

Surviving the deepening downturn

With the housing crisis having spread to the entire economy, woodworking companies face challenges to position themselves for future opportunities for profits and growth. What is the industry doing to sustain itself? As a follow-up to last year's survey, an exclusive study by Virginia Tech, the U.S. Forest Service and *Modern Woodworking* took an updated look at the market.

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What started as a correction in the housing market in 2007 has plunged the nation into recession and shaken the global economy. With financing unavailable to many prospective buyers and concerns by consumers about job security and the economic outlook, housing starts have reached levels not seen since the Great Depression. Given the importance of housing for secondary wood products industries, one can only wonder how the wood products industry is faring. As each company adapts to the current situation, this study offers insights into the ways companies are coping. *Modern Woodworking* readers can use this information to compare their own situation and to reflect on ideas to better position their businesses to survive the current conditions and be well-positioned for the coming recovery period.

Economy contracting, led by housing

Historically, home prices and incomes trend together [Figure 1]. When housing prices diverge significantly from income, homes become unaffordable to many prospective buyers – this reduces demand, and a price correction is inevitable. The gap between price increases and income peaked in 2006 for existing homes and in 2007 for new homes. As mortgage rates increased and financial markets realized the price levels were not sustainable, the housing market began a correction that will continue until prices and incomes return to a more normal relationship. Record inventories of unsold homes and elevated rates of foreclosures will ensure that further downward adjustments of housing prices will bring them in line with incomes and other metrics.

February 2009 marked the first month with increasing numbers of new residential construction starts after seven months of decline, with a total of 357,000 single-family homes and 226,000 multi-family homes started. However, compared to the 1.7 million single family

home starts measured in 2005, the market still is severely depressed and the excess inventory of homes remains high by historical standards. With foreclosure rates at 12 percent (This rate has never exceeded 7.0 percent since tracking started in 1979.), more supply is being added to inventories and maintaining downward pressure on home prices.

Housing is directly responsible for almost three-quarters of softwood lumber and structural panels consumed in the U.S. and for nearly two-thirds of the U.S. hardwood lumber not used in transportation (pallets, rail ties). Even furniture sales are indirectly tied to housing construction as people moving into newly purchased homes are likely to spend on new furniture. Thus, it is no surprise that the wood products industries are hard hit by the slowdown in the housing markets.

Figure 1. Home prices and family incomes (indexed to 1990=100), 1990-2008. Sources: NAHB and NAR for home prices; U.S. Dept. HUD for incomes.

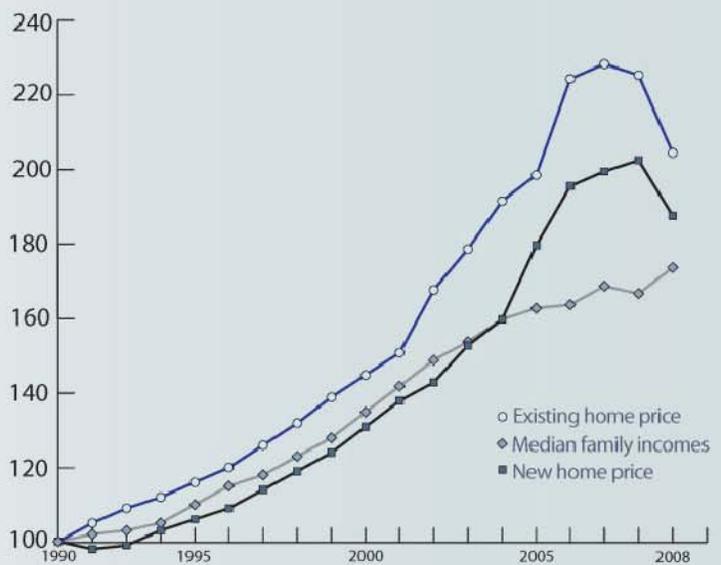


Figure 2. Reasons why sales volume decreased, 2008 and 2007 (scale anchored by 1=minor reason to 7=major reason).



Housing's impact on the secondary wood industry

The problems in the economy and specifically the housing market have caught up with the industry. Sales volume for 2008 versus 2007 declined by 20 percent or more for a third of the businesses responding to the "Wood Industry - Housing Market Survey" of *Modern Woodworking* recipients. Almost 60 percent of responding businesses lost sales volume, while only 26 percent reported an increase in sales volume. Sixteen percent said that sales volume in 2008 was unchanged from 2007. Compared to the same study conducted last year, those numbers show an increase in the number of businesses reporting a decline (37 percent reporting a decline in 2007 vs. 2006).

Fifty-two percent of respondents indicating that their sales volume declined in 2008 cited the downturn in the housing market as a major reason (rating of "7" on a seven-point scale anchored by 1=minor reason to 7=major reason), while 25 percent named the downturn in remodeling expenditures as a major reason. More than three quarters (80 percent) of respondents indicating that they had lower sales volume in 2008 cited the downturn in the housing market as having some influence (rating of "5" or higher), while 61 percent named the downturn in remodeling expenditures as influencing lower sales [Figure 2]. Offshore competition, competition from non-wood substitute products and more domestic competitors entering the market were rated predominantly as minor reasons (average rating of "3" or lower). Compared with last year's study, sales declines were more frequently explained with the downturn in the housing market (80 vs. 67 percent, 2008 vs. 2007) and on the downturn in remodeling expenditures (61 vs. 46 percent, 2008 vs. 2007). For the more minor reasons, the reverse seemed true; their influence was perceived to be greater in 2007. While results from respon-

dents experiencing sales growth in 2008 generally were consistent with last year's study, more respondents named entering new markets with existing products as a reason for sales growth in 2008 [Figure 3]. It seemed more emphasis was being placed on seeking out new markets for existing products rather than developing new products, perhaps an indication of the small size and specialized nature of many of the responding companies.

Actions undertaken in 2008 or planned for 2009

Respondents of this year's study indicated a variety of marketing actions were undertaken in 2008 or planned for 2009 to maintain or grow sales volume. Write-in comments indicated increasing efforts to bid for work, pursuing new markets with existing or adapted products, as well as placing more emphasis on customer service and relations. Working harder on relationships with existing and potential customers also seemed important. According to one respondent, the firm was engaged in "more hand-to-hand and eye-to-eye contact." Companies also indicated making investments in technology to improve productivity and to reduce costs, or to enable production of new products.

When presented with a list of 11 predetermined marketing actions undertaken in 2008 or planned for 2009, "We enhanced our product's value by adding features, benefits or services" was rated highest by respondents with an average rating of 4.0 (on a seven-point scale anchored by 1=strongly disagree to 7=strongly agree), followed by "We reminded our customers through advertising and personal selling of the basic benefits of our products and services" and "We developed differentiated product lines with features targeted to the unique needs of small potential customer groups or regional segments", each with an average rating of 3.9.

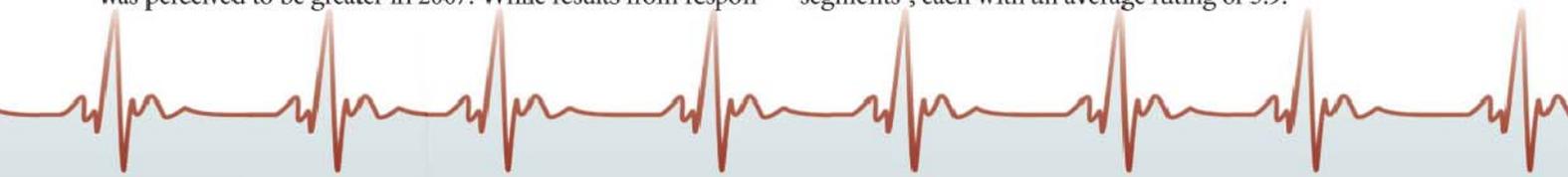
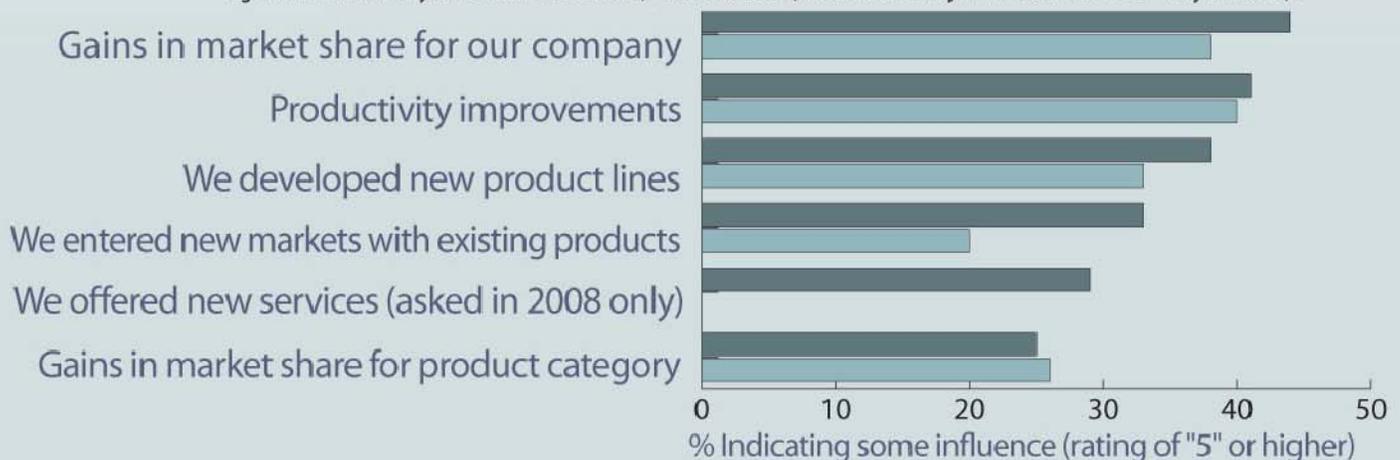


Figure 3. Reasons why sales volume increased, 2008 and 2007 (scale anchored by 1=minor reason to 7=major reason).



While the overall results were similar to last year's study, one action that obtained a higher rating (7.4 percentage points higher than last year), was "We designed service programs to reduce the perceived risks of new customers trying our products." Another action scoring somewhat higher (5.2 percentage-points higher than last year) was "We developed differentiated product lines with features targeted to the unique needs of potential customer groups." These actions were also consistent with several of the write-in comments.

Housing still critical

Compared to last year, fewer companies were serving markets directly associated with single family home construction, but this sector was still quite important. Almost a quarter of respondents said that none of their production

volume was directly associated with the single family residential construction market in 2008. Also, fewer companies reported that they had over 60 percent of their production volume committed to the new single family construction market, a drop of 11 percentage points from 2007 [Table 1]. The reduction most likely is a consequence of the decline in opportunities to do business in this market. Consequently, this year's survey also revealed that more companies participated in the residential repair and remodeling market than in the new single-family residential construction market in 2008. Almost 82 percent of respondents indicated that their company is involved in the residential repair and remodeling market versus 76 percent for the new single family residential construction market. The repair and remodel-

ing market has fared better than new housing over the past 24 months, which demonstrates the importance of being diversified in markets outside of new housing alone.

Over 90 percent of the survey respondents' companies participate in semi-custom and made-to-order markets in 2008, roughly the same as 2007. Over half of the respondents indicated that more than 60 percent of their business is from semi-custom and made-to-order product markets (55 percent and 59 percent, respectively). While most respondents indicated

that the share of semi-custom and made-to-order products in their product mix had remained "about the same" compared to three years ago, 18 percent and 15 percent, respectively, indicated that the proportion had increased from three years prior.

How are you maintaining sales volume?

"We are putting more emphasis on customer service and customer relations in an effort to create more value for our customers."

- MW survey respondent

Outlook – will construction markets improve?

Respondents' assessment of the nationwide construction climate for 2009 and 2010 in four different sectors (single family housing, multi-family housing, residential repair and remodeling, and non-residential/business construction) are fairly bleak overall [Figure 4], with all sectors, for both 2009 and 2010, having an average near or below the scale mid-point (anchored by 1=very poor to 7=very good). Only 6 and 7 percent of respondents, respectively, indicated that the single-family and multi-family housing markets were at least slightly good (rating of "5" or higher on the scale) for 2009. Results for the residential repair and remodeling and the nonresidential/business construction market were

Production volume tied to single family home construction

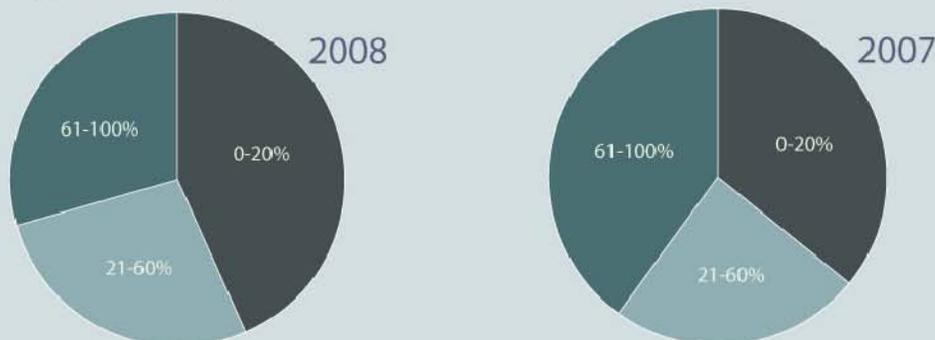


Table 1. Among responding companies, proportion of production volume directly associated with the single family residential construction market (used in the building or trimming of new homes, excluding furniture).

more positive, with 35 percent and 25 percent of respondents, respectively, reporting that the nationwide sectors were at least slightly good for 2009. Those results are lower than was found for a similar question in last year's survey, where respondents indicated at least slightly good market conditions in 2008 for single family housing (13 percent), multi-family housing (11 percent), residential repair and remodeling (48 percent) and the nonresidential/business construction markets (36 percent).

For 2010, respondents expect slightly better market conditions. Ten and 11 percent of all respondents expect market conditions for 2010 to be at least slightly good ("5" or higher on the scale) for single and multi-family housing, respectively. Conditions for the residential repair and remodeling and the nonresidential/business sector are expected to be better (40 and 29 percent, respectively). Expected market conditions fell considerably for 2010 from the expectations indicated in last year's survey. Single family housing, multi-family housing, residential repair and remodeling, and nonresidential/business construction saw a decrease of 19, 16, 9, and 13 percentage points in the number of respondents who now indicated at least slightly good market conditions for 2010 compared to last year's expectations for 2010.

Opportunities for green products

Green building efforts have received increased attention over the last few years and might prove to be a major market opportunity for businesses competing in the construction market. Fifty-four percent of respondents indicated they have seen increased interest from their customers in sourcing green products [Figure 5].

"Green" building could hold considerable promise for wood products. Wood, an environmentally friendly, sustainable and versatile material, can become a dominant material in numerous applications in green building construction if the industry finds ways to participate in the design and implementation of green building codes. Individual woodworking companies can potentially position themselves in specific green markets, using unique supply chains and production knowledge as competitive advantages to meet this growing demand.

Implications

Last year we wrote that "these are challenging times for businesses related to the housing markets." With the housing market problems having spread to much of the economy, perhaps the writing this time should read "these are challenging times for any woodworking business." Businesses have switched to survival mode, eliminating excess and trimming labor forces. The new housing market is currently performing at less than one-third of its peak level in 2005, foreclosures are still rising, and inventories remain at roughly double the historical average. Despite these challenges, woodworking companies throughout the nation have found ways to survive, if not grow their sales volume. Some have done so through specializing even more into niche markets, others by finding new markets for their existing products, while yet others are investigating and investing in new products and technologies. A symposium on lightweight panel technology held last November attracted 170 industry participants, about the number that would be ex-

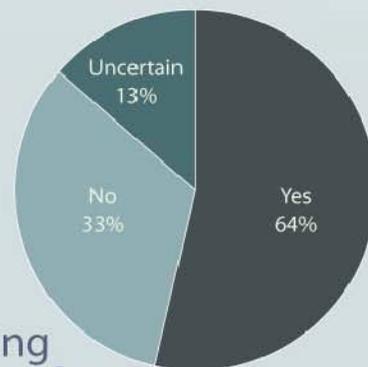


Figure 5. Have you seen increased interest from customers in sourcing products compliant with any green standards program?

pected in better economic times. This shows that industry participants continue to investigate ways to overcome the current challenges, while positioning their companies for the eventual better times ahead. The economy and housing markets have already begun the process of correcting imbalances, and eventually will recover, offering new opportunities for secondary wood products companies. **MW**



About the Study

The nationwide "Wood Industry — Housing Market Survey" conducted by Virginia Tech, the U.S. Forest Service and Modern Woodworking was internet-based and sent via e-mail by Modern Woodworking to a random sample of its subscribers in February 2009. A total of 318 usable responses were returned over a four-week period. Twenty-eight percent of the respondents were cabinet manufacturers, 14 percent were household furniture manufacturers, 9 percent were molding/millwork companies, 9 percent were architectural fixtures specialists, 4 percent were contract furniture companies, 3 percent were countertop manufacturers and the remainder were classified as "other." Nearly 57 percent of respondents were corporate or operating managers and another 9 percent classified themselves as production management. Over 39 percent of respondents indicated that their companies used mostly solid wood, and another 41 percent indicated that a combination of solid wood and wood composites was used. Geographic coverage in terms of both facility location and markets served was broad and somewhat evenly distributed across all regions of the U.S.

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