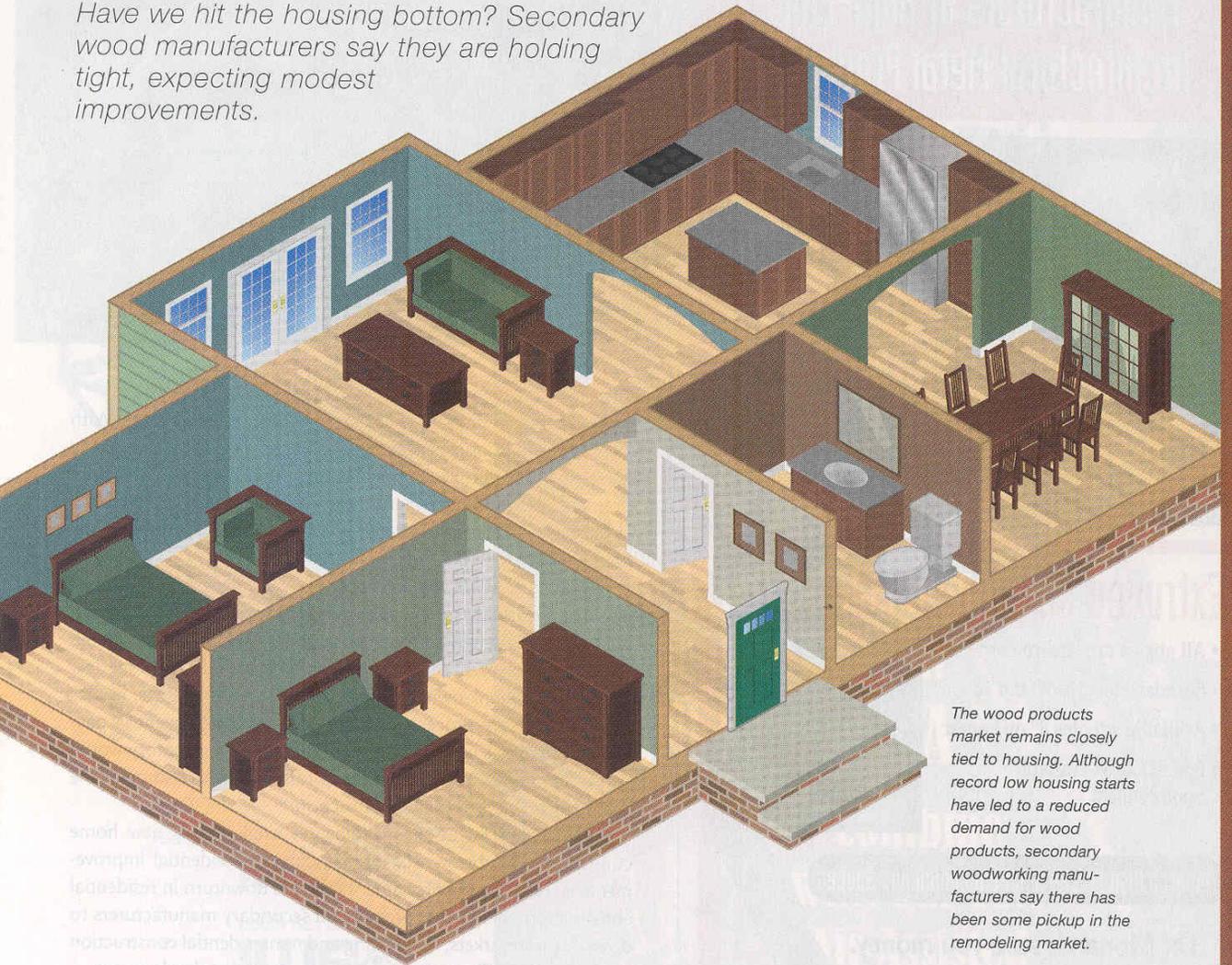


HOUSING MARKET'S IMPACT ON THE SECONDARY WOODWORKING INDUSTRY

Have we hit the housing bottom? Secondary wood manufacturers say they are holding tight, expecting modest improvements.



The wood products market remains closely tied to housing. Although record low housing starts have led to a reduced demand for wood products, secondary woodworking manufacturers say there has been some pickup in the remodeling market.

*By Urs Buehlmann, Matt Bumgardner,
Al Schuler and Karen Koenig*

The housing correction that started in 2007 and resulted in a global recession, is slowly running its course. Its effect, though, on the secondary wood products industry will continue to have impact for the next few years.

What the wood products industry is doing to adapt to the situation — and what manufacturers' can expect in terms of improvement — is the focus of a joint study by Virginia Tech, the U.S. Forest Service and *Wood & Wood Products*. Approximately 360 woodworking professionals from our VIP panel completed the survey, for a participation rate of

46 percent. The VIP panel is an online community of readers that act as advisors to the magazine, enabling us to gauge their thoughts on, and experiences with, topics of interest to the woodworking industry. Survey respondents spanned manufacturing industries integrally connected with the housing market: cabinet manufacturing, fixture and mill-works, furniture and components.

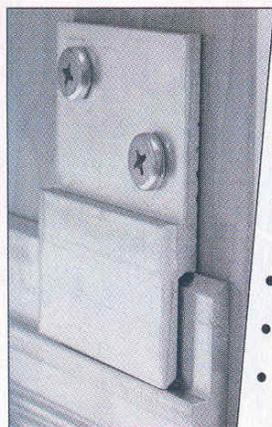
Excess Housing Inventory Presents Problems

Although some aspects of the economy have improved of late, housing continues to suffer from excessive inventory

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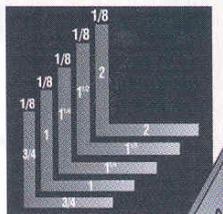


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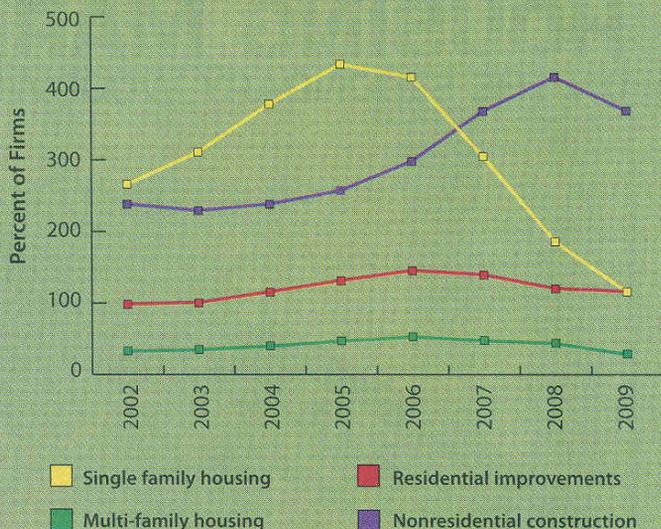
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Value of Private U.S. Construction

Figure 1



levels, limited credit availability and record foreclosure rates. With inventories high and demand for new construction waning, the corresponding decline in single family housing starts has been dramatic — dropping 74% from its peak in 2005 through 2009 — although starts have showed some improvement through the first quarter of 2010.

In March of 2010, the inventory of new homes for sale was at about a six-month supply, with an eight-month supply of existing homes. Generally, a four- to six-month supply is considered “healthy.” However, these figures do not include the “shadow inventory” of bank-owned homes not yet on the market, homes in the foreclosure process, or homes seriously delinquent in payments. While it is unlikely that all of this shadow inventory would go on the market at the same time, it does illustrate some of the current headwinds to new construction.

As shown in Figure 1, spending on single family new home construction fell below that of spending on residential improvements in 2009 for the first time. While the downturn in residential construction puts further pressure on secondary manufacturers to diversify their markets, remodeling and nonresidential construction markets might offer opportunities for new market development.

Continuing Pressure on Wood Industry Sales

Although 23% of respondents reported that none of their production volume was directly associated with new single-family home construction, almost one-quarter said 1-20% of their production was in single-family construction, while amounts of 21-60% production was cited by 26% of respondents. An additional 27% of respondents said more than 60% of their production volume went toward single-family construction (Figure 2A).

Sales also are diversifying into the remodeling markets. As shown in Figure 2B, more firms overall were engaged in this market compared to single family construction, but fewer firms had a large proportion of their production volume geared toward repair and remodeling; a plurality indicated that 21-60% of their production was in repair and remodeling markets.

Proportion of Production Volume in Single Family Housing

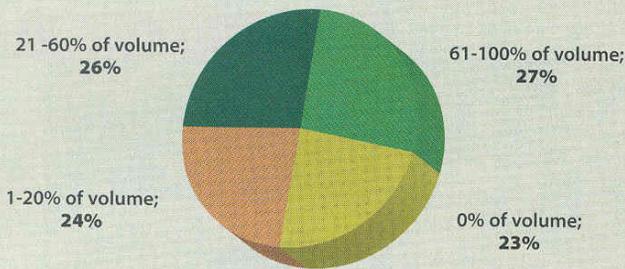


Figure 2A

Proportion of Production Volume in Residential Repair & Remodeling

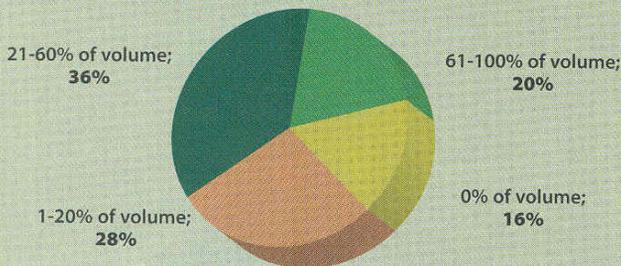


Figure 2B

Consequently, the soft housing market, especially new single-family homes, continues to affect sales volume for many secondary wood products manufacturers. For a majority of firms (6 out of every 10), sales volume declined by 20% for 2009 compared to 2008. Overall, 81% of respondents indicated that they lost sales volume in 2009, compared to 13% who reported an increase in sales volume. Another 6% of respondents indicated no change in sales volume from 2008 to 2009 (Figure 3). These are somewhat dramatic changes for the worse from a year ago, when a similar study found that sales had declined by 20% or more for a third of secondary wood businesses, and that 60% of secondary wood firms overall had lost sales volume in 2008 compared to 2007.

Compared to 2008, was your 2009 sales volume...

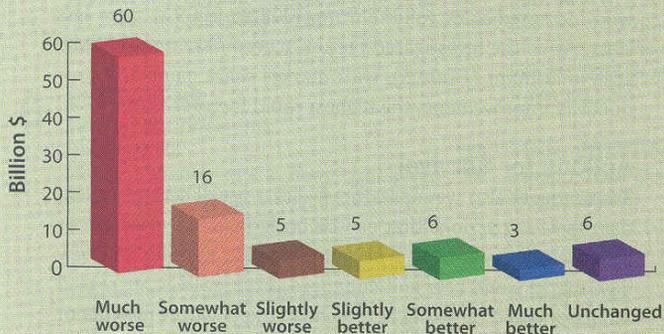


Figure 3

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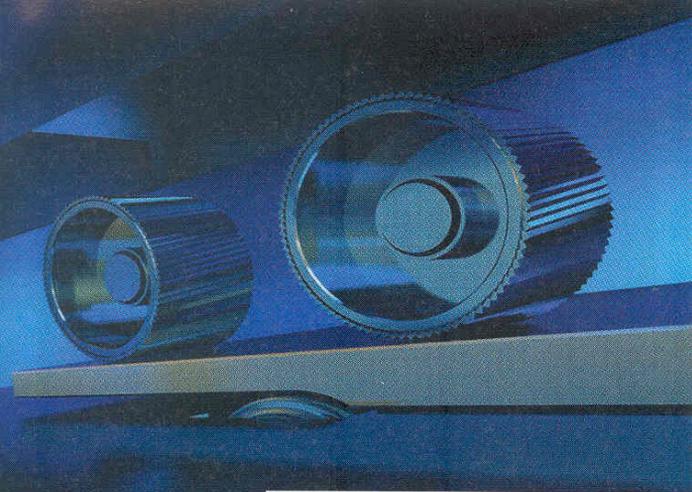
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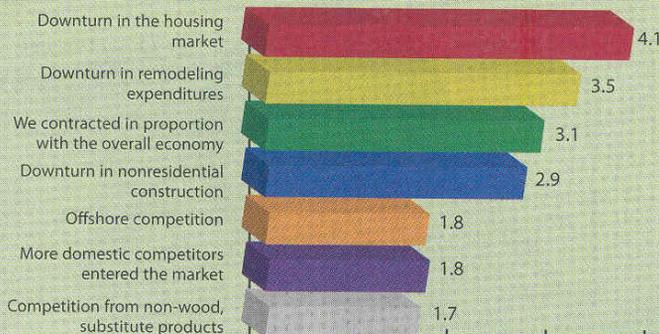


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Causes for Sales Decline in 2009

Figure 4



1 = Minor Reason to 5 = Major Reason

Causes for Sales Increase in 2009

Figure 5



1 = Minor Reason to 5 = Major Reason

When specifically asked why sales volume declined in 2009, the role of housing becomes even more apparent. For those firms losing sales volume, “downturn in the housing market” and “downturn in remodeling expenditures” were the highest rated factors, followed by the nonresidential construction and contraction of the overall economy (Figure 4.) Less important was competition from other firms, whether offshore or domestic, and competition based on non-wood products. Conversely, the factors behind success for some firms – those who increased sales volume from 2008 to 2009 – were less clear. All of the investigated factors scored near or below the scale mid-point (Figure 5), with market share gains and productivity improvements the highest rated factors.

Actions for Survival

Respondents also were presented with a list of several potential marketing actions that can be undertaken to maintain or increase sales volume in a declining market. Earning relatively high marks were: new and enhanced product lines, increased advertising and targeting new niche markets. A low number of respondents cited exporting, making it one of the least likely actions to have been undertaken.

As one respondent said, they now “quote more projects, many of which we passed on in previous years.” Another indicated a “major focus on developing niche markets outside of the residential disaster.” New product development was another somewhat common response, as was lowering prices. However, those that reported either sales increases or unchanged sales volume over the 2008-2009 period (69 firms or 19% of the sample) were much less likely to

mention lowering prices as an action they had taken, but instead were more likely to stress the importance of product quality. Several other respondents mentioned cost reductions, process improvement (i.e., reducing lead times, lean manufacturing, etc.), and improved customer service as actions they had taken.

Less frequently mentioned actions to improve sales, but interesting even so, included “hiring new talent,” such as

salespeople, designers, or accountants, networking with other shops and reconnecting with previous customers. As one respondent noted, they “increased personal networking.” Another stated they were “networking with others in related fields — it’s been one of the best things we’ve done!” Still another mentioned they were seeking to “reconnect with previous customers for upgrades or resales.”

Another emerging opportunity for some firms was demand arising from green markets; nearly 58% of respondents said already this year they have seen increased interest from customers in sourcing products compliant with green building standards programs. A few companies further indicated they had been able to increase sales volume from 2008 to 2009 by becoming certified or expanding their green products.

“Nearly 58% saw increased interest in sourcing green products.”

Another trend seen across the board by those surveyed was the increase in demand of custom and semi-custom products; 70% of respondents indicated that at least 81% of their overall product mix involved customers specifying all aspects of the product (i.e., species, finish, hardware), including design. For about 20% of firms, the proportion of custom and semi-custom production was higher in 2010 than three years prior; only about 8% of firms indicated it was lower. Additionally, more than 63% of respondents indicated that their price-point in their primary product category was either medium-to-high or high. This trend is likely in response to a loss of competitiveness in markets characterized by commodity-type, lower-priced products to offshore producers.

Firms in this study tended to be domestically focused, as only 26% (93 firms) reported an increased use of wood imports in their product lines over the last five years. A slight majority of these firms — 58% — imported components or lumber rather than finished product.

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Mild Optimism for Housing

Given the close ties between secondary wood products demand and the new construction and remodeling markets, respondents expect a somewhat challenging, but improving 2010-2011 period.

Until new housing displays steady improvement this year, survey respondents said they are reigning in their 2010 expectations, though still projecting mild optimism for 2011. Only 3% and 5%,

respectively, rated new single family and multi-family housing as at least somewhat good for 2010, although residential repair and remodeling ranked somewhat better, with 33% of respondents rating this market as at least somewhat good.

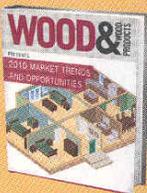
For 2011, however, 17% said they anticipate single family housing to be at least somewhat good – still low, but an improvement over 2010. More positively, residential repair and remodeling was

anticipated to be at least somewhat good in 2011 by 39% of respondents.

In the meantime, these firms say they are using the current economic situation to lean their businesses, rethink their marketing approaches, expand or switch market segments and improve customer service. This will make them well-positioned to take advantage of new opportunities as housing and the broader economy improve.

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ABOUT THE SURVEY



The Housing Market survey was conducted in March 2010 via e-mail to *Wood and Wood Products'* VIP panel of professional woodworkers. A total of 786 were sent; 359 usable surveys were

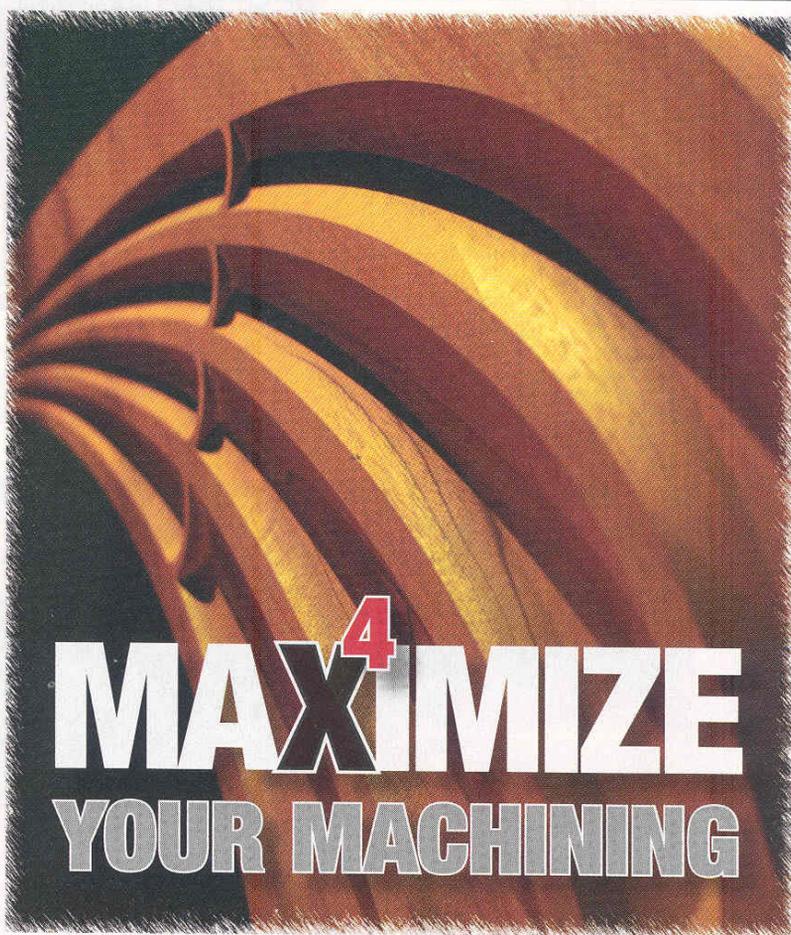
returned, for a 46% response rate.

Of the respondents, more than 36% were cabinet manufacturers, 13% were millwork producers, 8% each were household furniture and architectural fixtures firms, respectively, 7% were contract/office furniture producers, 5% produced dimension or components, and 2% were countertop manufacturers. Although 21% indicated that their production was in "other" categories, most (70%) could reasonably be classified into one of the aforementioned categories, mostly millwork or contract furniture. Nearly 45% had total sales of less than \$1 million in 2009; another 33% had sales between \$1-\$10 million.

Nearly 58% of respondents were corporate or operating managers, 14% were owners and 8% were production management. A majority (57%) indicated that their firms used a combination of solid wood and wood composites, and another 29% used mostly solid wood.

Responses were received from 46 states, with CA, IN, WA, MN, PA, NC, and WI each accounting for at least 4%. Geographic markets served ranged from 49% doing regular business in the Midwest to 28% doing regular business in California. Overall, coverage was somewhat evenly distributed across all regions of the United States. Most (58%) indicated they did regular business in one of eight regions listed on the survey: Northeast, Mid-Atlantic, Southeast, South, Southwest, California, Midwest and Northwest.

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