



| In Manufacturers |

The State of the Industry

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by **Rob Kirkbride**

A mixed bag or (another) perfect storm? That's the question industry watchers are trying to answer about the economy. It's a queasy ride watching the rise and fall of the stock market. And listening to the mixed economic data is enough to lose sleep.

If the country goes into a recession, the industry could face another downturn, and with it job cuts, plant closings and a round of consolidation.

But hold on, say some experts. The office furniture is far different than it was when the economy went into a tailspin at the beginning of the millennium.

The major companies in the industry are well positioned, said Budd Bugatch of Raymond James. But if the economy goes into a recession, there's little that can be done to protect it.



"I think the worst case scenario is that we go into multiyear recession," he said. "The trigger pullers for making purchasing decisions for office furniture are typically CFOs. If their budgets get curtailed, they can say, 'We're done' and walk away.

"If credit dries up and we run into a multiyear recession, that will work its way into this industry and we could have more than one down year."

The best case, Bugatch said, is that the economy stays relatively flat or grows by 3 percent and after a few years, gets back to a manageable 3 percent to 5 percent growth rate.

What will actually happen? That remains to be seen.

But the industry is different than it was when the bottom fell out of the economy seven years ago.

The industry is far leaner than it was before. Few major manufacturers hired full time workers, even as the economy grew over the past few years, instead relying on the flexibility of temps. And the industry is diversifying. Even if the market for office furniture slows, many of the major players are now tapping into the healthcare furniture market, education and other niche areas.

Still, the industry is going to be bound by economic variables such as corporate profitability, GDP growth, office space and leasing, Bugatch said.

Worries over those variables have caused a correction in the share price of publicly traded office

furniture stocks that were driven up by "exuberance" over gains in the industry. He said the correction "wasn't a total surprise." Bugatch gives the industry high marks for being "very proactive in running their businesses."

"I don't have any singular criticisms of companies in the office furniture industry," he said. "They were forced after 2000 to reduce their manufacturing footprints by up to 40 percent, and they did so by and large as humanely and successfully as you can in that difficult and unpleasant (task)."

The industry has adjusted to the new economic reality. Companies have successfully blended in imported parts, outsourced other product and are assembling their own products for their customer bases. That's a big difference from seven years ago.

"The leading players in the furniture industry are far more diversified than they were five or seven years ago," said Brian Bascom, principal of Velocity Partners, a market research firm specializing in the furniture, healthcare and technology sectors. "I'm not ready to cry wolf and pull in the reigns. Since the last industry downturn, there has been significant investment by many industry players in new product development."

People seem to be talking themselves into a recession, said Todd James, vice president of sales at Haworth Inc., who said the market for his company's furniture remains strong.

"Our activity level is extremely high and is robust, which seems to be a disconnect from the industry. Not only are we having success with the top line, but the activity level in the funnel is strong," he said.

Haworth, like many office furniture makers, has invested heavily through the industry rebound. The company opened a Calgary showroom last week. Its New York showroom opens in two weeks. And its new headquarters opens in a month.

"Haworth has benefitted from what's been an unprecedented level of investment in the marketplace," James said. "These are very positive and successful days for Haworth."

In addition to healthcare and education, some manufacturers have invested in crossover furniture -- furniture that can be used in commercial contract applications and high-end residential markets.

Marketing alliances also have thrived since the last recession. For example, in March office furniture and seating company izzydesign and healthcare furniture and seating manufacturer Nemschoff created a strategic alliance, capitalizing on each other's market strengths. Herman Miller also has a marketing alliance agreement with Brandrud Inc., a manufacturer of healthcare a public seating products, and with Bretford Inc., a manufacturer of furniture products for training, meeting, visual display and library applications.

Other firms, like Nucraft Furniture Co., have carved out profitable niches by offering furniture that's very different from the vanilla and chocolate served up in the industry in years past.

"The trend is toward freestanding furniture," Bascom said. "You're seeing it a lot on the West Coast. Products like Teknion Marketplace and Knoll AutoStrada are being embraced by large corporations that are taking a serious look at not only their facility strategy, but how (their employees) work as well.

"That's going to be good for some and bad for others."

If the economy slows, some companies who have not positioned themselves properly are in for a "rude awakening," Bascom said.

That, he said, will lead to consolidation in the industry. Several companies in the industry are for sale --

some publicly and some privately.

"I've been approached by two large office furniture companies recently about who can be identified for sale," he said. "Some of the purchasers are not just furniture companies. There are private equity companies whose money is looking for traditional hard assets."

Office furniture makers have touted their environmental, healthcare and education markets as areas of growth.

Bugatch said it remains to be seen if those markets will drive growth -- and if so, by how much.

He said the industry is to be commended for its thoughts on sustainability and green issues.

But it is "unknown at this point in time" how much that will boost the bottom line," Bugatch said.

The industry is in far better condition to weather a coming storm, said Michael Dunlap, principal of Michael A. Dunlap & Associates, an industry consulting firm that publishes a quarterly survey on the health of the industry.

"I think companies in the industry have learned the lessons of lean," he said. "In the second half of the 1990s, things were going so well that there was a bit of naivety that they could weather anything. They didn't realize this wasn't a storm, it was a hurricane.

"Now, industry far better prepared for any kind of downturn. There better prepared psychologically, with their facilities and financially. There has been a significant shift in the way the industry operates."

Dunlap's October 2007 Survey Index is 55.62, which slipped slipped from 58.49 in July 2007 after falling to 53.25 -- its historical low -- in April 2007. The highest index recorded was 59.72 Index in July 2005. The average since the survey started in August 2004 is 56.96.

An index of 100 means that things "couldn't be better," an index of one is "absolutely the worst" it can be, and an index of 50 means it is neutral -- no change "up" or "down."

The majority of respondents cite the economy, the credit crisis, healthcare costs, transportation costs and especially energy costs, as the "largest threats to individual company's growth." The "largest threats to the industry" are identified as imports from low cost countries, such as China, and a deep concern for the global economy.

The the long-term X-factor for the industry appears to be Asia. Although Chinese imports have been limited to the low end, fears that Asian companies could tap into the dealer network remain. Components used to make office furniture already are flooding the industry. Whether China decides to put those pieces together and ship them whole to the U.S. -- as they did with the residential furniture market -- remains to be seen.

The industry is relying on its tight control of dealers and specialized ordering as protection from Asian imports.

Despite those barriers, the threat is growing. According to the U.S. Department of Commerce, U.S. consumption of office furniture from China has increased 34.3 percent this year.

When you slice and dice the economic data, it is a mixed picture indeed. The Business and Institutional Furniture Manufacturer's Association, shows U.S. office furniture market demand will grow by 5 percent in 2007 and another 3.4 percent in 2008. BIFMA projects supply will increase by 2.3 percent next year to keep up with demand.

Steve McMahon, director of furniture solutions for Staples Contract Division told the Wall Street Journal that buyers should keep an eye on ever-rising oil prices and steel prices, even though the market remains "fairly strong." He said he believes there will be a round of price hikes in the furniture market next year.

A report by McGraw-Hill Construction shows that spending on commercial and manufacturing buildings, such as offices warehouses and hotels, will decline 7 percent next year in dollar volume and 10 percent in square feet of space build, compared to an 11 percent increase in dollar volume this year.

That's not good news for an industry that relies so heavily on new office space and the new furniture that goes with it.

So what does the Fed say? In his testimony earlier this month before Congress, Fed Chairman Ben Bernanke said the group's policy committee sees growth slowing "noticeably" in the current quarter and remaining "sluggish during the first part of next year" but "then strengthening as the effects of tighter credit and the housing correction begin to wane."

Consumer spending, which affects corporate profitability, should stay steady, he testified. And the labor market, important to the industry because more workers means more desks, has remained reasonably strong.

Most industry experts expect a general slowdown, a dip to be sure from the breakneck pace set the last few years, but still positive growth.

"If you go back to the Herman Miller webcast and HNI's as well, those two have said the indicators are definitely there that orders have slowed down and backlogs reduced," Dunlap said. "If look at all the different indexes, gross sales are down, backlog is down. Everything has just dropped a notch.

"I don't see anything in reverse. I don't think we're going to fall into the pit."

The next quarterly financial reports from the major companies in the industry should tell us more about where the industry stands.

And expectations are high about NeoCon. All of the major industry players are expected to launch major products at the show this year.

But will new products be enough to keep the industry out of the doldrums? Stay tuned.

Related Quotes		Volume	Market Cap	Days Range	Date/Time
Herman Miller	24.96 - 0.75 (2.92%)	588,917	1.52B	24.83 - 25.57	11/19/2007 1:55pm
HNI	38.45 - 0.85 (2.16%)	282,200	1.77B	37.87 - 39.05	11/19/2007 1:49pm
Knoll, Inc.	16.16 - 0.74 (4.38%)	459,100	812.65M	16.14 - 16.68	11/19/2007 1:50pm
Staples	20.49 - 0.60 (2.84%)	3,307,062	14.63B	20.47 - 21.17	11/19/2007 1:55pm
Teknion	1.90 +0.00	1,038	N/A	1.90 - 1.90	11/19/2007 12:14pm
Vornado Realty	93.73 - 3.23 (3.33%)	901,737	14.27B	93.51 - 96.10	11/19/2007 1:50pm

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