpassed \$20 billion, 11% above last year.

Despite the imposition of anti-dumping tariffs, China led the way with shipments of nearly \$11 billion, up 18% over 2004. Producers there now account for nearly 50% of all imported furniture. Last year's performance marks a significant slowdown from the 30%-plus growth rates in recent years.

Canada, the number two source, has seen its competitiveness erode with a weaker U.S. dollar. Its shipments to the U.S. grew only 1% last year to \$2.5 billion.

Italy, another high cost source, saw its shipments to the U.S. fall by 12% to \$1.15 billion. The 42% increase in Chinese upholstery shipments to the U.S. contributed to Italy's plight as their sales of this product category declined by 31%.

Vietnam, the newest low-cost source, jumped to number six in the import ranks with shipments totaling \$670 million, up from \$362 million in 2004.

No Surprise - Chinese Producer Reports Strong Sales

Samson Holding, owner of Chinese casegoods producer **Lacquer Craft**, reported FY2005 sales of \$517 million, up 13%. Profits rose to \$89 million, generating a whopping profit margin of 17.2%.

About 90% of Samson's products are sold in the U.S., with 88% of that volume moving through its Universal and Legacy Classic brands and 12% through private labeling.

The company is expanding its Jiashan and Dongguan plants to produce an additional 1,000 containers of furniture per month. Additional investments are planned in upholstery, home office, and youth product categories.

In early May Lacquer Craft acquired Craftmaster, an upholstery producer based in Taylorsville, NC. The company plans to leverage the synergies created by sourcing imported cut and sewn covers and exposed wood components in China while using the North Carolina plant for special order fulfillment. This acquisition represents a major strategic initiative by a Chinese furniture maker and evidences their recognition of mass customization and fast delivery requirements in the upholstery sector.

News among U.S. furniture producers remains mixed as more plants are shuttered and imports grow...

Furniture Brands International reported a 3.1% gain in its 1Q2006 sales driven by strength at its Lane and Thomasville divisions. Gross margin was flat while operating margin fell from 6% to 5.7%. Its Thomasville division announced the closure of its Plant D. The 309,000 ft

Ethan Allen, perhaps the most recognized brand name in furniture, reported a 15.5% increase in its 3Q2006 revenues. Gross margin rose from 47.8% to 50.5% while operating margin remained about flat. The higher revenues resulted from higher advertising and increased store management. Management is raising prices to offset higher freight and raw material costs. The company operates 11 domestic plants and a retail network of 311 stores, 129 of which are company-owned. About 65% of its line is manufactured in the U.S.

Canadian furniture maker **Dorel Industries** announced that its 1Q2007 furniture sales fell by 4.4% accompanied by an 11% decline in earnings. Higher particleboard prices negatively impacted gross margin.

Canadian RTA producer **Gusdorf** has filed for bankruptcy protection blaming pricing pressure from Chinese imports. Its plans include closing a factory in Laval, Quebec, and becoming more import-based.

RTA furniture maker **O'Sullivan Industries**, which has been operating in Chapter 11 since last October, has emerged from bankruptcy with a new financing package. Meanwhile, its auditors have reported concern with its ability to overcome sales declines and losses from operations.

Crescent Fine Furniture of Gallatin, TN, has ceased production and will import its product line. Its plant will transition into a distribution center. The third generation, family-owned company had seen sales of its domestically made solid wood casegoods decline, while its five-year old import line has prospered.

Chromcraft Revington said that its 1Q2006 sales increased by 2.8% over the same period last year. The company is focusing on a hybrid strategy of domestic production combined with imported components and finished goods. Initiatives are underway to improve the flow of its imports and to increase its mass customization techniques. At the recently completed High Point Market, the company exhibited its largest-ever new product introduction.

Hooker Furniture of Martinsville, VA, announced a 20.7% increase in its 1Q2006 earnings on sales growth of 6%. These gains were fueled by a 26% rise in sales of their imported products. Sales of its domestically made products fell nearly 29%.

Stanley Furniture reported flat sales and a 6.4% decline in net income in its 1Q2006. The decline was attributed to a softer retail climate for furniture in March. As a result, management is now forecasting a 2 to 5% decrease in 2Q sales and full year sales of \$335 to \$345 million, slightly below earlier projections. The company produces about two-thirds of its revenues in its U.S. plants.

Mastercraft, mid-priced upholstery maker based in Council Bluffs, IA, has shut down operations.

Office Furniture

BIFMA reported that April orders and shipments increased by 6%. On a trailing twelve-month basis, orders grew 11% to \$10.4 billion. Likewise, shipments rose by 10.2% during the same period. At \$10.345 billion, annual shipments are now about 22% higher than the market bottom of \$8.47 billion in November 2003.

BIFMA's latest forecast for 2006 calls for shipments to grow 11.5% and orders 9.5%. While these targets are higher than earlier forecasted, BIFMA reduced their 2007 predictions for shipments to 6.3% and orders 6.6%.

At the company level...

Knoll, Inc. reported a 20.7% gain in its 1Q2006 sales. Its gross margin (historically among the highest in the office furniture sector) was 32%, down slightly from the same period last year. Cost of sales was impacted by higher material and transportation costs. Operating margin jumped to 10.2% from 9.5% last year.

HNI, headquartered in Muscatine, IA, saw its 1Q2006 office furniture sales rise by 14.8% to \$490 million. Operating profit in this category was \$40.5 million or 8.2% of sales.

Wood Flooring

March 2006 shipments of strip flooring rose to over 49 million square feet, up 20% compared with the same month in 2005. Year to date the industry has shipped 13% more flooring than in the first three months of 2005.