

## Cutting Edge Newsletter™ June 2008

### Business Briefing

**Swimming against the Tide**, by Art Raymond, [araymond@raymondnet.com](mailto:araymond@raymondnet.com)

While the pace of furniture plant closures continues in the U.S., world number one furniture retailer **Ikea** has opened its first American manufacturing operation in Danville, VA. Operated by its **Swedwood** subsidiary, the 910,000-square-foot facility is employing leading-edge technology to supply Ikea's 35 U.S. and 11 Canadian stores.



Ikea is a cult brand among its primary demographic, young furniture buyers. Last year over 583 million shoppers visited Ikea stores in 37 countries to choose from over 7,000 items. The company distributed 191 million copies of its catalogs. As *Business Week* put it, Ikea provides "a one-stop sanctuary for coolness."

Ikea's growth and profitability are driven by relentless attention to cost cutting. Unlike many furniture makers, Ikea invests heavily in product engineering to find ways to cut both material and labor cost from its products. Its goal is to lower prices across its product line by two to three percentage points every year. One of its best selling sofas, introduced in 1999 at \$354, is now priced at \$202.

This cost obsession is paired with a culture for design. The idea is to design beautiful products that are inexpensive and functional. The result of this combination is high volumes. And remember that nothing trumps unit volume in the quest for production efficiency and low manufacturing cost.

With high volume as a basis, Swedwood can invest in mass production equipment rather than focus on the one-at-a-time, custom manufacturing philosophy followed by many U.S. woodworking companies. The new Danville plant's products are based on lightweight panels made on a specially-designed press line supplied by Bürkle. These panels are then cut to required component sizes, edge banded, and drilled on lines provided by Homag. Two finishing alternatives will be available when the plant is fully equipped: (1) a wet finishing line with grain printing and UV-cured topcoat capabilities and (2) a foil laminating line.

Swedwood operates 38 factories in Sweden, Germany, Poland, Hungary, Latvia, Romania, Slovakia, Russia, and now the U.S. Its key to success is focusing each of these factories on one production technique, one base raw material and a limited product range.

Consuming such a huge volume of composite wood panels in the manufacture of its products, Ikea recently announced the formation of a new subsidiary to produce particleboard and HDF.

*Bottom Line:* Ikea proves what Henry Ford first espoused about price and cost nearly 100 years ago, "One of the ways of discovering what the cost of a product ought to be is to name a price that forces everybody to the highest point of efficiency. A low price makes everybody dig for profits." Such focus on great product engineering and manufacturing execution can work even in the furniture business.

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#### Economic Quote

"Economists set themselves too easy, too useless a task if, in tempestuous seasons, they can only tell us that when the storm is long past the ocean is flat again."

- John Maynard Keynes

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#### Sector Report

##### Kitchen Cabinets

##### Resale Value of Kitchen Remodels Drops

According to *The Wall Street Journal*, the resale value of big-ticket renovations like a new kitchen

or bath is dropping. In the past up to 90 cents on the dollar of an investment in a new kitchen or bath was recouped at resale. A recent survey by *Remodeling* magazine found that an average kitchen remodel recovers only 83 percent of its \$21,100 cost. With kitchen remodeling being critical to cabinetmakers, this news adds to the overall pessimism in this sector. Today the best payback comes from projects that add curb appeal like new windows and siding, fresh paint and well-manicured landscaping.

Is this news the beginning of a trend or just an aberration caused by the drop in home prices? Stay tuned.

According to the KCMA's *Trend of Business Survey*, April cabinet sales fell by 9.5 percent versus the same month last year. Year-to-date cabinet sales have dropped 10.3 percent vs. 2007 with stock cabinet sales down a whopping 20.2 percent. Remember too that April 2007 sales were down nearly 10 percent.

At the company level ...

- **Masco**, the largest cabinetmaker in the U.S., reported a 13.7 percent drop in its 1Q2008 cabinet sales to \$596 million, down from \$691 million in the same quarter last year. Operating profit came in at 4.7 percent, down from 10.4 percent year-over-year. Its KraftMaid Cabinetry division announced a lay-off of hourly and salaried personnel at its new West Jordan, UT, plant. No details on the number of jobs being cut were released. In January the company idled 400 workers at its Middlefield, OH, plants.
- **Canac Kitchens** announced the closing of its Thornhill, Ontario, Canada, operation. Built in 1967, the 300,000-square-foot plant shipped much of its production to the U.S. market and hence has been adversely impacted by the strength of the Canadian dollar. Since 2002, the Canadian dollar has risen from US\$0.63 to parity. In addition, increasing residential development of the area surrounding the plant led to complaints about noise, traffic and air pollution. Responding to the Ontario government's demand to eliminate emissions, Canac relocated its finishing operations to its Statesville, NC, plant in January 2007. Finished components were shipped to the Thornhill plant for final assembly. The resulting increases in transport costs combined with the currency issue and the drop in the U.S. housing market ultimately led to the closure. After reducing its staff by 600 since last September, the final 400 jobs will be eliminated this June. Canac is owned by U.S. bathroom fixture giant **Kohler Co.** which also owns Baker Furniture and McGuire Furniture.

## Home Furniture

### Foreign Furniture Makers Report Sales Declines

The weakness in U.S. furniture retailing has hit foreign suppliers directly in their pocketbooks. No matter where furniture is made, it is simply not selling through at retail here. A look at the results of publicly-traded foreign furniture makers reveals the impact of our furniture economy around the globe...

- Singapore-based upholsterer **HTL** reported a 4.4 percent drop in revenue in the fourth quarter of 2007 and a 90 percent decline in profits. For the full year its sales fell 1.3 percent, and profits decreased by 81 percent. Sales to North America dropped by nearly 9 percent.
- China-based **Kasen International** said its 2007 sales fell by 15.5 percent led by a 27.8 percent drop in shipments to the U.S., its largest market. The company closed three plants.
- **Samson Holdings**, parent of U.S. brands Universal, Legacy Classics, and Craftmaster, saw its 2007 sales fall by 10.5 percent with profit falling 46 percent.

### Credit Woes Hit Furniture Industry

Over the past three years many furniture retailers have closed their doors, and industry experts predict continuing bankruptcies. As a result many factors and lenders to the furniture industry have significantly tightened credit availability citing increasing risk. Many furniture makers and importers rely heavily on factoring their accounts receivable and borrowing against their inventories.

**GE Capital Solutions** announced recently a cutback in unsecured inventory financing for furniture companies. **CIT Group**, the biggest name in furniture factoring, has tapped its credit line and sold stock to raise capital to offset recent losses experienced in furniture.

As credit standards tighten, those companies with poor cash flow and excessive inventory investment will suffer and perhaps close. The loss of these marginal players will strengthen the market positions of those companies who effectively manage their operations.

### Latest on Formaldehyde

Recently the California Air Resources Board (CARB) approved strict guidelines that will take effect on January 1, 2009, on the amount of formaldehyde released by composite wood products like plywood, MDF, and particleboard. These regulations require paperwork from every step in the supply chain – the board producers, distributors, end product manufacturers and resellers.

The new rules apply to any board sold in California regardless of origin. Since manufacturing separate products for sale only in that state will prove onerous, the CARB rules will become the *de facto* standard for the world.

Compliance will depend on third party certification firms approved by CARB and, of course, the honesty of panel producers and the rest of the supply chain. Today CARB has approved only two U.S. certifiers and none in Asia where vast amounts of furniture is sourced for U.S. consumption.

A petition urging the Environmental Protection Agency to adopt the CARB limits nationwide is currently circulating. Such action by the EPA would effectively level the playing field for all users of composite board. However some producers indicate that compliant board will cost 10 to 20 percent more and drive end product prices higher.

Stay tuned for news on this petition.

### Wood Certification Gaining Importance

With being green as the strategy *du jour*, certifying the source of wood in furniture is gaining value in the quest for the consumers' dollars. More furniture makers are now using wood certified by the Forest Stewardship Council and the Sustainable Forestry Initiative as being harvested from sustainably managed forests.

Promoting responsible wood purchasing is a primary aim of the Sustainable Furniture Council, an industry group focusing on eco-friendly business practices. **Harden Furniture**, a producer of fine solid wood case goods, was awarded the SFC's Silver status for documenting that 15 percent of its wood comes from certified forests.

A significant piece of green news comes from the recent consumer survey conducted by chemical giant **DuPont** and flooring producer **Mohawk Industries**. U.S. homeowners indicated a willingness to pay \$8.30 more per \$100 purchase for products that use renewable resources. The argument that no one is willing to pay more to be green seems to be losing steam. We may be reaching the tipping point where selling green actually pays.

### Furniture Makers in Singapore Aim for Higher Exports

Singapore's furniture industry plans to double its share of world furniture exports by 2015. Producers there currently ship \$2.4 billion of furniture to consumers around the globe. Over the past five years the industry there has grown annually by 10 percent driven by demand in the U.S., India, China, the Middle East and Europe.

To meet this target Singaporean furniture makers must expand capacity and increase efficiency. Those needs translate into higher demand for new machinery thus making Singapore an attractive market for export-oriented WDMA members.

At the company level ...

- Despite a 14.3 percent decline in 1Q2008 sales, **Furniture Brands** reported \$10.6 million in operating income, a 32 percent gain.
- Producer/retailer **Ethan Allen** announced that its 3Q2008 sales fell 4.3 percent. Operating income fell to \$15.6 million, down 44.5 percent vs. the same quarter last year.
- **Bassett Furniture** Industries announced an 11.1 percent increase in its 1Q2008 revenues due to a large new product introduction in its 131 retail stores. The higher sales along with internal cost reductions resulted in a small profit vs. the \$4.2 million loss in the same quarter last year.
- **Stanley Furniture** reported 2Q2008 sales of \$62.5 million, down 16.7 percent from a year ago. Gross margin for the quarter came in at 17.7 percent; operating margin, at 3.6 percent.
- **Chromcraft Revington** posted an 18.9 percent decline in its 1Q2008 sales and an operating loss of \$2.2 million.
- **Carolina Accents** has acquired a 230,000-square-foot plant in Ripley, MS, that was previously part of Berkline/BenchCraft. The operation will initially employ 125.

- Case goods producer **Vermont Precision** announced the closure of its Morrisville, VT, plant and its exit from domestic production. The company will continue to sell its imported Bolton Furniture line. Founded in 1989 as a youth furniture specialist, the company's domestic volume had fallen for the last seven years. The closure will idle about 20 plant employees.
- Upholstery maker **Berne Furniture** has ceased operations at its Berne, IN, plant. Management indicated that the firm is studying reorganization. The company was founded in 1925, and its work force had fallen from 125 two years ago to 20.
- Canadian producer/importer **Shermag**, following a failed bid to take the company private, has sought protection from its creditors under Canada's equivalent of Chapter 11 bankruptcy. Battling a strong Canadian dollar that hurt its competitiveness in the vital U.S. market, the company has closed six of its eight plants and laid off 75 percent of its work force since 2004.
- Another Canadian producer, **Dorel Industries**, reported a one percent drop in its 1Q2008 home furnishings sales. Its RTA producer, Ameriwood, posted its fourth consecutive profitable quarter.
- **Universal Furniture**, owned by Chinese-based **Lacquer Craft** (a division of Samson Holdings), is merging its imported upholstery line into its sister company, Craftmaster Furniture, of Taylorsville, NC.
- Promotional wood bedroom maker **Higdon Furniture** of Quincy, FL, filed for Chapter 11 bankruptcy protection.

#### Office Furniture

BIFMA, the sector trade association, reported a one percent gain in April orders and a two percent jump in shipments.

More importantly, the association is now forecasting a worsening outlook for the office furniture sector over the next two years. On May 16, BIFMA and its research advisor Global Insight lowered their forecast for the fifth consecutive time. During 2008 the deterioration in new office construction, corporate profits and capital spending, and white-collar job growth will result in a 6.8 percent decline in consumption vs. last year. The outlook is predicting a further 6.3 percent drop for 2009. The previous, more optimistic forecast released in February called for a 0.6 percent decline in 2008 followed by a 2.6 percent decline in 2009.

2007 marked the fourth straight year of growth as this sector shipped \$11.4 billion, up 5.5 percent from the previous year. Unfortunately 2008 will most probably bring the end of this run.

At the company level ...

- **Steelcase**, the world's largest manufacturer of office systems and business furniture, announced plans to cut its work force and close plants to rebalance capacity with the economic uncertainty the company sees for the next 12 months. Up to 250 white-collar jobs will be eliminated from salaried personnel at the company's Grand Rapids, MI, facilities. The plant closures will affect facilities in City of Industry and Corunna, CA. In addition some production at its Ontario, CA, plant will be shifted to other facilities.
- **Knoll** reported an 8 percent increase in its 1Q2008 revenues. According to industry analysts the company appears to be outperforming its peers in top line growth. However both gross and operating margin declined slightly from the previous year. Given the headwinds predicted for this sector, management is calling for only one to four percent growth in its 2Q.
- **HNI Corporation** announced a 7.5 percent decline in its 1Q2008 sales. Office furniture sales fell 6.4 percent.

#### Wood Flooring

At the company level ...

- **Armstrong World Industries** reported wood flooring sales of \$160.3 million in its 1Q2008, a decline of 20 percent from the prior year. The company attributed the drop to the severe slump in residential construction and remodeling. Operating income also fell to \$2.5 million from \$8.4 million in the same quarter of 2007.

- **Mohawk Industries**, in its 1Q2008 report, announced that sales of its Unilin flooring products fell 6.2 percent year-over-year. The operating margin of this product line dropped to 12.4 percent vs. 17.2 percent in the same quarter last year.

#### **Non-Residential Construction**

The American Institute of Architects' Architecture Billings Index rose to 45.5 in April from its all-time low of 39.7 in March. Scores below 50 indicate weakness in the pipeline for new projects that will be constructed nine to 12 months in the future. The Index fell below 50 this past February. Design firms in all regions of the U.S. reported weaker business conditions. Those specializing in institutional projects are, however, seeing steady business conditions vs. commercial/industrial architects. Many firms are concerned about existing projects being put on hold or slowed down.