

**EMERGING ECONOMIES  
&  
COMPETITORS**



**An Update on China**

NCFA Annual Meeting  
Hickory, NC  
October 2, 2008

# *Introduction*

---

The emergence of China in the forest and wood products economy in the mid 1990s has no doubt revolutionized all sectors of that business more in the last ten years than in the prior 30.

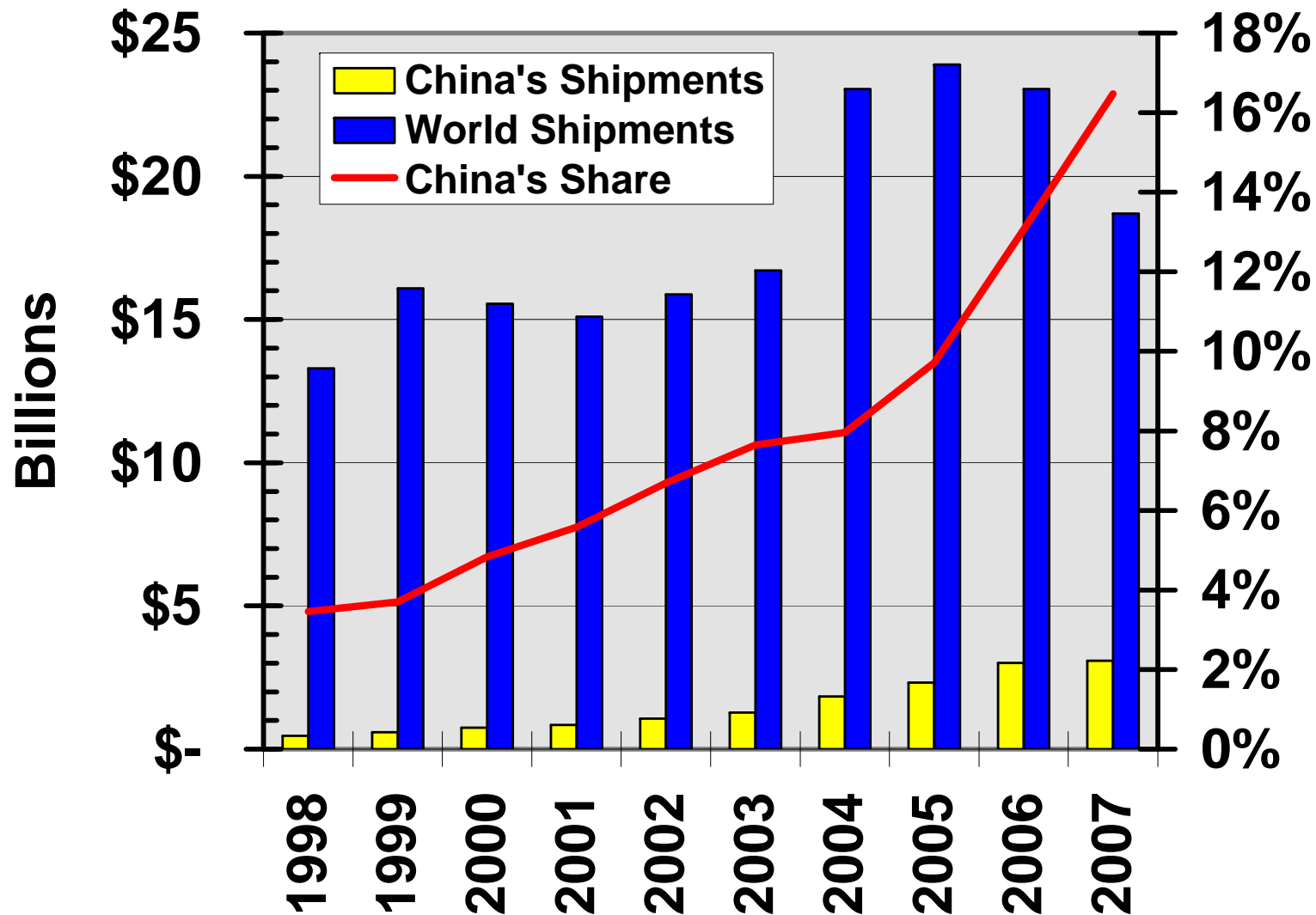
During the first few years of the Chinese tidal wave, that country's producers were typically suppliers to U.S. companies. Now they have morphed into competitors with direct sales and distribution operations here in our market space. Additionally, as their domestic economy has evolved, China is fast becoming a substantial buyer of U.S. products.

Looking at our trade in forest and wood products with China, you can draw one simple conclusion:

***The U.S. supplies logs and lumber to Chinese producers who convert them into value-added wood products for our markets. We are, therefore, much like a lot of third-world countries around the globe when it comes to trade with China.***

But unlike the third world, the U.S. is clearly the engine that drives the Chinese wood products economy.

# *U.S. Imports of Forest Products*



Source: USDA FAS

# *U.S. Imports of Forest Products*

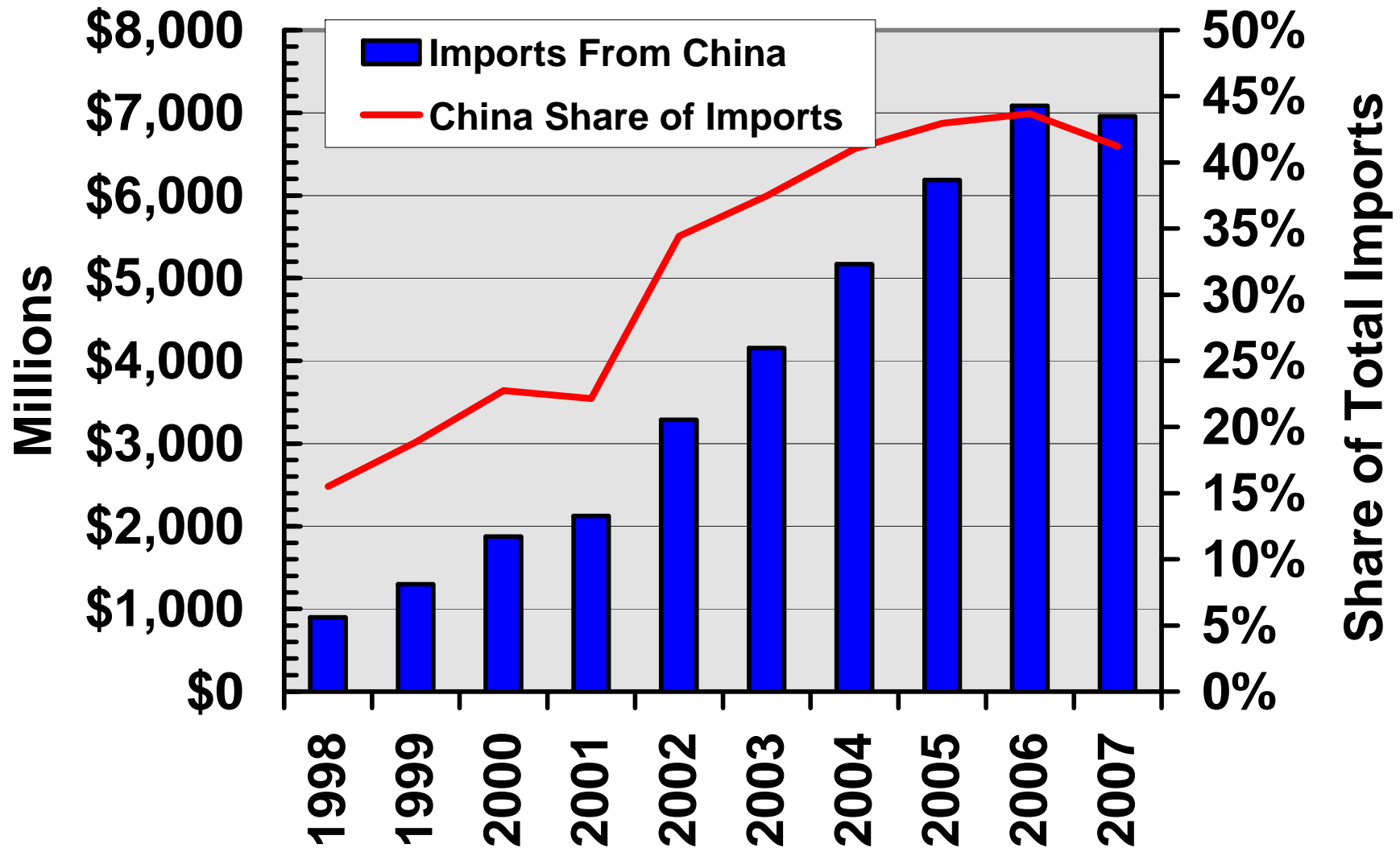
---

Of the \$18 billion of forest products we import, over 16% or \$3 billion originates in China. That's nearly 10 times the value of U.S. exports to China of these products. And 84% of our exports were logs and lumber in 2007.

China ranks as the no. 1 source country for softwood/hardwood flooring, hardwood Moulding, hardwood siding, hardwood plywood, flooring panels, and other miscellaneous wood products. And the numbers shown on the previous page don't include furniture-related products which we will discuss in a moment.

In the first half of 2008 Chinese shipments declined only 2.6% while total imports fell by 22%. China is taking market share in most of these product categories.

# Value-Added U.S. Wood Imports



Source: U.S. ITC

# *Value-Added U.S. Wood Imports*

---

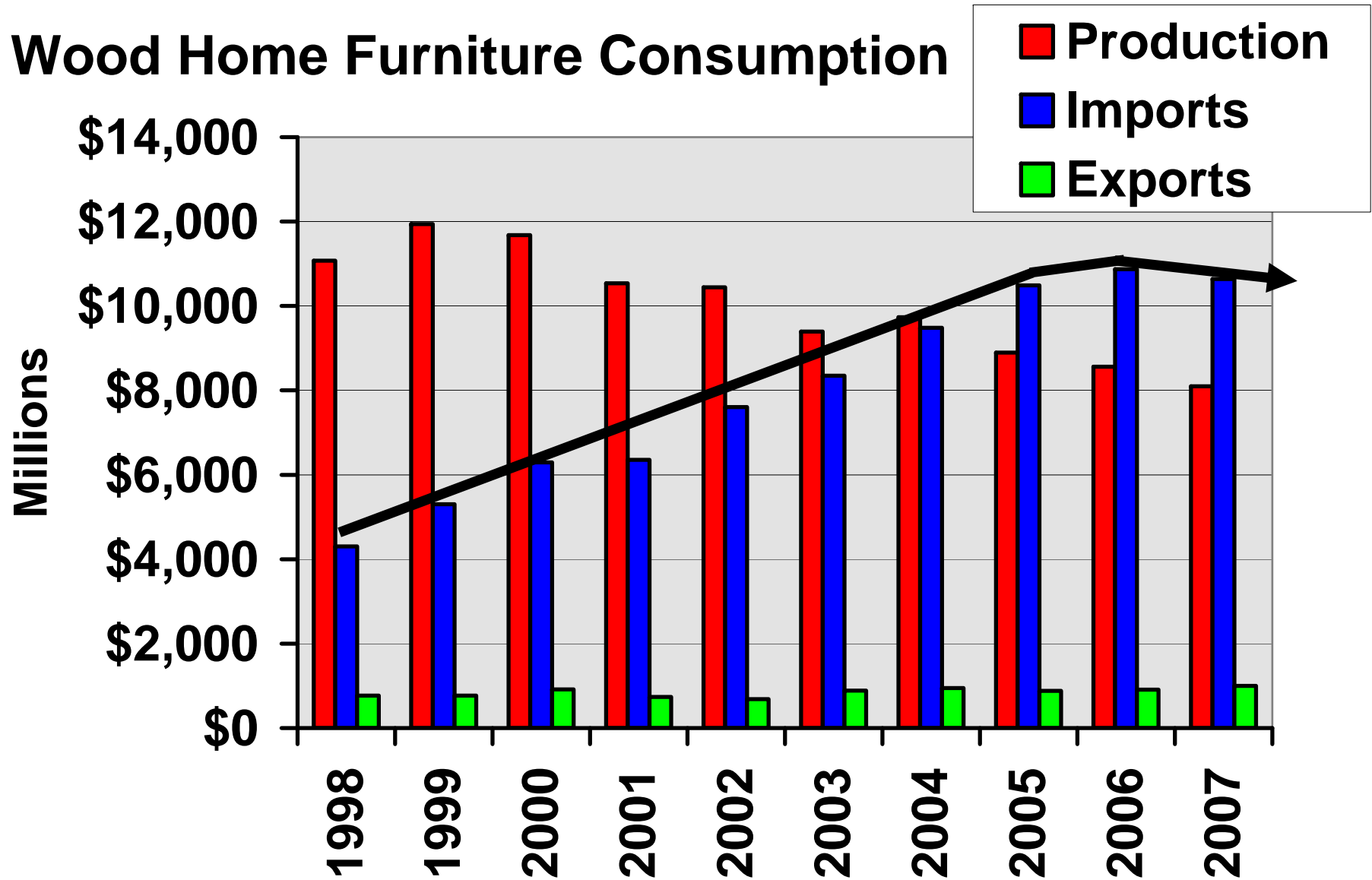
The higher-value, higher labor content Chinese imports graphed on the previous page include moulding, flooring, furniture and furniture components, cabinetry, and plywood.

In those categories the U.S. imported \$7 billion of products from China in 2007 and China accounted for over 40% of total imports.

Let's look closer at these product categories to see how this competition from China is affecting our domestic wood products industry...

# Wood Home Furniture

## Wood Home Furniture Consumption



# *Wood Home Furniture*

---

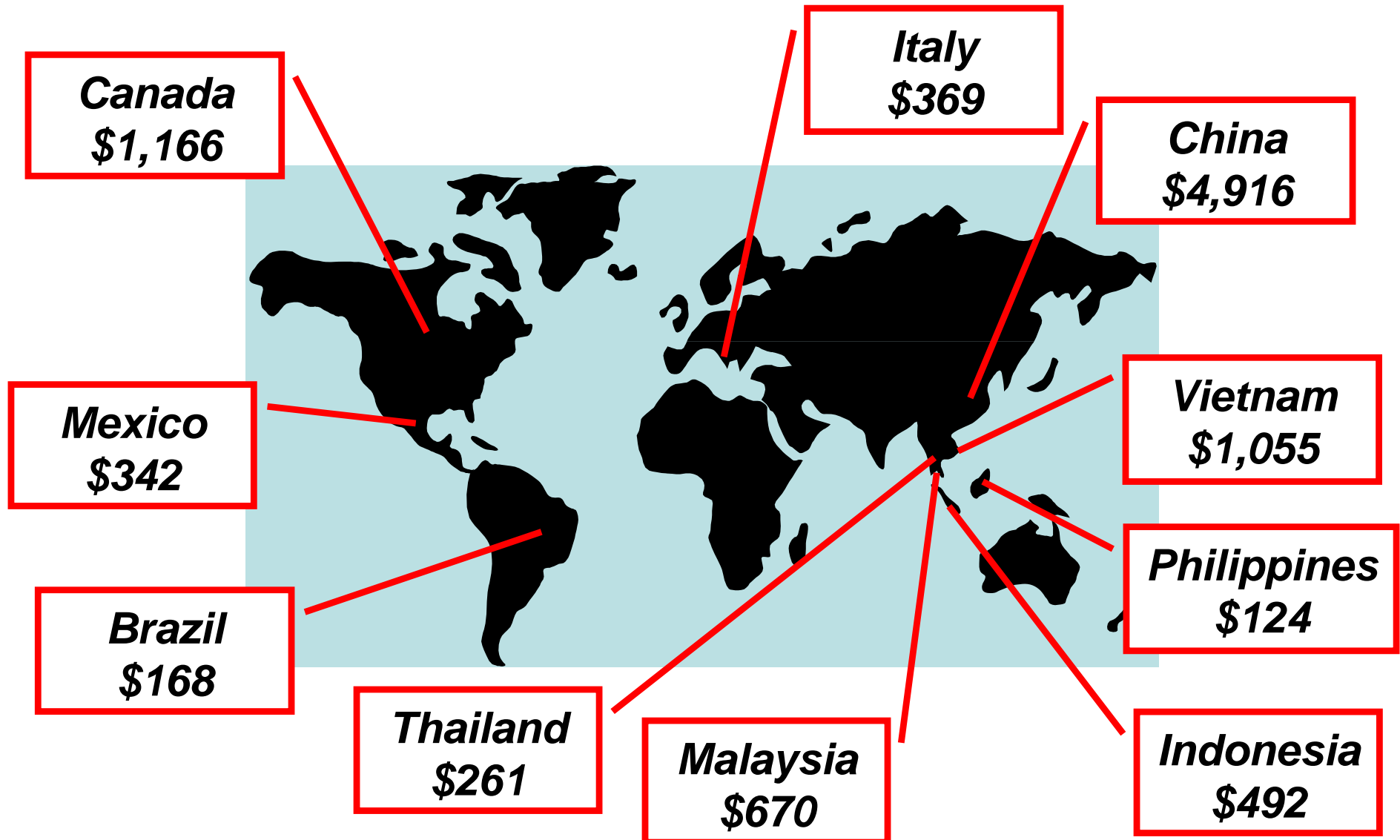
The story in wood furniture has been plant closures and retail chaos primarily caused by China's emergence as the prime source country in the late 1990s.

In 2006 we saw the growth rate of wood furniture imports decline. Last year that growth turned negative as imports fell by 2.2%. Remember that wood furniture imports nearly tripled during the last 10 years.

While this change in trajectory bears watching, this downturn is most probably a reflection of the poor state of furniture at retail in the U.S. Consumers are simply not buying furniture no matter where it is manufactured.

At retail about 56% of the wood furniture market is now supplied by foreign producers. That's double their 28% market share 10 years ago.

# Wood Furniture Source Countries



US\$ values in millions for 2007

Source: U.S. ITA

A. G. Raymond & Company

# *Wood Furniture Source Countries*

---

China has been the no. 1 source country since 2000 and in 2007 controlled 46% of all wood furniture imports with \$4.9 billion of shipments. But its producers too saw negative growth of -4.6% last year.

In the first half of 2008 Chinese shipments fell 11% while the rest of the world slipped only -7.4%. Its share of the U.S. import market fell to 44%.

The rising star of the furniture universe is Vietnam at the no. 2 ranking thus far in 2008. Shipments last year exceeded \$1 billion for the first time. In 1998 its producers' shipments were less than \$1 million.

As you can see from the map on the previous page, most of the source countries have low labor costs and in many cases access to domestic timber.

Over 280 U.S. furniture plants have closed since January 2000. Many old line industry names - Broyhill, Basset, Lane, Hooker, Lexington, and Pulaski – no longer operate wood furniture plants in the U.S.. Once buyers of wood furniture from China to supplement their product lines, these companies found the economics of sourcing compelling enough to close their domestic plants. Now they are seeing Chinese producers also become direct competitors.

# *Wood Home Furniture Attributes*

---

<b>• Wood Species</b>	<b><u>1997</u></b>	<b><u>2007</u></b>
» <b><i>Oak</i></b>	<b>22%</b>	<b>7%</b>
» <b><i>Cherry</i></b>	<b>19%</b>	<b>16%</b>
» <b><i>Other U.S. Species</i></b>	<b>25%</b>	<b>33%</b>
» <b><i>Foreign Species</i></b>	<b>15%</b>	<b>27%</b>

# *Wood Home Furniture Attributes*

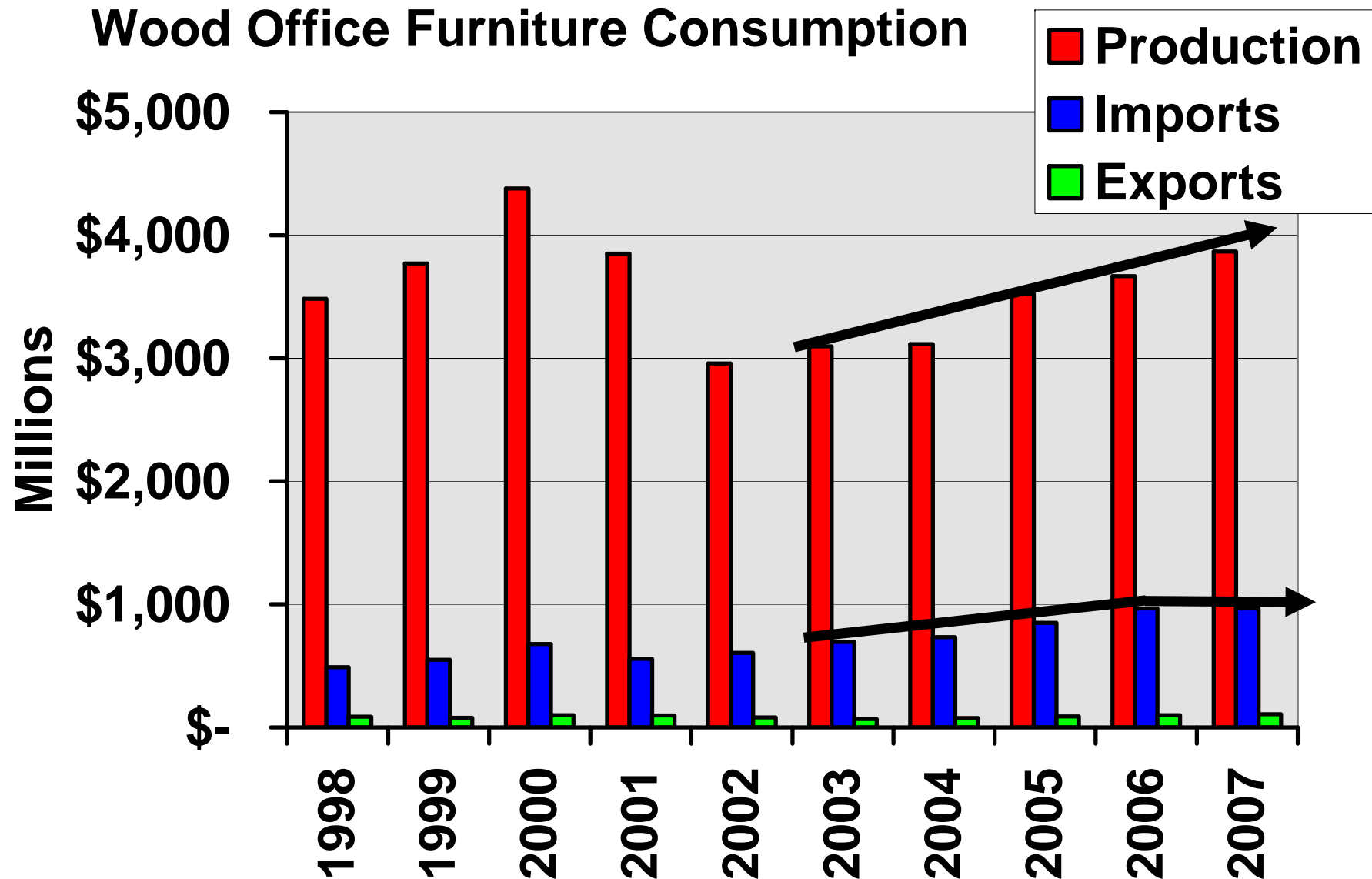
---

This increased import penetration has brought more foreign wood species to the store floors. Cherry remains in first place in the species rankings. Rubberwood has taken over second position from Maple while the total category of foreign woods has jumped from 15% in 1997 to 27% last year.

U.S. consumers now place a lower value on solid wood furniture made from U.S. hardwoods and are focusing more on price as a key purchase attribute. Thus the pressure on Chinese furniture makers to use U.S. hardwoods in their products is lessening.

Recent industry news has included stories of domestic producers adding jobs at some of their remaining wood furniture plants. While no one is predicting a reversal of the import tidal wave, these events bear watching to see if a minor trend toward more U.S. production develops.

# Wood Office Furniture



# *Wood Office Furniture*

---

The bursting of the dot.com bubble in early 2001 ruptured the U.S. office furniture industry. But since then this sector has bounced back 35% from that bottom.

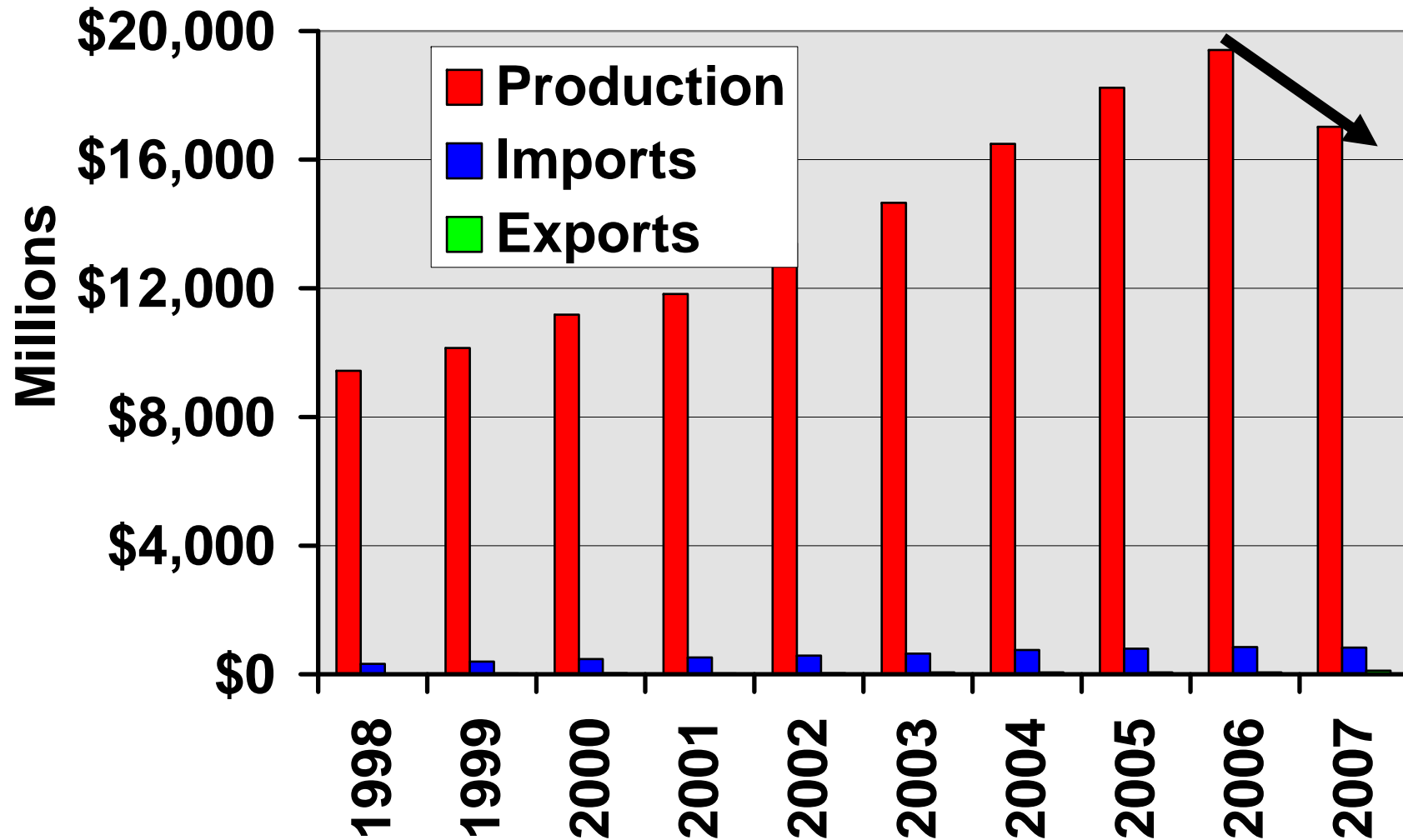
Foreign competition has impacted this category less than wood home furniture. Imports grew less than 1% in 2007 while domestic production advanced by 5.5%. Last year Chinese shipments grew by 7.3% at the expense of Canadian producers who saw their share of imports drop by 3.5%.

In the first half of 2008 Chinese imports fell by 10.6% while total world imports dropped only 4%.

Like in wood home furniture we can see China's share of U.S. imports softening.

# Cabinetry

## Kitchen Cabinet Consumption



# *Cabinetry*

---

Cabinetry was the star performer in the U.S. secondary wood products industry until the housing bubble broke with a thud. Up to November 2006 this sector had a run of 128 consecutive months of growth. During that period cabinetmakers were key buyers of U.S. hardwoods.

Imports hold less than a 5% share of the U.S. cabinet market. Unlike wood furniture this sector competes not just on price but also on mass customization and delivery speed. At the low end of the market however, China is making an impact. As a result, Chinese cabinetmakers are closing in on Canada as the no. 1 source country.

Last year Chinese cabinet exports to the U.S. grew by 48% taking their share of the import market to nearly 35%. Pretty good performance for a country that supplied less than 2% of U.S. cabinet imports ten years ago.

So far this year their cabinet shipments to the U.S. have grown another 4% in the face of a very weak market.

# *Cabinet Attributes*

---

- **Wood Species**

- » *Maple* 47%
- » *Cherry* 18%
- » *Oak* 22%

- **Door Materials**

- » *Wood* 90%
- » *Foil* 6%

# *Cabinet Attributes*

---

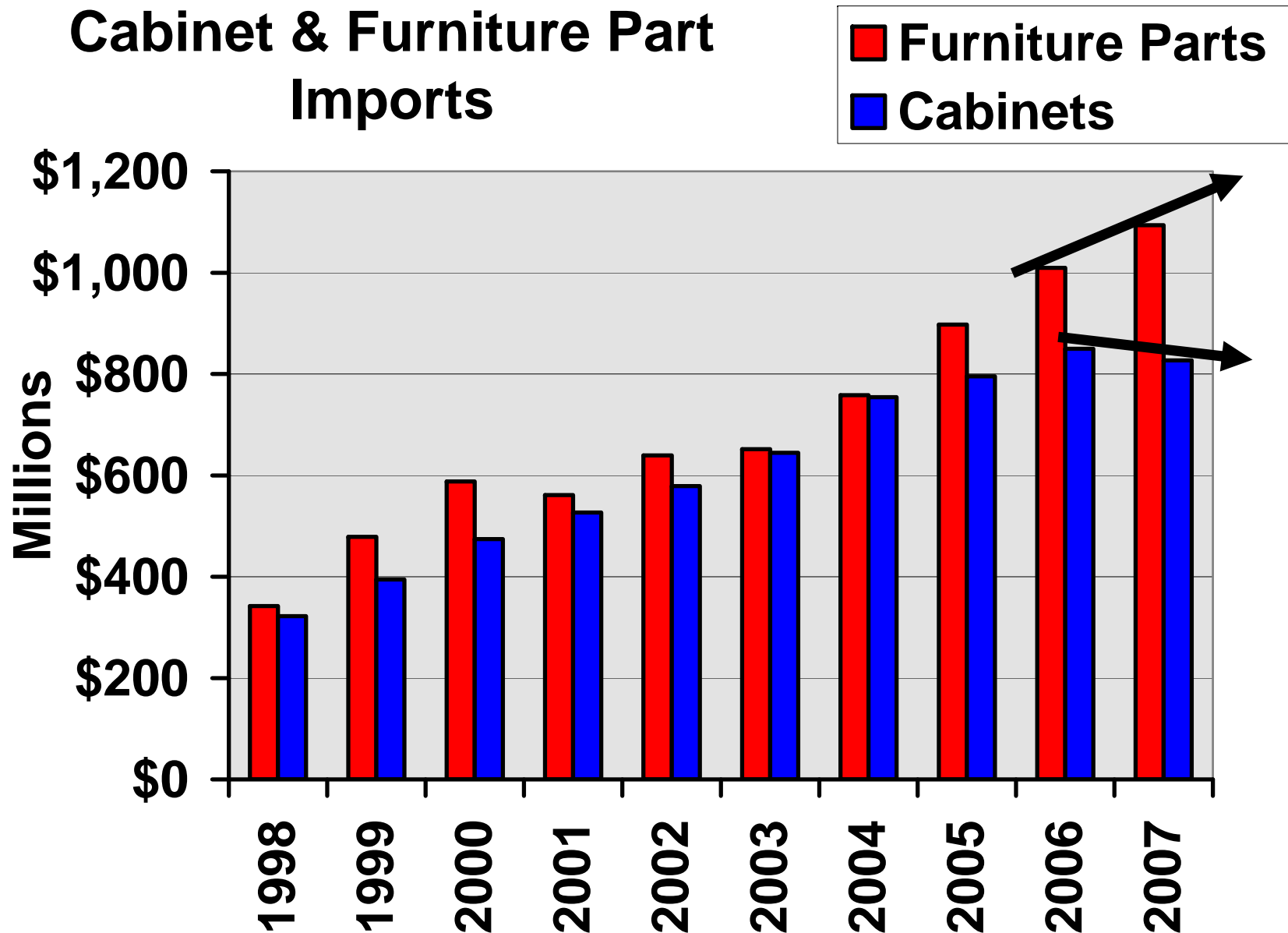
Thankfully U.S. hardwoods continue their dominance as the consumer's material of choice for cabinet doors, drawer heads, and front frames. The most popular cabinet woods continue to be Hard Maple, Cherry, and Oak.

And hardwood remains dominant as the material of choice for cabinet fronts over such materials as foil and high pressure laminates.

One other note regarding the U.S cabinet industry – plumbing hardware giant Kohler has recently announced the closure of its Canac cabinet division. Canac operated plants in Canada and the U.S. This event marks the first major plant closings in this downturn.

# *Furniture Parts*

## Cabinet & Furniture Part Imports



# *Furniture Parts*

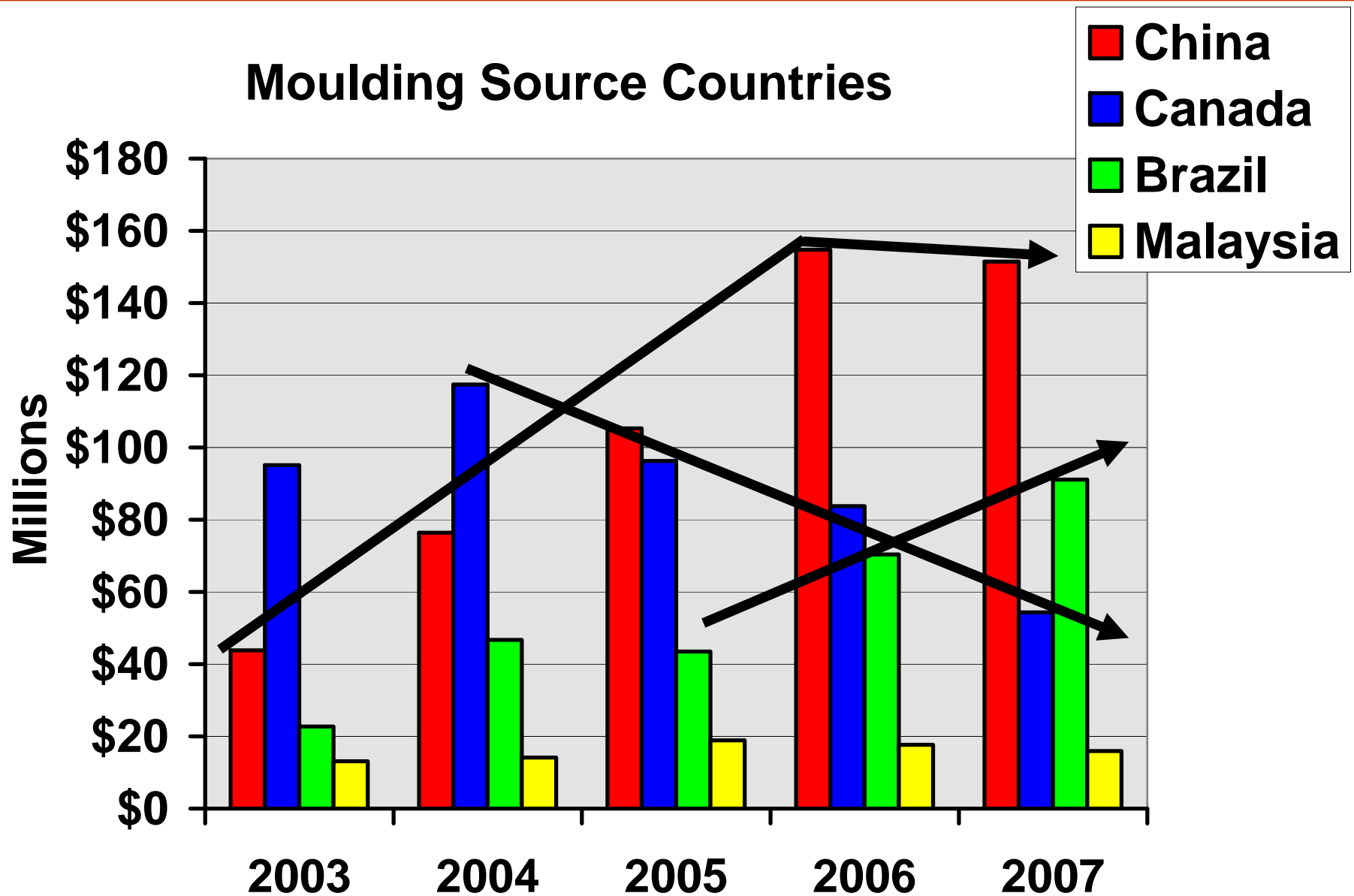
---

In spite of weaker domestic production of furniture and cabinets, U.S. producers bought more imported furniture parts in 2007.

China is the fastest growing supplier of these parts with 33% of the import total. Like in the cabinet sector, Canada has suffered from Chinese competition. Their share of U.S. imports fell from 41% in 2001 to 25% last year.

Overall imports of wood parts fell by only 3.4% in the first half of this year. With China's shipments falling by 8.5% during that period, you can again see their dominance of our import market weakening.

# Moulding



# *Moulding*

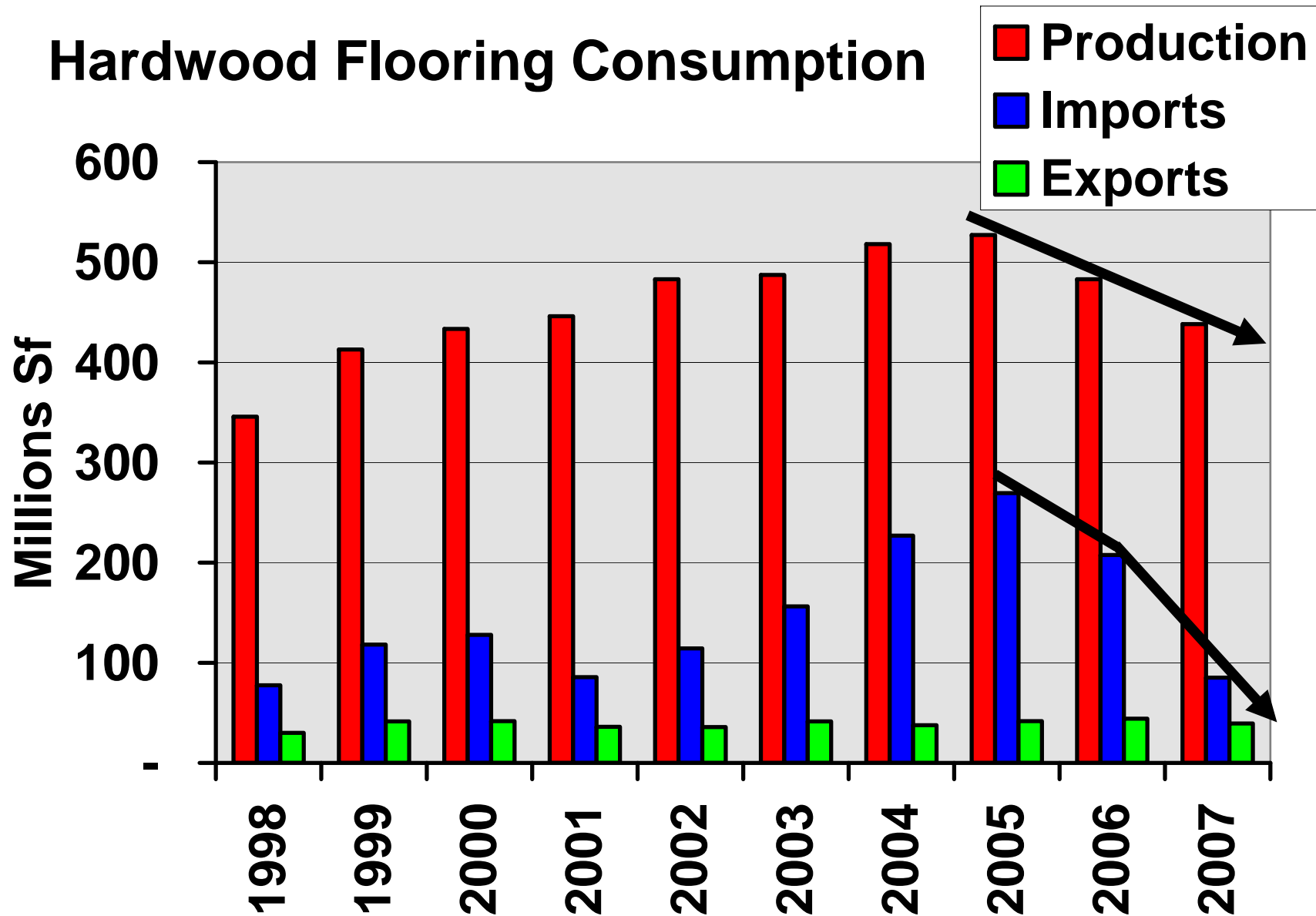
---

China's shipments of hardwood moulding to the U.S. grew six fold since 2001. Last year in the softer U.S. economy, China's moulding shipments to the U.S. fell by only 2% vs. Canada's, by 35%; and Malaysia's, by nearly 10%.

Thus far this year, however, China's moulding shipments have fallen by 31% while total world imports dropped only 27%.

Hardwood moulding also appears to be a category where China's dominance on the U.S. import market is weakening.

# Hardwood Flooring



# *Hardwood Flooring*

---

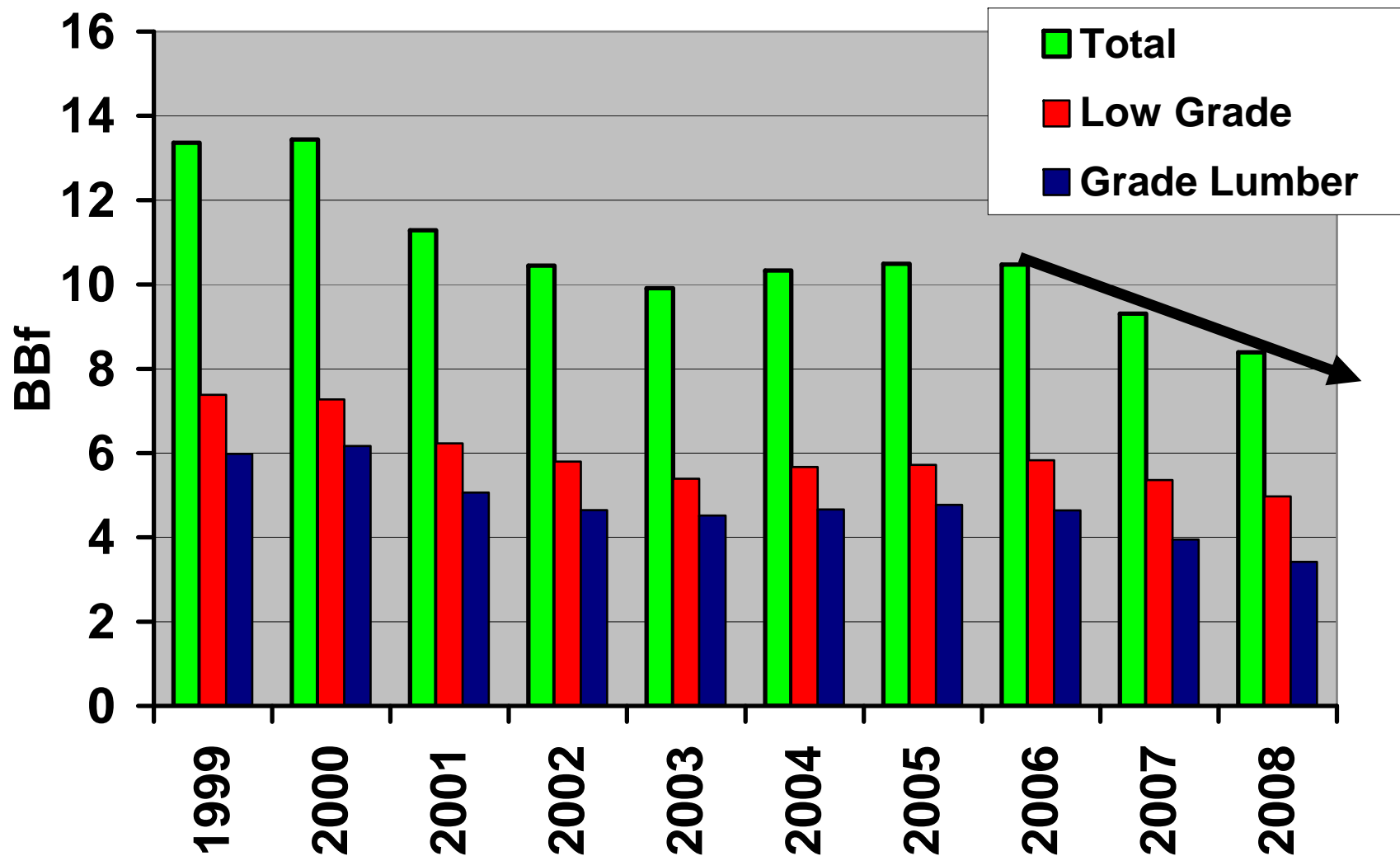
Like most wood products, flooring too has been hammered by the housing downturn. The residential market accounts for about 80% of wood flooring demand. Domestic shipments of strip flooring declined by about 9% in 2007.

China is far and away the no. 1 source country for hardwood flooring. Thus far this year Chinese producers have shipped nearly 40% less flooring to the U.S. market. The rest of the world, however, has shipped 66% less.

While China's export flooring mills have lost their value-added tax rebates, they are remaining dominant in the U.S. import market.

# *Impact on U.S. Hardwoods*

## Total U.S. Hardwood Lumber Usage



Source: *Weekly Hardwood Review*

A. G. Raymond & Company

# *Impact on U.S. Hardwoods*

---

What has all of this foreign competition done to usage of U.S. hardwoods? In 2000 demand peaked at nearly 14 billion board feet (BBf). This year demand will fall to just above 8 BBf.

Last year the primary hardwood using industries in the U.S. bought 13% less lumber than in 2006. Without question, Chinese wood products exports to the U.S. have hurt our hardwood business.

For U.S. hardwood saw mills, exports have been the key savior. As a percentage of total production, exports grew steadily since 2000. Last year however that growth declined. China's sales of value-added wood products to Canada has hurt our exports to that country.

China is the no. 2 buyer of U.S. hardwood lumber. Unfortunately their purchases dropped by 19% last year and have decreased by another 12% over the first half of 2008.

Look at page 27, however, at hardwood log shipments to China. China is the no. 1 buyer of our logs with about 22% of total shipments and grew their purchases by 35% in 2007. For the first half of '08 log exports to China declined by just under 11%. The rest of the world has bought about 8% fewer dollars of logs this year.

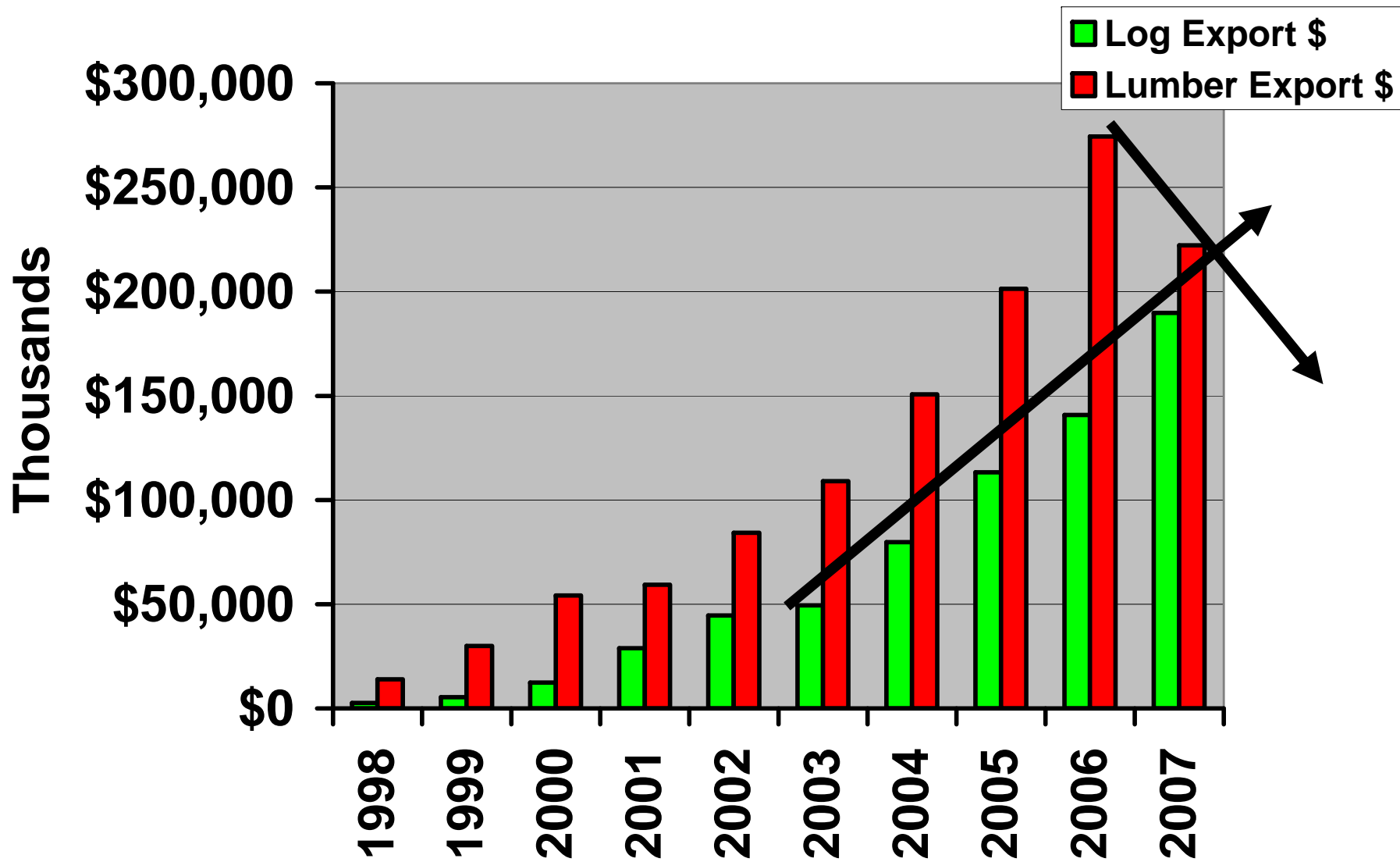
# *2007 Hardwood Use By Sector*

---

- **Furniture** ↓ 12.2%
  - **Cabinetry** ↓ 20.4%
  - **Dimension/Millwork/Moulding** ↓ 14.8%
  - **Flooring** ↓ 10.5%
- Total Usage** ↓ 13.0%

Source: *Weekly Hardwood Review*

# Logs & Lumber To China



Source: USDA FAS

# *China's Competitive Challenges*

---

- **Rising Currency Value vs. U.S. \$**
- **Increasing Labor Cost**
- **Higher Ocean Transport Cost**
- **Reduced VAT Rebates**
- **Excess Capacity**
- **Poor Domestic Timber Supply**
- **'Green' Regulations**

# *China's Competitive Challenges*

---

But Chinese buyers as customers for U.S. products are confronted with a number of challenges:

Since China unpegged their currency from the US\$ in July 2005, it has risen by 15%.

The combination of higher wages (up 66% in 3 years) and tighter labor laws is driving labor costs up.

Container rates have jumped with the higher cost of fuel.

The Chinese government has eliminated or reduced many of the rebates of value-added taxes for exporters.

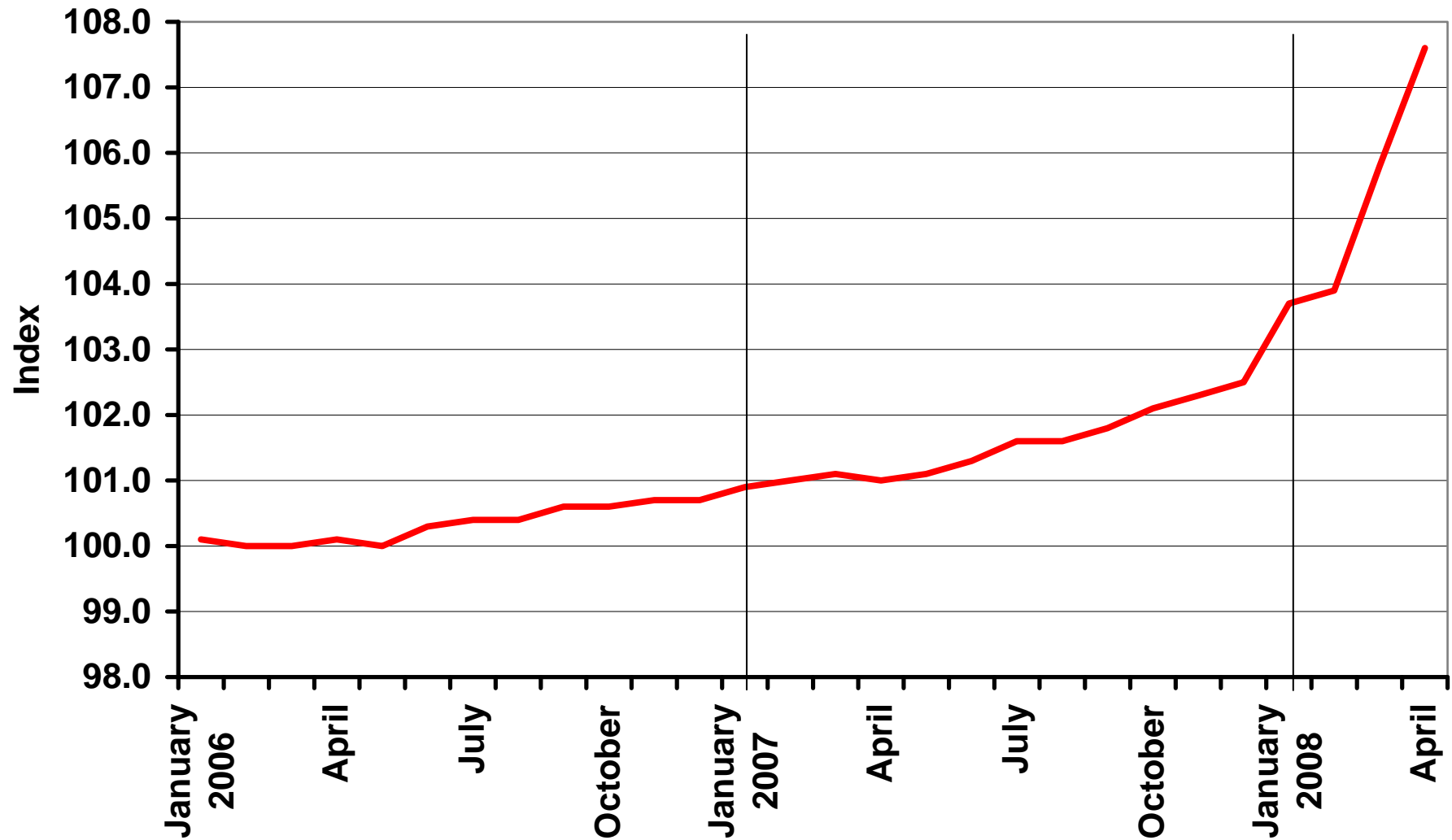
Furniture companies in particular have overbuilt production capacity and are now closing some of these plants.

Their timber resource is unsustainable.

The increasing impact of green regulations such as the recently-passed Farm Bill banning the use of illegally-harvested timber in products sold in the U.S. will mean higher material costs for Chinese producers.

# *Imported Furniture Inflation*

---



Source: Bureau of Labor  
Statistics

# *Imported Furniture Inflation*

---

Chinese government policies toward exporters clearly shows a desire to move their economy from low value, high labor content production to higher tech, high value-added industries. This development mirrors the transition that occurred in Taiwan, once the no. 1 source of U.S. wood furniture imports.

As a result of these pressures, prices of finished products like furniture from Chinese producers have increased significantly in the last year.

Publicly-traded Chinese furniture makers are reporting lower sales and profits. Samson Holdings, owner of three U.S. furniture companies (Universal, Legacy, and Craftmaster) as well as the second largest Chinese furniture producer, reported a 9% drop in sales for the first half of 2008.

Manufacturers there are consequently seeking to lower costs. They have a lot of headroom to improve their production efficiencies through better management and machinery. And they are also seeking lower cost sources of raw materials.

# *Competition for China's Purchases*

---



**China is aggressively sourcing from many countries...**

# *Competition for China's Purchases*

---

One place that China is exploiting for logs, lumber, and a myriad of other materials is Africa. Another is Russia. However, the latter country is reducing its log exports through a high export tariff in an effort to stimulate value added by domestic manufacturing.

China is the world's no. 1 consumer of timber as well as zinc, iron and steel, lead, aluminum, copper, nickel, tin, coal, cotton, and rubber. And the second leading consumer of oil. As a result there are 800 Chinese state-owned companies operating in Africa. They are investing billions to buy mining and timber rights. More importantly, they know how to play the game with the local politicians and officials.

Of every 10 tropical logs traded internationally, five are bound for China. In Mozambique their commercial timber resource may be gone in five years.

China is simply going direct to the source and opting out of the international system of commodity trading.

# *Conclusions & Recommendation*

---

As China develops alternative sources for timber, the potential for purchasing from the U.S. may lessen. Only time will tell whether the initial downturn in purchases of U.S. hardwood lumber seen in 2007 will become a trend.

What can you conclude from these data:

- China may have peaked as a wood products exporter to the U.S. – Time will tell if the recent declines in exports to the U.S. are cyclical or structural.
- China will remain the world's no. 1 importer of many materials including timber – Its domestic economy will consume these materials as its middle class continues to develop. Already their domestic furniture industry is three times the size of its furniture export sector.

To maintain sales to China U.S. companies must shift their effort to those companies producing furniture and the like for the domestic market. As noted earlier, exports are critical to U.S. sawmills. Given that fact, we simply must be willing to stay proactive in all foreign markets including China's.