

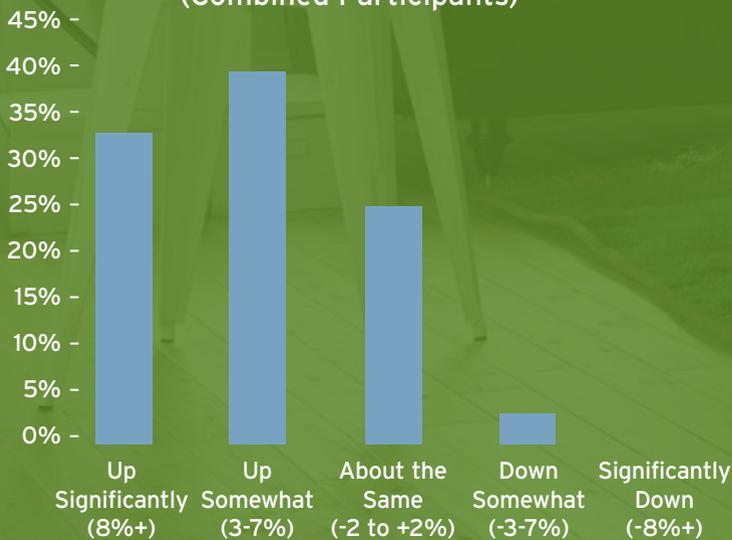
Industry Outlook

By Lindsay Konzak
& Angela Poulson

2016 was a strong year for NWFA members as a whole; most reported sales of their wood-flooring products grew. Contractors reported the largest gains, with 39 percent seeing sales grow by 8 percent or more, according to NWFA's 2018 Industry Outlook survey. Halfway through 2017, most survey respondents were optimistic they'd end this year on a positive note.

And they expect that momentum to carry into 2018. More than 70 percent of respondents - including manufacturers, distributors, retailers and contractors - expect sales growth of at least 3 percent in 2018, with a third expecting sales will grow significantly (8 percent or more).

2018 EXPECTED SALES GROWTH
(Combined Participants)



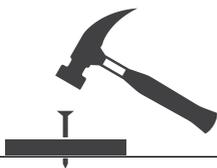
According to one manufacturer of general floor covering tools, equipment and chemicals, “our largest projected growth is within the hardwood industry.”

Customers are “ripping out a lot of carpet. No more old school,” said one contractor. Another agreed with the shift: “I’ve seen more and more people moving to hardwood in their homes over carpet.”

That optimism aligns nicely with overall forecast growth in construction markets.

The American Institute of Architects (AIA) Consensus Construction Forecast projects annual growth in the 3.5 percent to 4 percent range for the rest of 2017 and into 2018. That forecast, which incorporates other leading construction forecast data, does note a slower-growing commercial/industrial market and a challenged institutional sector.

THE AMERICAN INSTITUTE
OF ARCHITECTS (AIA)
PREDICTS
CONSTRUCTION
MARKET WILL
INCREASE BY 4%



“Housing has made significant gains since the Great Recession, but is still working back to full strength.”

- Granger MacDonald, Chairman of National Association of Home Builders

According to National Association of Home Builders Chairman, Granger MacDonald, housing has made significant gains since the Great Recession, but is still working back to full strength. Healthy home-price appreciation has driven the NAHB/First American Leading Markets Index to above-normal, but builders are being hit on the supply side, with rising material prices and a shortage of buildable lots and skilled labor, according to the organization’s chief economist.

In June, the most recent month for which data was available, privately owned housing starts were 8.3 percent above May and 2.1 percent above the prior year. Building permits were 7.4 percent above May and 4.1 percent above June 2016.

The remodeling market also remains strong, with NAHB’s Remodeling Market

Index posting a reading of 55 in the second quarter of 2017 that, while down from the first quarter, still indicates high market activity. Monica Irgens, president of floor-heating elements manufacturer Electro Plastics Inc., said rising home prices have kept people in their homes longer. Rather than foot the bill for a new home, consumers are instead “remodeling room by room or area by area to fit their budget,” she said. Survey respondents expect this market to stay healthy in 2018.

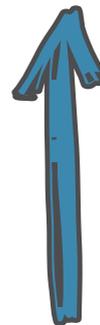
While 2018 is looking up, NWFA members still face headwinds, including growing competition from non-wood products such as LVT and WPC. And strong demand, especially in housing, is both

a blessing and a curse, as many members in the NWFA survey reported ongoing struggles to recruit and retain skilled labor to meet market needs, which also has resulted in increased labor costs.

SINCE 2016

HOUSING STARTS
INCREASED 2.1%

BUILDING PERMITS
INCREASED 4.1%



PRODUCT DEMAND

More Demand
 Less Demand

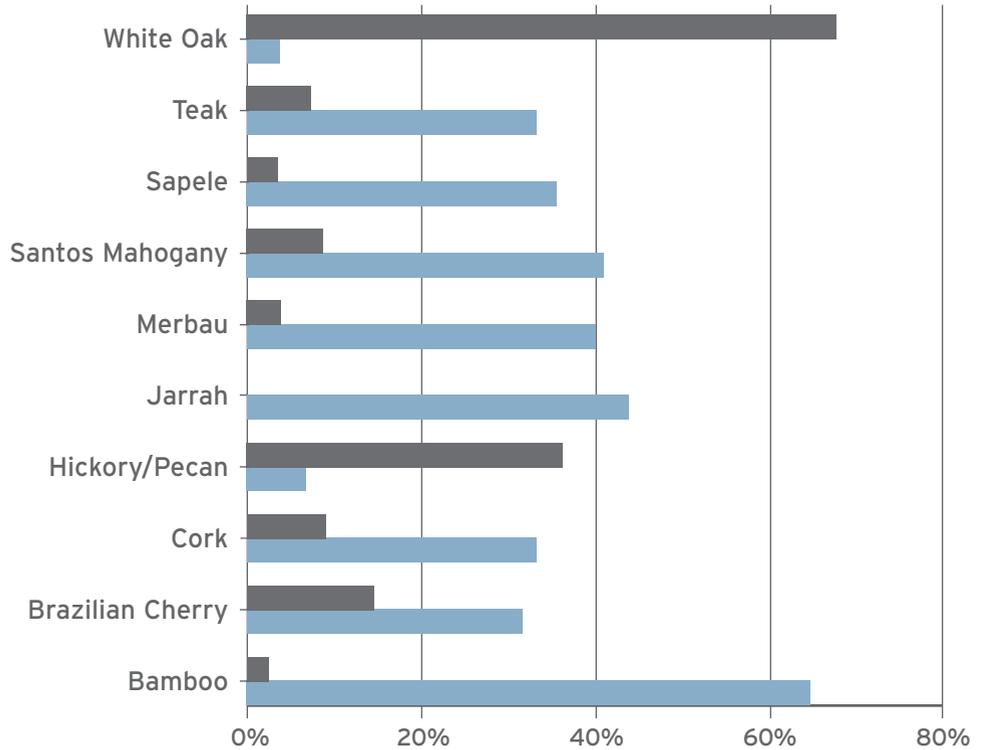
Percentages reflect members who anticipate a higher or lower demand for that species or flooring type.

While product-demand expectations always vary market to market, NWFAs members in the survey seemed to agree that demand for white oak will continue to grow in 2018. Wide-plank, long board and ceruse and grey finishes are also en vogue, a trend in line with many consumers' growing preference for "rustic," "authentic" and "organic" looks, members in the survey said.

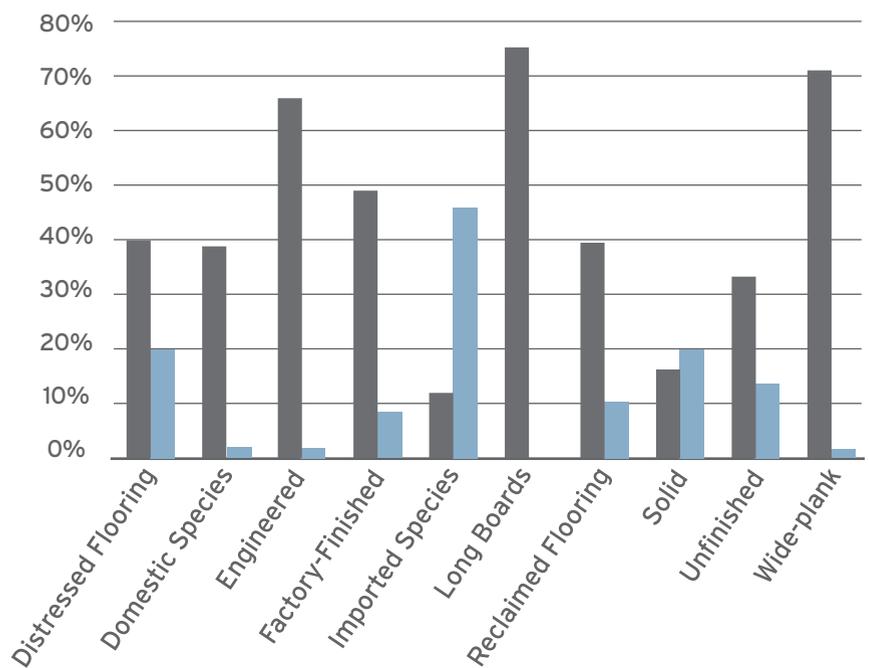
Demand for bamboo, on the other hand, is broadly expected to decline despite its previous popularity as a more rapidly renewable wood alternative. Cork and high-gloss or moisture-cured finishes are also falling out of favor, members said.

Growing demand for resilient non-wood/wood-look floor coverings are challenging NWFAs members. Forty percent of manufacturers named competition from wood-look floor coverings as a top concern going into 2018. More than half of distributors and retailers said the same. Contractors named luxury vinyl tile (LVT) as the top threat among non-wood coverings including LVT, WPC, laminate and tile.

EXPECTED DEMAND FOR SPECIES IN 2018



EXPECTED DEMAND BY FLOORING TYPE IN 2018



PRODUCT DEMAND

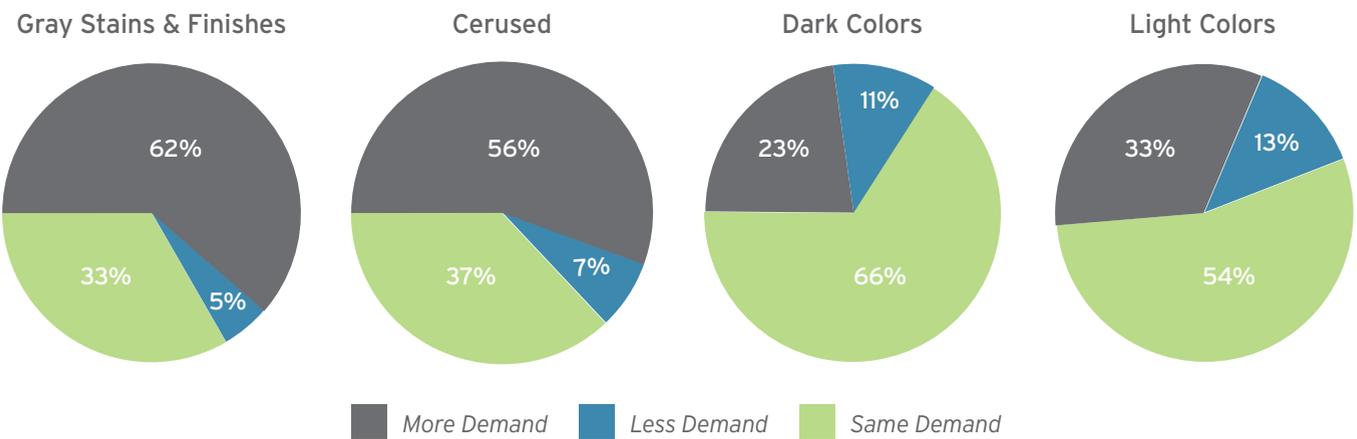
Flooring manufacturers like Tarkett, Armstrong and Mohawk have been increasing investments in LVT in response to strong growth. Armstrong, for example, reported a double-digit LVT sales increase in the second quarter, which offset lower volume in wood flooring and residential sheet. LVT and resistant laminate have

outperformed Mohawk's other hard-surface product sales so far this year.

"LVT and WPC are very strong and overtaking wood sales," said one manufacturer, who also said they are concerned about reduced tariffs on imports.

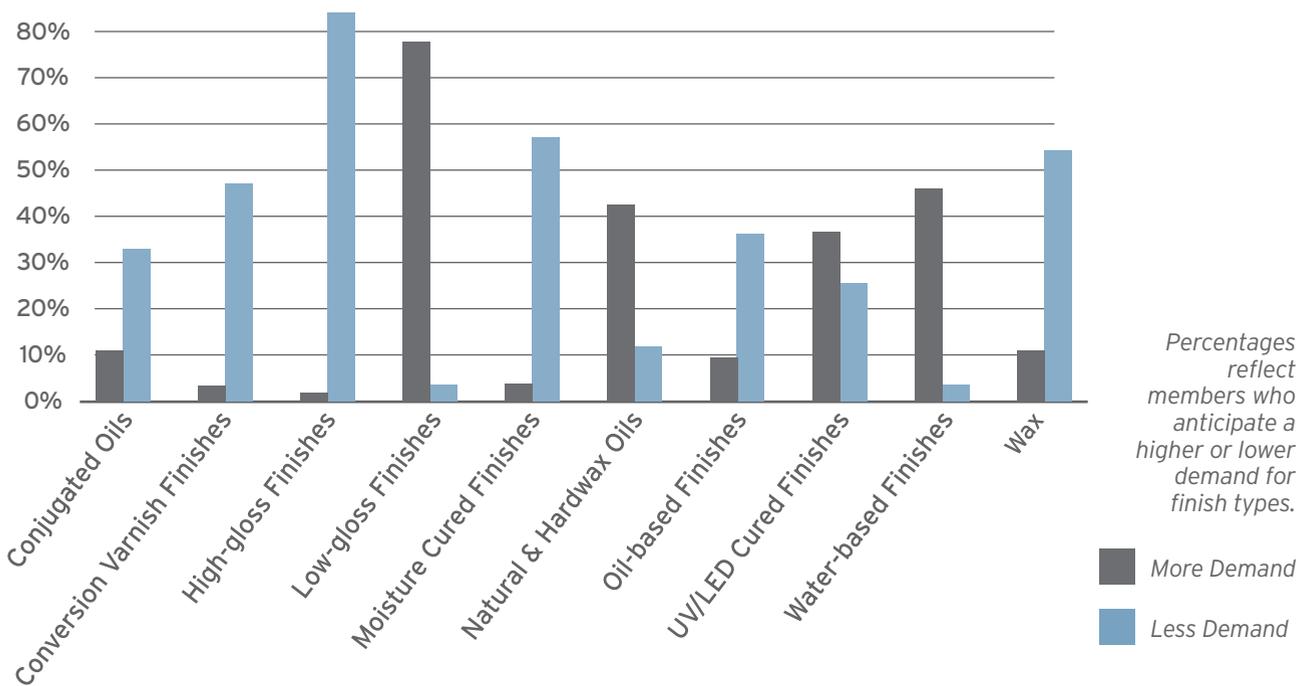
Some members think LVT and other non-wood challengers threaten the lower end of the wood-flooring market more than high-end; some previously wood flooring-specific retailers and distributors in NWEA reported they have started to sell LVT in select situations.

EXPECTED DEMAND BY COLOR IN 2018



Percentages represent the amount of members expecting more, less, or the same demand in 2018.

EXPECTED DEMAND BY FINISH IN 2018



Percentages reflect members who anticipate a higher or lower demand for finish types.

CHALLENGES & CONCERNS

Despite the optimism in the industry, NWFA members noted several challenges moving into 2018:

The Pricing Pinch

NWFA members at every stage of the supply chain are struggling to sustain adequate margins due to ongoing pricing pressures from discount retail, big-box stores and cheaper Asian imports.

What's driving commodity pricing? "The box-store mentality of volume is king rather than reasonable margin (at the mill level)," according to one distributor. Another said: "Good looks on lower-quality platforms and finishes. While we have some budget-priced options, we continue to take the high road in terms of quality and managed distribution, avoiding the 'display on every corner' syndrome." Another distributor pointed to some contractors, who are "looking for cheaper and cheaper wood to install."

Competition from wood-look products is also on the rise, driving pricing down in some categories of wood flooring. The popularity of wider, longer wood planks is also commoditizing and driving down pricing for more traditional narrower cuts, members said.

To combat pricing pressures, many companies are looking to diversify in 2018 to avoid commodity-prone products and to develop and offer new, unique lines. Some manufacturers are focusing on higher-end product. But another noted that doing so continues to be a challenge. "We are trying to produce

WOOD-LOOK PRODUCTS ARE CAUSING PRICES OF WOOD FLOORING TO DROP

products that do not compete in the commodity arena when we can. However, solid strip continues to become more and more price-driven."

Thirty-seven percent of manufacturers in the survey said they plan to

63%
MANUFACTURERS
EXPECT RAW MATERIAL
PRICES TO RISE



increase pricing in 2018. Another 63 percent plan to keep pricing about the same, despite the same percentage saying they expect raw materials prices to go up.

Regulations

Regulation was No. 3 on manufacturers' list of top concerns going into 2018.

In March of 2016, the Occupational Safety and Health Administration passed regulations controlling employee exposure to crystalline silica. One manufacturer said that while they support the new policy, it is "a concern for all in the industry" because of the difficulty applying the regulations to real-world conditions:

"How can we keep our customers/end-users compliant long after our tools and equipment leave our factory?"

Environmental Protection Agency regulations passed in December of 2016 are also affecting members who are manufacturing, using or selling formaldehyde-emitting products. One flooring manufacturer said they've moved away from formaldehyde-based adhesives to stay in compliance, and a manufacturer of fillers, finishes and stains is developing "more water-based technologies" in response.

Uncertainty around trade policy has left members guessing how it may impact them in the coming year. President Trump, who initially threatened China with higher import taxes during his first few months in office, has since softened his stance. Shifting focus to Canada in April 2017, the Trump administration announced plans to impose Canadian lumber tariffs of up to 24 percent. The U.S. Secretary of Commerce announced in a preliminary determination that additional duties would be charged to softwood lumber importers from Canada in response to an antidumping investigation.

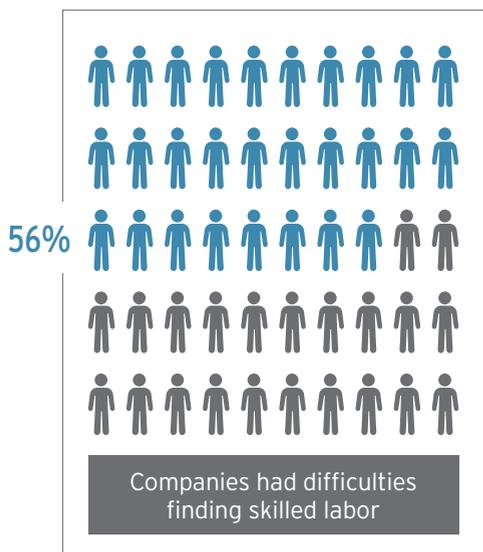
CHANGE
IS HERE
TO STAY

NEW POLICIES
& REGULATIONS
ARE AFFECTING THE WAY
MEMBERS DO BUSINESS

Going Direct

Only 5 percent of manufacturers sold direct to consumers in 2016, according to the survey, but nearly a third plan to shift business among their channels in 2018. Some will grow online channels or go “more direct,” but not all are looking to shorten the supply chain. One manufacturer selling exclusively through retailers in 2016 said they will start selling through distributors in 2018.

Finding Skilled Labor



More than half of respondents to the survey reported problems finding skilled labor.

Paul Stringer, vice president of sales for Somerset Hardwood Flooring, said that as a manufacturer, industry labor shortages are affecting his

business at all stages of the supply chain. “A lot of our freight companies say they can’t hire enough drivers,” which creates problems getting his product to market. Somerset customers also have a hard time finding qualified installers once the product arrives. “It affects us at every level of where we’re trying to do business,” Stringer said, “all the way to the builder who can’t find people to build homes.”

Some members have turned to automated or computer-guided mill systems to alleviate labor shortages. One manufacturer said they have “spent millions putting machinery in that reduces the number of employees,” and

because of continued labor shortages, they said they will continue to invest in new technology. “We’re investing heavily,” said Tracy Rowlett, product manager for Danzer, a global supplier of hardwood veneers and lamellas.

“We’re in the middle of a project in which we’re looking at different ways of digitalization to increase our yields and also to speed up our manufacturing and become more consistent with our manufacturing and our grading.

“If the computer can do it, and we could use digitalization to be more effective and more efficient and make better more consistent decisions, then you’re not relying on a person to do that every single time.” Rowlett added that they have also invested in new skills as a result, including IT and engineering.

Some survey respondents expressed frustration with students’ and parents’ mentality that college is always the best path to a good job. According to Scott Tarpinian, project manager with Boulder, Colo.-based Berlin Flooring, the hardwood flooring industry lacks the training and educational requirements of other professions like electricians and plumbers, since installers don’t need any special training – or in many states even a license – to get started.

While ease of entry helps get people interested in the trade, Tarpinian said, “the con is you get tons of hacks out there who really shouldn’t be in the business.” It hurts the trade when inexperienced installers do poor-quality work, he says, giving other installers a bad name and keeping pricing low.

“WE’RE LOOKING AT DIFFERENT WAYS OF DIGITALIZATION TO INCREASE OUR YIELDS AND ALSO TO SPEED UP OUR MANUFACTURING AND BECOME MORE CONSISTENT WITH OUR MANUFACTURING AND OUR GRADING.”

FSC chain-of-custody documentation

Nearly all respondents to the survey said that demand has not increased for FSC chain-of-custody documentation, which verifies that FSC-certified material has been identified and separated from non-certified/non-controlled material as it makes its way along the supply chain. It provides consumers a way to tell how product is sourced. One manufacturer wrote they are “almost never asked about this anymore.” One distributor dropped its certification altogether due to “no demand.”

Claims

Most manufacturers reported that claims have stayed steady – with no increases – so far in 2017.

Customer training

Distributors reported that customer training was either extremely important or somewhat important on the products they sell, hosting schools throughout the year. Retailers report they don’t view educating consumers on differences between floor-covering materials as a challenge. “We do a lot of consumer education on our showroom floor, through our website and also social media,” one said.

Advertising Media

Combined results

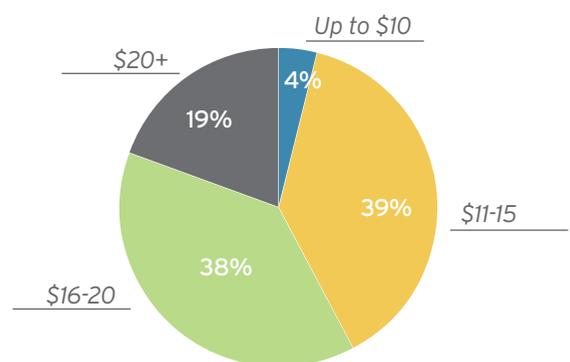
Trade Magazines	67%
Trade Shows*	57%
Facebook	43%
Twitter	29%
Pinterest	29%
LinkedIn	24%
Instagram	24%
Other (Houzz)	19%
Direct Mail	19%
Consumer Magazines	10%
Snapchat	5%
Radio	5%
TV	0%

*Primarily manufacturers

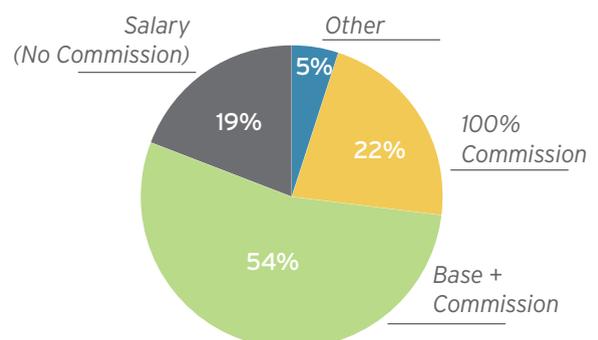
Compensation

More than half of manufacturers and distributors pay their sales reps base plus commission; most retailers paid either base plus commission or commission only. The average hourly wage for warehouse and delivery staff was \$16-\$20 for distributors; about two-thirds of manufacturers pay above \$13 an hour.

Average Hourly Wage:
Warehouse/Delivery Staff
(Manufacturers & Distributors)



Sales Rep. Compensation
(Manufacturers, Distributors, Retailers)



Nearly 40 percent of NWEA contractors – the greatest percentage of the four groups surveyed – saw significant sales growth (more than 8 percent) in 2016, and another 28 percent saw sales increase somewhat (3-7 percent). In 2018, 77 percent of contractors expect wood flooring sales to continue to grow.

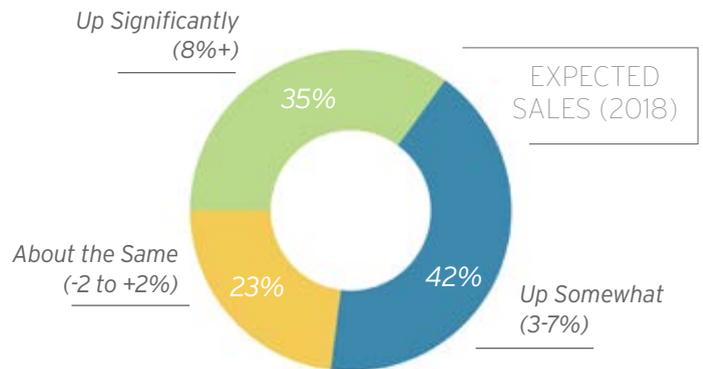
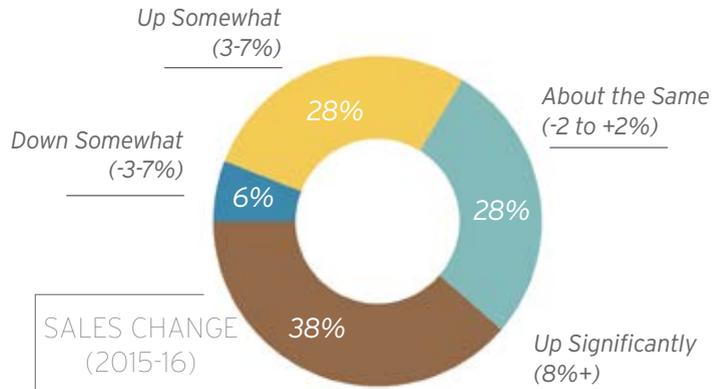
Overall, contractors’ most significant end-market by a wide margin was residential remodeling, accounting for, on average, 70 percent of sales volume for respondents. The most common cut of flooring installed in 2016 was plainsawn, and the most common installation method was nail-down over wood subfloors. Water-based finishes were widely common, and contractors expect them to continue to grow in popularity in 2018.

Long term, 58 percent of contractors see LVT as the biggest threat to real-wood products. While some wood flooring-exclusive installers have resisted this trend, others have come to embrace LVT for use in select locations such as basements, where temperatures are consistently cool and customers are less willing to pony up for real wood.

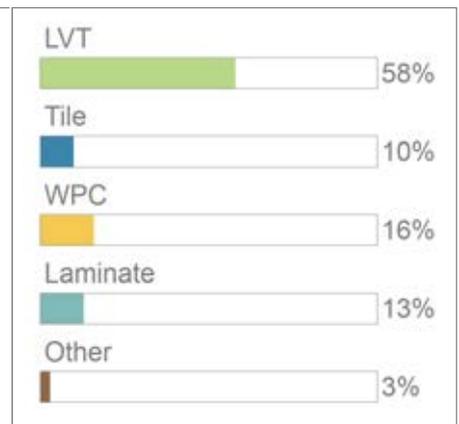
Labor shortages have been and will continue to be a top challenge for contractors in 2018. Not surprisingly, this shortage has created another common problem: keeping up with customer orders. Some have taken on “demanding scheduling” to try to keep up, and others have been forced to push back projects. “I’m constantly booking several months out in advance,” one contractor said. “But that doesn’t seem to be an issue with my clients.”

Pricing pressures from low-bidding competitors was also among contractors’ top challenges going into 2018. For one contractor, “clearly articulating the value of our services over lower-priced competitors” is their biggest obstacle.

Customer expectations, not aligning with what survey respondents called their “cheap” budgets, has also been an issue. According to one member, “Everyone wants wood floors, but they set a low budget. So they can’t always buy the cut, width and/or species that they want.” Not buying quality can lead to problems after floors are installed, according to members; nearly a third of contractors listed “unrealistic customer expectations” on their list of main call-back issues, second only to “seasonal gaps.”



BIGGEST LONG-TERM THREAT TO REAL WOOD PRODUCTS



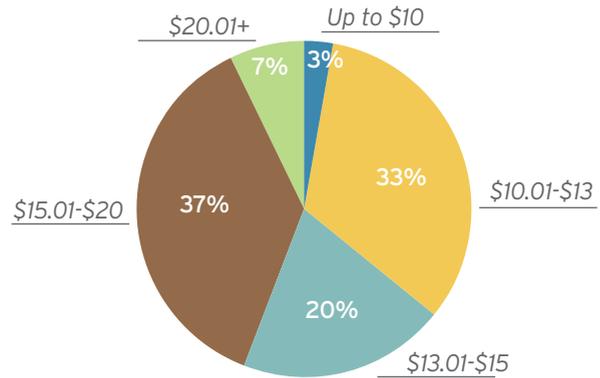
Top Concerns in 2018 for Contractors

1. FINDING SKILLED LABOR
2. LOW PRICES/"RACE TO THE BOTTOM"
3. KEEPING UP WITH DEMAND

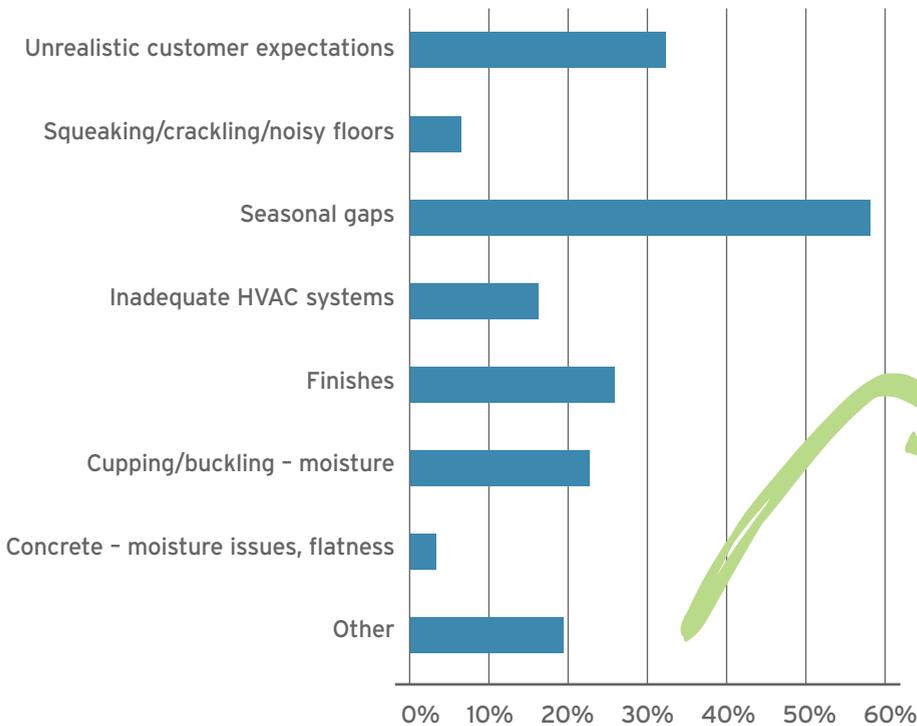
CONTRACTORS

87%
 OF CONTRACTORS
 PREFER TO
 BE PAID
 BY THE
 HOUR
 VS. PIECE RATE

Average Entry-Level Hourly Wage For Contractors



MAIN CALL-BACK ISSUES



OTHER CALL-BACK ISSUES

- As a hardwood inspector, the items I checked are the repeat issues that I find. In almost every case it is installation related. From improper surface preparation, moisture protection, or following manufacturer's requirements.
- Moving company damage.
- Putty that doesn't match the wood well.

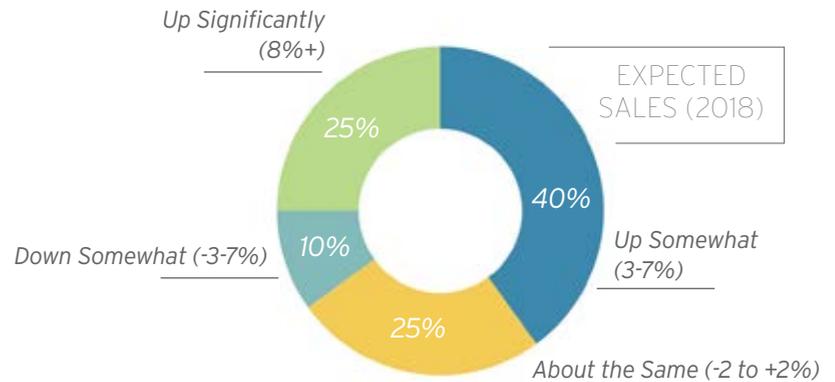
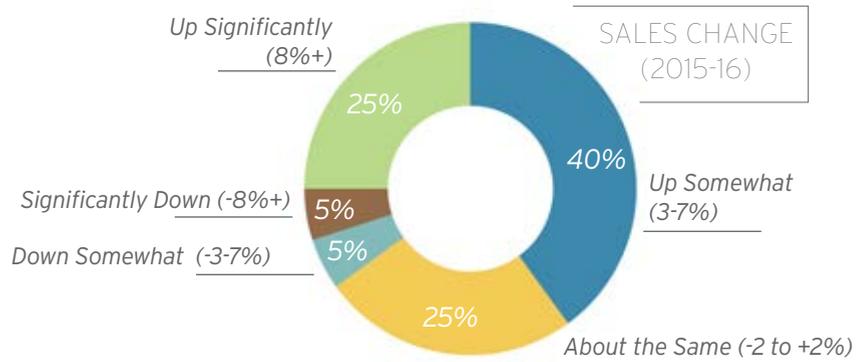
Most NWEA manufacturers saw wood-flooring products sales grow in 2016. Twenty-five percent of manufacturers experienced growth of 8 percent or more, and another 40 percent said sales were up 3-7 percent. Halfway through 2017, most respondents continued to see strong results, with most forecasting growth for the full year.

Manufacturers are slightly more optimistic about 2018 sales results than they were about 2017 results, with about 40 percent expecting modest growth (3-7 percent) and a quarter forecasting significant growth (more than 8 percent). None expect significant declines.

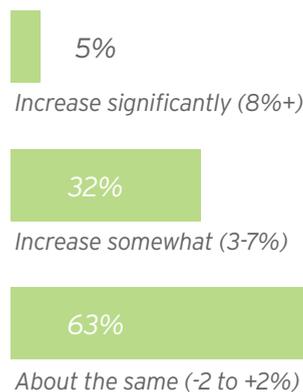
About a third of manufacturers saw raw material prices increase in the first half of 2017. Despite this, the clear majority kept product pricing about the same, and another 16 percent even lowered prices. According to survey-takers, competition from LVT and pressure from their distributors to maintain consistent pricing have prevented increases and tightened margins.

More than a third, however, plan to raise prices in 2018. Broad expectations for raw material cost increases in 2018 are helping to drive this.

Competing product categories such as laminate, LVT, and WPC; competition from Asian imports; and competitive pricing pressures topped manufacturers' lists of top challenges going into 2018. Asian manufacturers "continue to flood the market with lower- and lower-priced commodity engineered hardwood," according to one manufacturer. They also mentioned operational challenges, including the inability to keep up with production demands, and long lead times.



2018 EXPECTED PRICING

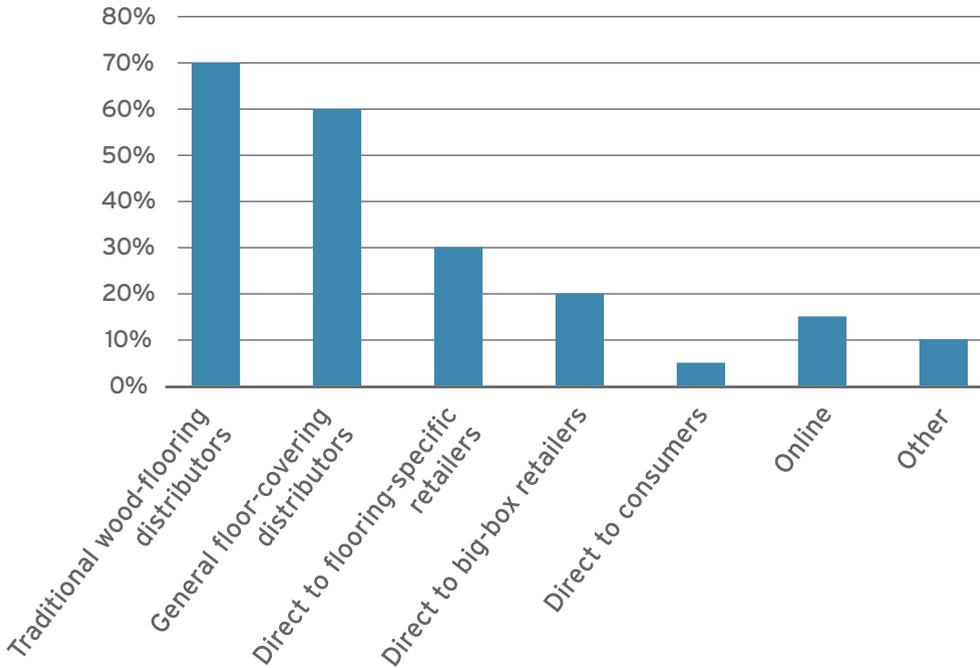


Top Concerns in 2018 for Manufacturers

1. ASIAN MANUFACTURERS
2. NON-WOOD FLOOR COVERING COMPETITION
3. GOVERNMENT REGULATION
4. ECONOMY
5. POLITICAL CLIMATE

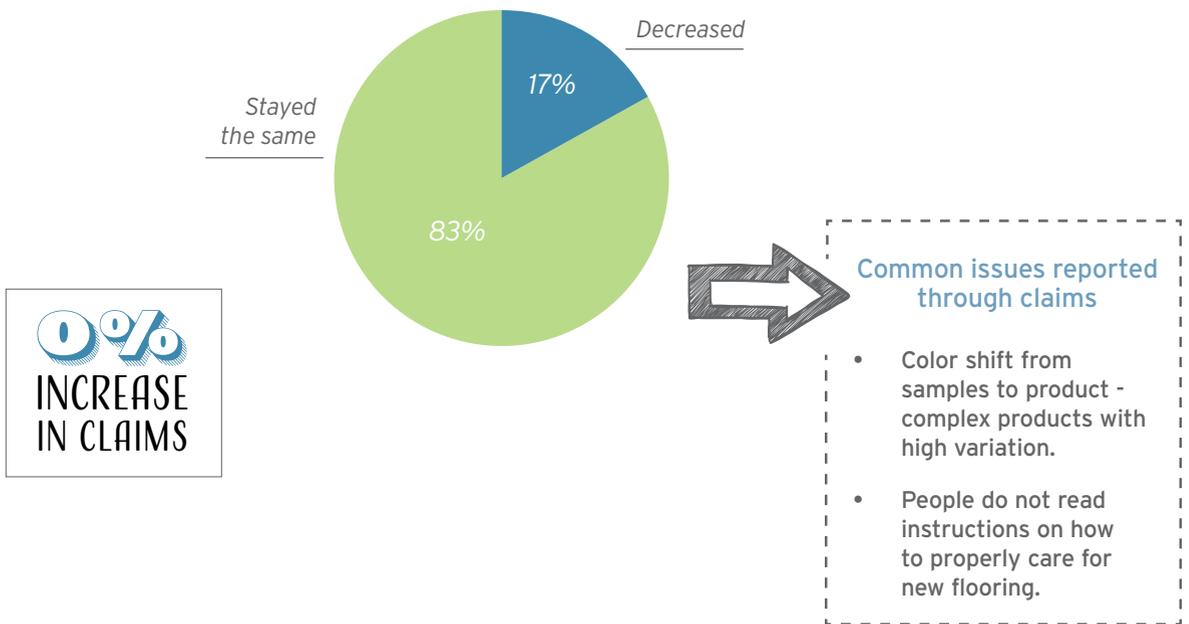
MANUFACTURERS

BY WHICH SALES CHANNELS DO YOU GO TO MARKET?



68%
DO NOT EXPECT
TO SHIFT BUSINESS
AMONG CHANNELS
IN 2018

Have Claims Increased, Decreased Or Stayed The Same In 2017?



More than half of NWEA distributors saw sales increases in 2016, according to the 2018 Industry Outlook survey. Halfway through the year, expectations for 2017 were optimistic, with 85 percent expecting sales to increase at least 3 percent. More than two-thirds expect sales growth in 2018.

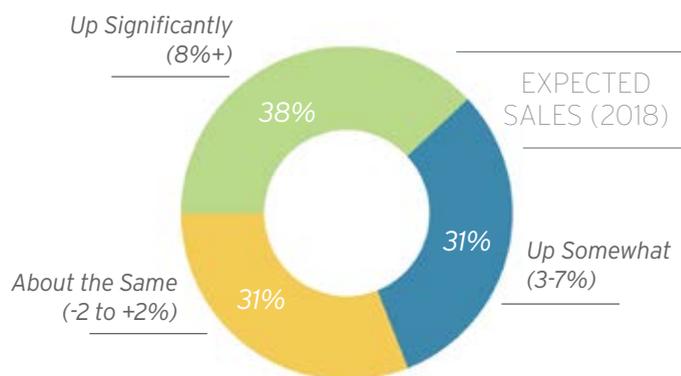
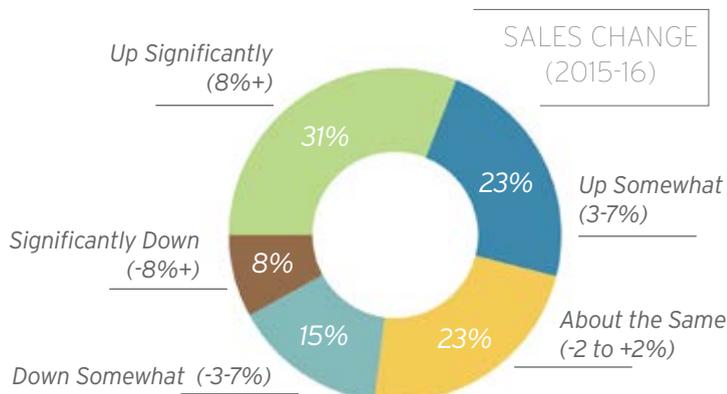
On average, new residential construction and residential remodeling were distributors' most significant end-markets in 2016. Distributors don't expect a significant end-market shift in 2018.

Services – including installations, refinishing, design, repair, and training – weren't offered by three-quarters of NWEA distributors in 2016. Nearly 1 in 5, though, expect them to contribute more to sales in 2017 and 2018. Accessories are also expected to become a more prominent contributor to distributors' top lines in 2018.

Competition from non-wood floor coverings, uncertainty about the economy, and manufacturers selling direct were top-of-mind for distributors looking to 2018. Commodity pricing was also a top concern, with distributors citing the economy, big-box retailers, discount retailers, the internet, and mills' focus on volume over quality as drivers.

In response to pricing pressures, distributors currently offering private-label products plan to increase those offerings in 2018. They are also diversifying their mix, in some cases shifting their focus away from price-sensitive products. "We continue to take the high road in terms of quality and managed distribution – avoiding the 'display on every corner' syndrome," said one member.

- COMPETITION FROM LOCAL DISCOUNT RETAIL
- COMMODITY-LEVEL PRICING
- POTENTIAL HOUSING BUBBLE COLLAPSE

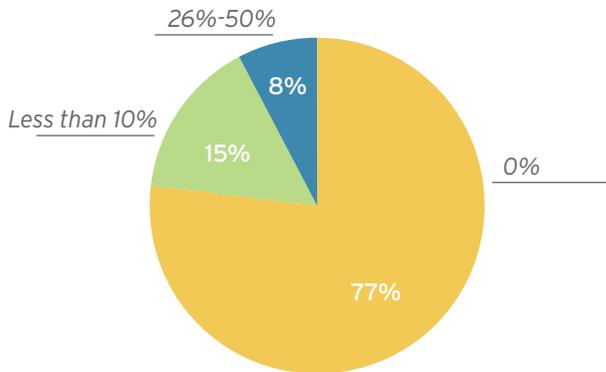


Top Concerns in 2018 for Distributors

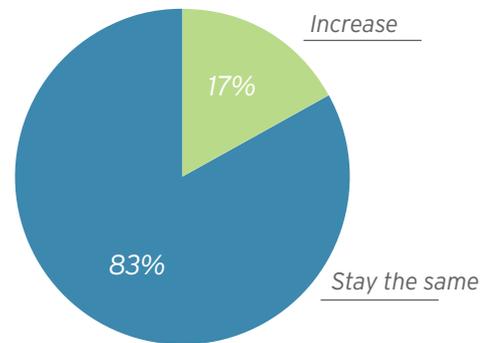
1. NON-WOOD FLOOR COVERING COMPETITION
2. ECONOMY
3. MANUFACTURERS SELLING DIRECT
4. POLITICAL CLIMATE
- 5.

DISTRIBUTORS

Percentage of Sales in 2016 from Services
(Install, Refinishing, Design, Repair, Training, etc.)

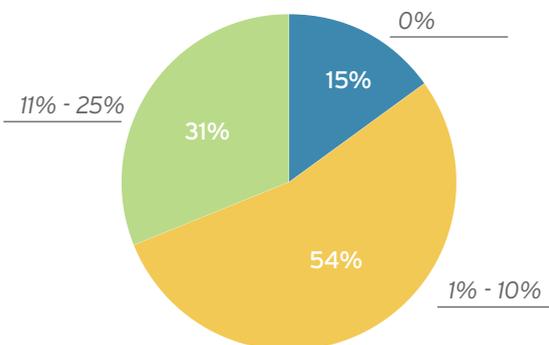


Projected Change in Services
Percentage in 2018

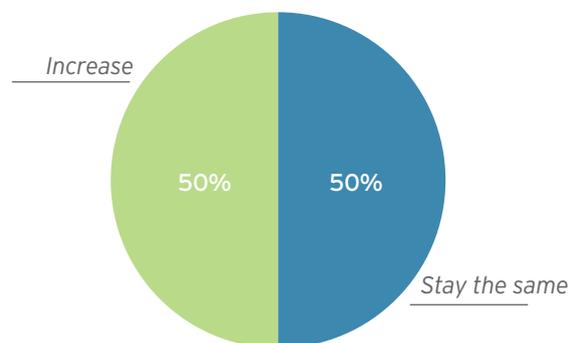


100%
OF DISTRIBUTORS
DON'T EXPECT
END-MARKET MIX
TO SHIFT
IN LATE 2017 AND INTO 2018

Percentage of Sales in 2016 from Accessories
(Equipment, Fasteners, Finishes,
Adhesives, Fillers, etc.)



Projected Change in Accessories
Percentage in 2018



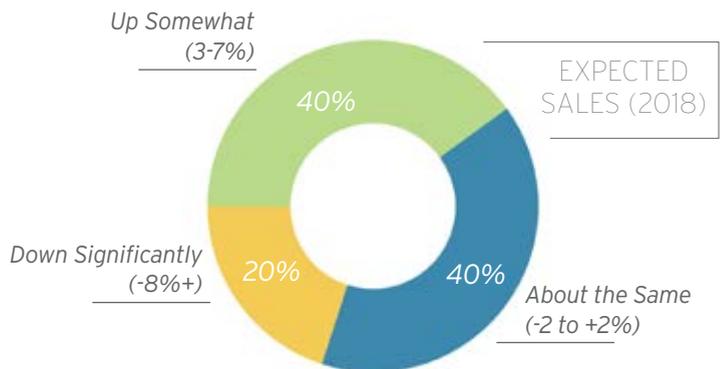
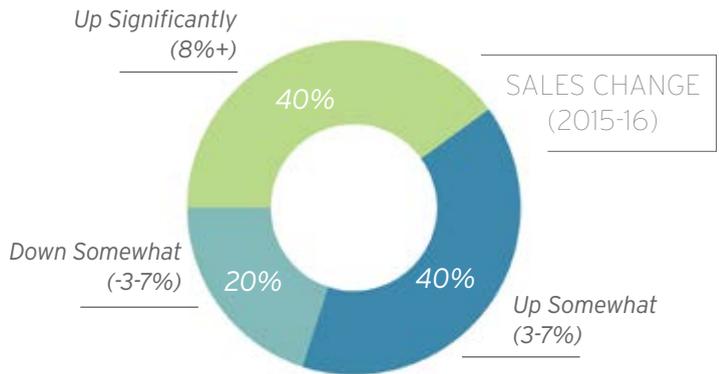
About 80 percent of NWEA retailers reported either modest or significant growth in 2016. Halfway through 2017, they were optimistic about growth, but less than half expect significant sales growth in 2018.

Retailers' most significant end-markets were residential remodel and new residential construction. On average, most of this flooring was installed by retailers' own contractors.

Services – including installations, refinishing, design, repair, and training – accounted for up to half of 2016 sales for most retailers, and most members expect this percentage to stay the same in 2017 and 2018. Retailers also expect accessories sales, which made up less than 10 percent of 2016 sales for most, to hold steady in 2017 and 2018.

Just as with distributors, private-label sales are expected to grow in importance in 2018 for the retailers in the survey.

Most retailers surveyed said wood-look products such as LVT, WPC, and laminate have not affected their wood-flooring sales. Like distributors, most retailers named competition from non-wood floor coverings, uncertainty about the economy, and manufacturers' selling direct as their top three challenges going into 2018. The political climate and online sales were also top of mind.

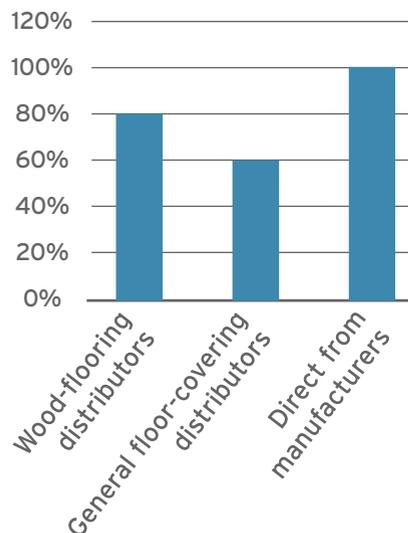


Top Concerns in 2018

for Retailers

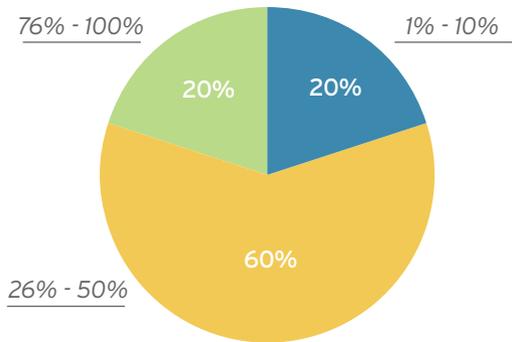
1. ECONOMY
2. COMPETITION FROM NON-WOOD FLOOR COVERINGS
3. MANUFACTURERS SELLING DIRECT
4. POLITICAL CLIMATE
5. ONLINE SALES

In 2016, Retailers Sold Wood Flooring Purchased from the Following Sources

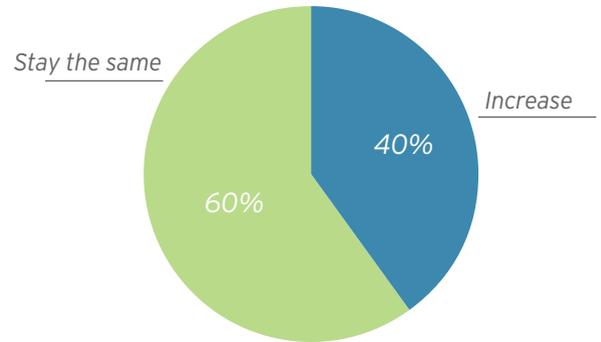


RETAILERS

Percentage of Sales in 2016 from Services
(Install, Refinishing, Design, Repair, Training, etc.)

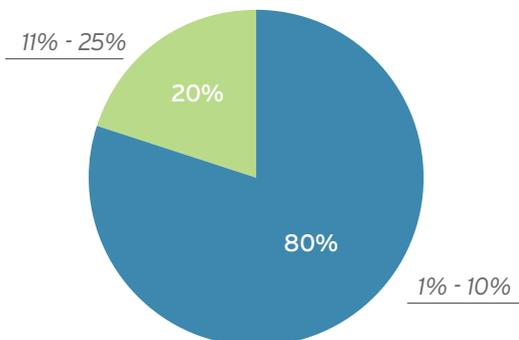


Projected Change in Services
Percentage in 2018



60% OF
RETAILERS SAY WOOD-LOOK
PRODUCTS DON'T AFFECT
REAL WOOD
PRODUCT SALES

Percentage of Sales in 2016 from Accessories
(Maintenance Products, Sundries Items,
Accessories, Upgrades, etc.)



Projected Change in Accessories
Percentage in 2018



Overall, most members who responded to the NWFA survey were optimistic about 2018, and are employing strategies to remain competitive despite the challenges ahead.

“As our company is expanding, we are leveraging our increased sales toward better pricing on our raw materials,” wrote one manufacturer. “Doing so, we have been able to decrease the price of our equipment and tooling to make it more accessible to our new and existing customers.”

Another manufacturer recently introduced a new line of entry-level wide-width product with long boards. Others are investing in technology. And some are looking to new markets, including multifamily construction, which was mentioned by several.

Green tech is still front of mind for members, who plan to continue to promote their eco-friendly offerings in 2018.

Distributors and retailers are looking to add new lines, offer more training, bring in more private-label products and target new geographic areas or market segments. Some are adding or have already added wood-look products to their mix. Some contractors are specializing and offering higher-end custom work, which generally comes at a higher price point. Many are focused heavily on finding skilled workers to meet the demand they're facing.

Chris Zizza, chairman of NWFA Board of Directors, said the continuing labor shortage - combined with favorable demand - is giving everyone in his market plenty to do in 2017. “They were slow coming out of the gate in the first quarter, but right now everybody is busy. Everybody's schedule is stretched, and that is not just the flooring trade - that's all the trades. It's a good time right now, and I think it's going to continue.”



Photo by Breather

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