Business Briefing

Remodeling Set To Grow in 2007

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Many experts are forecasting that strength in the remodeling sector will partially offset the decline in housing starts. As housing starts continue to decline in 2007, fewer families will enter the housing market and instead will opt to improve their current homes.

Kitchen + Bath Business is estimating that spending on kitchen remodeling jobs will rise by 6.9 percent in 2007 to nearly $79 billion. While the number of projects will rise only 1.2 percent, most of these kitchen jobs will fall in the mid- to high-priced category.

Anecdotal evidence from kitchen dealers around the U.S. is confirming continued strength in kitchen remodeling. Some of this resilience is undoubtedly coming from older Americans who want to remain in their existing homes. A recent study by The Home Depot found that life events common to the 50 and older demographic, such as retirement and the birth of grandchildren, are triggers for home improvement projects.

Sixty percent of this age group expects to live in their current residences for five or more years and 65 percent plan to remodel. Importantly for cabinetmakers, 73 percent say the kitchen is the most important room in their homes.

Keep your eye on this important segment of the cabinet business over the next few months.

Customization Critical To Upscale and Younger Furniture Shoppers

Younger furniture buyers and those able to afford the exact furniture they want are an important, yet oft, overlooked consumer segment. Of late, industry experts claim a sharp rise in the number of shoppers willing to pay a premium for custom-configured upholstery as well as dining sets and other wood furniture.

In upholstery, the segment of shoppers who prefer a custom look has remained relatively constant at 30 percent. This group is the prime target for U.S. upholstery makers at a time when imported sofas and chairs have about 22 percent of the market. Customization in the form of fabric and frame selectivity combined with fast order delivery provides a powerful weapon in defending market share from importers.

Most upholstery makers have converted to plywood frames that can quickly be produced on large format CNC routers. This technology, along with computerized pattern making and fabric cutting, enable a domestic producer to fill a custom order in hours if the correct fabric is in stock.

Selling custom-configured products requires a knowledgeable retail floor sales staff and time. For that reason, many upholstery producers now enable their resellers with point-of-sale technology that allows a consumer to "build and see" a sofa before buying it. Some even offer this visualization software via the Internet.

While the market share of imported upholstery has tripled in the last decade, domestic wood furniture makers have lost over half of their market share. Customization has long been available in casual dining sets where consumers want to contrast or match their semi-custom kitchen cabinetry. However bedroom, entertainment, home office, and other wood product categories offer few custom configuration opportunities. Domestic wood furniture producers are missing this opportunity. In fact, this gap is rapidly being filled by sharp cabinetmakers who now offer products for other rooms in furniture-grade finishes.

No doubt wood furniture can be "cabinetized," i.e. converted to a more modular, customizable product. This opportunity requires smart product engineering combined with quick set-up equipment for woodworking and finishing. A network of specialty component suppliers is also useful to supply carvings, turnings, and other special parts that add style to a casegood. The enablers for customized wood furniture - machinery, software and suppliers - exist. The missing ingredient is a willingness among furniture executives and entrepreneurs to implement an innovative business model.

Economic Factoid

For years "protectors," e.g. politicians and industry executives, of the U.S. manufacturing base screamed for the Chinese to float their currency. For the decade prior to July 21, 2005, the Chinese renminbi was pegged at a rate of 8.28 renminbi to the US dollar. The dollar now buys only 7.77 Chinese renminbi, a decline of 6 percent. This decline means that Chinese manufacturers now pay less for raw materials like hardwood lumber that are purchased in U.S. dollars while their labor costs remain low.

Sector Report

Kitchen Cabinets

Last November cabinet sales broke a 127-month run of positive monthly growth by declining 4.8 percent versus the same month in 2005. In December that weakness continued as the KCMA's Trend of Business Survey showed a decline of 11.7 percent for the month. Sales for 2006 were up 7.8 percent versus 39.2 percent in 2005. Drilling into the numbers, December custom cabinet sales fell by 0.1 percent; semi-custom cabinet sales, by 6.4 percent; and stock cabinet sales, by 18 percent.

At the cabinetmakers...

Masco, the largest cabinetmaker in the U.S., has reported the layoff of several hundred workers at four of its cabinet plants in Ohio and Pennsylvania. The company blamed the decline in housing starts.

Home Furniture

Retail furniture sales are weakening in step with slower sales of new and existing homes. Analysts indicated that furniture sales lag trends in housing by six to twelve months. Given the continuing weakness in housing, a meaningful improvement in furniture at retail will not occur in the first half of 2007.

However, for those U.S. producers who brought anti-dumping charges against Chinese wood furniture makers, cash is coming in from duties collected since June 2004. The U.S. government has distributed $21.9 million with $5.4 million to Stanley Furniture, $3.9 million going to La-Z-Boy, $3.8 million to Vaughan-Bassett Furniture, $1.55 million to Bassett Furniture and smaller payments to 17 other U.S producers. Some of the recipients plan to invest these windfall gains in upgrading their manufacturing processes.

On an operating level, company news continues gloomy...

Ethan Allen reported a 6.7 percent decline in its 2Q2007 sales, as continued retail weakness impacted performance. Gross margin, however, rose to 52 percent while operating profit fell from 16 to 14.2 percent. Interestingly, as the company continues to close manufacturing plants, Ethan Allen has increased the number of company-owned stores to 149, nearly half of its total retail presence.

While full year sales were up 1.3 percent, Furniture Brands announced that its 4Q2006 ended down 1.2 percent. Management indicated that this weakness will continue into its 1Q2007, as retail conditions remain "abominable". Full 2006 earnings were down 10.4 percent versus the prior year.

Bassett Furniture reported a 13.7 percent decline in its 4Q2006 sales. Earnings dropped nearly 83 percent. For the full year, revenues declined 2.1 percent while earnings fell nearly 45 percent versus FY2005. Bassett, who supplies 134 branded retail stores, saw its retail sales rise by 19.8 percent while wholesale shipments dropped by 5.5 percent. About 72 percent of wholesale shipments were to its branded stores.

Stanley Furniture reported its 4Q2006 sales down 13.3 percent versus the same period last year. Gross margin declined to 17.7 percent versus 24.7 percent last year while operating profit dropped to 4 percent from 11.4 percent. Previously, the company announced the lay-off of 200 workers at its Robbinsville, NC, plant because of slowing sales.

Hooker Furniture is closing its last remaining domestic wood furniture plant. The 700,000 square foot facility, located in Martinsville, VA, adjacent to company headquarters, employed 280 workers. Warehouse operations for imports will continue at the location. Management attributed the closure to declining demand for its U.S.-made wood products. Two longtime Southern furniture makers, Hooker and Broyhill, are now sourcing 100 percent of their wood furniture from offshore. Hooker operates four upholstery plants in North Carolina in its Bradington-Young subsidiary.

Schnadig is shifting production of its upholstery line offshore. As a result, production lines in Belmont, MS, and Corona, CA, will be shuttered. These facilities will continue as warehouses for both imported wood and upholstered products. Limited custom options will be available.

Casegoods producer **Oakwood Furniture**, Tazewell, TN, has closed its 82,000 square foot factory that employed 56 workers. Management blamed competition from imports in its product categories, bedroom and entertainment furniture.

RTA producer **Bush Industries** will eliminate one-third of the workforce at its 1.1 million square-foot Erie, PA, plant as operations are consolidated at its Jamestown, NY, factory. The company's increase in importing will result in the loss of 90 jobs.

Vaughan-Bassett Furniture is seeking a buyer for its Atkins, VA, lumber processing/parts production facility. The plant presently employs 55 and produces parts for the company's Galax, VA, and Elkin, NC, furniture plants.

Sun Capital Partners announced the purchase of upholstered furniture producer **Rowe Furniture**. Rowe had been operating under bankruptcy protection. Sun also owns wood furniture importers Lexington Home Brands and Powell.

Canadian upholsterer **Sklar Peppler** has purchased **Alan White**, longtime producer of mid-priced upholstery with plants in Shannon, MS, and Stamps, AR.

Office Furniture

BIFMA's monthly report shows continuing signs of moderating growth in the business and institutional sector. December orders grew by 2 percent year-on-year, but declined 3 percent from November. This performance marked the fourth consecutive month of reduced order growth. December shipments grew 5 percent versus last year, but the 7.4 percent growth in 12-month shipments was the lowest growth performance since January 2005. More importantly, the unfilled order backlog declined in December by 9 percent from November. Industry growth seems to be slowing to the 7 percent rate experienced in the 80s and 90s. Analysts continue to believe the longer term will see the growth rate slowing further to 3-6 percent, in line with the U.S. GDP.

At the company level...

Steelcase, the world's largest producer of business furniture, reported a 6.8 percent increase it its 3Q2007 revenues over the same period a year ago. Gross margin improved to 31.5 percent benefiting from gains in international sales. Operating income grew to 5.8 percent, up from 5.3 percent a year ago. Overall performance was negatively impacted by poor results from the company's North American wood furniture operation, which lost about $6 million in the quarter. Management forecasts that profitability will not be achieved in that segment until early FY2008.

Herman Miller reported 2Q2007 sales of $499 million, up 13.9 percent from a year ago. Operating margin jumped to 11.8 percent, up from 10.1 percent last year. With incoming orders during the quarter up 22 percent, the company's backlog also improved.

Wood Flooring

December 2006 shipments of strip flooring declined to 33.174 million square feet, down 20 percent compared with the same month in 2005. For 2006 the industry shipped 527.241 million square feet, a 8 percent decrease compared with 2005.

At the company level...

Analysts have trimmed estimates for Mohawk Industries, the largest producer/ distributor of flooring in the U.S. The company produces laminate flooring under the Unilin brand. Forecasts of laminate flooring sales for 2006 have been pared from 10 percent to 6 percent while growth assumptions for 2007 are now set at 4 percent. Additionally price deflation, estimated at 2.5 percent annually, continues to impact industry revenues. Chinese-made laminates are also impacting sales of domestic manufacturers.

Softwood Lumber

Industry expert International Wood Markets Group is forecasting an 11 percent decline in 2007 housing starts to 1.6 million units, down from a peak of 2.07 million in 2005. As a result, "lumber producers need to realize that we are only half way through this housing market cycle correction, and a second wave of lower lumber demand is still to come. Another significant round of capacity curtailments will need to occur in 2007."

Lumber consumption in North America probably decreased from 75.8 billion Bf in 2005 to 72.8 billion Bf in 2006. A further fall of 3.3 billion Bf is predicted for 2007. About half of this decline will come from reduced imports, primarily from Europe. Wood Markets also forecasts a fall in Canadian lumber production.

The price for the benchmark 2x4 No. 2 random-length lumber will fall from an average $353 per MBf to $275 in 2007.

Interestingly, the National Association of Home Builders (NAHB) is working with Swedish officials to increase softwood lumber exports to the U.S. According to the NAHB, the U.S. softwood industry has insufficient capacity to meet its demands. The association has also met with Russian government and industry officials to discuss increasing imports of Russian lumber. NAHB's interest in additional import sources is reportedly driven by "serious uncertainties for U.S. builders over the availability and price of Canadian lumber". Canadian supplies may be impacted the complicated system of taxes and quotas mandated by the recently-completed lumber trade agreement between the U.S. and Canada.

Non-Residential Construction

Spending on non-residential construction expanded at a 16 percent annual rate during the twelve months ending in September 2006. *Building Design + Construction* predicts that total sector growth will slow somewhat in 2007. Its experts estimate that spending on retail and warehouse construction will rise by 9.7 percent this year. Office construction is expected to jump by nearly 16 percent this year as rents and vacancies have improved. Spending on manufacturing plant construction is projected to expand by nearly 9 percent in 2007. Sharply higher room and occupancy rates drove hotel construction up 52 percent in 2006, and this segment is set to increase another 22 percent in 2007. School construction increased 6.5 percent in 2006 and will grow by 10 percent in 2007 primarily for middle and high schools as well as university facilities. Increasing employment that translates into higher insurance premium income plus higher Medicare/Medicaid budgets will drive spending on new healthcare facilities up nearly 18 percent in 2007. This sector of the economy is an underappreciated contributor to sales of numerous wood products ranging from doors, millwork, cabinetry, and fixtures.