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I N D U S T R Y P R O F I L E

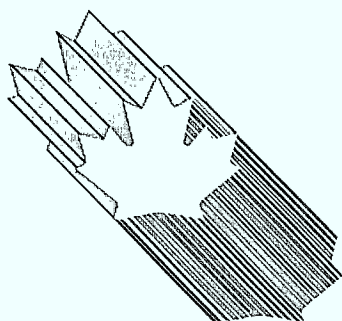


Industry, Science and
Technology Canada

Industrie, Sciences et
Technologie Canada

Converted Wood Products

Canada



I N D U S T R Y

P R O F I L E

CONVERTED WOOD PRODUCTS

1988

FOREWORD

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In a rapidly changing global trade environment, the international competitiveness of Canadian industry is the key to survival and growth. This Industry Profile is one of a series of papers which assess, in a summary form, the current competitiveness of Canada's industrial sectors, taking into account technological and other key factors, and changes anticipated under the Canada-U.S. Free Trade Agreement. Industry participants were consulted in the preparation of the papers.

The series is being published as steps are being taken to create the new Department of Industry, Science and Technology from the consolidation of the Department of Regional Industrial Expansion and the Ministry of State for Science and Technology. It is my intention that the series will be updated on a regular basis and continue to be a product of the new department. I sincerely hope that these profiles will be informative to those interested in Canadian industrial development and serve as a basis for discussion of industrial trends, prospects and strategic directions.

1. Structure and Performance

Structure

The industry includes companies which use, or further process, primary wood inputs such as lumber and panels as major components of manufacturing a wide range of end products. Major products include kitchen cabinets (19 percent of total sector shipments), wooden windows (17 percent), doors (13 percent), manufactured housing (nine percent), mobile homes (four percent) and wood pallets (seven percent). Other products include fencing, log homes, trusses and other structural housing components, boxes, turnings, furniture components, mouldings, flooring, cooperage, architectural millwork, laminated timbers, dimension lumber stock and a variety of miscellaneous and specialty items.

In 1986, the industry had estimated shipments of \$2.7 billion and employed about 32 000 people in approximately 1900 establishments. Total 1986 exports from the sector were \$450 million (94 percent of which were to the United States), while imports totalled \$233 million in the same year (81 percent from the United States). Statistics on the major products for 1986 are shown below:

MAJOR SUB-SECTORS OF THE CONVERTED WOOD PRODUCTS INDUSTRY

Product	Shipments (\$ millions)	Exports (\$ millions)	Imports (\$ millions)	Employment
Kitchen Cabinets	520	35	5	7 900
Windows	470	5	32	5 300
Doors	360	31	5	4 000
Manufactured Housing	250	76	21	2 400
Mobile Homes	100	—	5	600
Pallets and Boxes	200	10	13	1 200
Total	1 900	157	81	21 400
OTHER	800	293	152	10 600
Total Converted Wood Products	2 700	450	233	32 000

Regionally, the industry is concentrated in southern Ontario and Quebec which respectively have 33 percent and 30 percent of the activity. British Columbia has 16 percent. The remaining 21 percent is distributed across the Prairie and Atlantic provinces. With the exception of manufactured housing and mobile homes, which are sold largely in rural areas, most plants are located in or near urban population centres which provide the major markets.

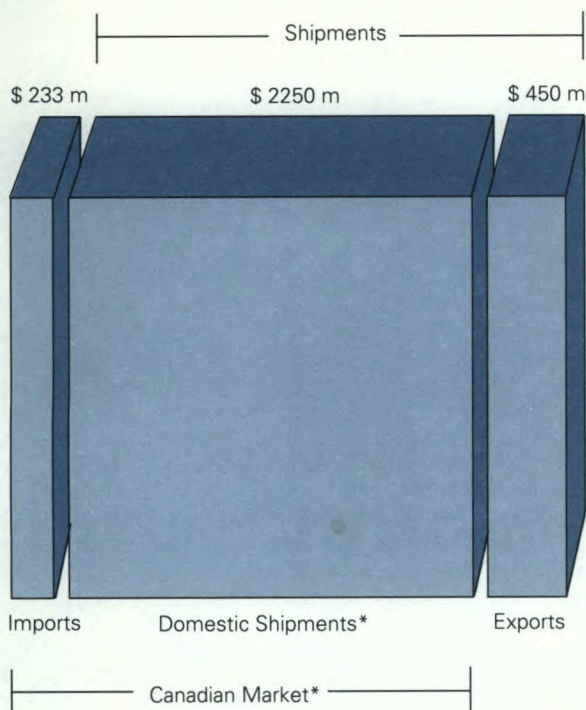
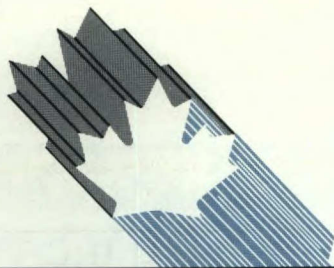
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**Imports, Exports and Domestic Shipments
1986**

* Estimated.

Most firms are small to medium-sized and are not vertically integrated with the primary producers. A few leading companies account for a significant share of industry production. For example, in the door sub-sector, four of the 50 or more companies have roughly 50 percent of sales and in the window sub-sector, seven of almost 400 firms have about 50 percent of sales. The concentration is less in kitchen cabinets, where eight of about 700 companies have 25 percent of sales; and in manufactured housing, 10 of about 90 companies have 30 percent of the sales. In general, the larger firms are national in scope, while the smaller firms service local or regional markets.

Performance

Performance of this industry correlates with such general economic growth trends as the level of housing starts and renovation activity. In the decade to 1981, industry shipments grew at 2.2 percent annually. The subsequent recession saw a decline in industry shipments averaging 20 percent, with the situation particularly severe in western Canada. The value of shipments in 1986 recovered to the 1981 levels, with southern Ontario showing the strongest recovery.

During the housing decline of the late 1970s and the 1981-82 recession, the manufactured housing and mobile home sub-sectors lost more than 75 percent of earlier production levels. Major corporate failures occurred as well in the door, window and kitchen cabinet sub-sectors. The outcome has been a leaner, more competitive industry. Companies have reduced their inventories and concentrated on improving production efficiency. Some have pursued export markets, mostly in the United States, to offset the reduced domestic demand and increased competition, and to take advantage of the improved competitive situation resulting from the lower exchange value of the Canadian dollar since 1976.

Exports, mostly to the United States, have shown steady growth since the 1976 devaluation of the Canadian dollar. Since then, exports have exceeded imports and they now represent close to 17 percent of total sales.

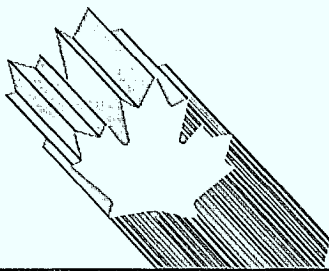
While the industry is small relative to the Canadian lumber and panel product sectors, it adds additional value to primary production and generates substantially more employment per unit of wood and per dollar of sales than primary production. Nonetheless, employment has increased only marginally between 1976 and 1986, reflecting increased automation and productivity in the sector over the period.

Historically, the industry has earned profit margins comparable to the average in the manufacturing sector, and has had conservative debt-to-equity and working capital ratios. The 1981-82 recession reduced the profitability and liquidity of the industry, and increased its liabilities relative to the situation in the mid-1970s. Since 1984 the industry situation has improved. While a new economic and housing downturn would result in further restructuring, the industry is now in a better position to respond, due to the restructuring that has already taken place.

2. Strengths and Weaknesses

Structural Factors

Given the dominance of small business enterprises in the industry and the fact that the majority are located in or near the larger urban population centres where the markets exist, the following structural strengths and weaknesses have direct relevance to the future health of the sector. These, for the most part, are common to all sub-sectors constituting the industry, however, differences from the norm are discussed where appropriate.



The most significant structural weakness throughout the industry is the relatively small scale of most operations, partially a function of the dispersed Canadian market. This results in serious competitive disadvantages in productivity, cost performance and marketing capability relative to the United States and other countries. This small scale means less opportunity for mechanization, improvements to product flow, smaller discounts for volume purchasing, and a disproportionate amount of time spent on product set-up and changeover, as well as on market development. On average, Canadian levels of automation and mechanization in the industry are substantially below those in the United States.

In the window, kitchen cabinet, manufactured housing, mobile home, pallet and moulding sub-sectors, even the largest Canadian plants are dwarfed by those in the United States, Japan and Europe. The largest U.S. window plant, for example, has a volume of production similar to the entire Canadian window industry. In a few sub-sectors, such as doors, flooring and fencing, scale differences are not as significant, due to the similar average size of member companies in the other countries.

A large number of very small companies in this industry experience difficulties in addition to those caused by the small scale of their operations. They include limited management capability, marginal financial resources and very limited experience in marketing. Studies of Canadian window and door companies, for example, have shown that companies with less than \$3 million in sales tend to show substantially lower profit margins.

There is a continuing, chronic overcapacity situation in the industry which tends to have a detrimental effect on unit costs of production. This weakness is a result of the small and dispersed Canadian market and is exacerbated by fluctuations in housing demand. Canadian companies are currently averaging 75 percent to 80 percent capacity utilization on a single-shift basis, an improvement over the 1981-82 period when the sector was operating at 50 percent capacity. The U.S. performance in this regard is superior and, in addition, U.S. plants have a tendency to work multiple shifts, whereas single-shift production is the norm in Canada.

With a Canadian dollar exchange rate in the range of US80¢ to 85¢, some U.S. companies enjoy advantages in unit material costs and hourly labour rates, resulting in lower production costs on average. Canadian products also face a freight cost disadvantage due to the long distances in Canada between material source, plants and dispersed markets, and higher freight rates.

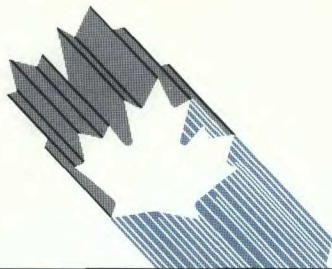
Most Canadian companies are not highly skilled in marketing and market development, compared to their U.S. counterparts which benefit from national advertising. Distribution and promotion of many of these products can be complex, costly and intensely competitive, often involving warehousing, distribution centres and product literature. Nonetheless, a few of the leading, more progressive Canadian companies have established their products in the United States, Europe, Japan and elsewhere. The Canadian manufactured housing sub-sector, for example, particularly with its industrial camps, has been prominent in international markets over the last decade.

Canadian production facilities, although smaller and less specialized than foreign competitors, are well suited to respond to small orders, both domestically and internationally. In addition, many Canadian companies have a solid reputation for competitive quality and service and, as a result, have been able to develop export niches in international markets for products such as doors, modular housing and log homes.

Product technology and design are significant factors in the marketing of converted wood products. Products must meet the tastes of the consumer, as well as being durable and functional. As requirements are constantly changing, this flexibility in terms of production is another plus for Canadian companies in the development of export markets. While many of the innovative ideas for housing are initiated in the United States, and innovations in the window, door and kitchen cabinet sub-sectors originate mostly in continental Europe, Canadian companies tend to keep up with these developments and, in general, maintain their products at comparable levels of quality and design. In addition, they lead in product technology in such areas as energy conservation, where Canadian requirements are very specific. Most product innovation is done "in-house."

Trade-related Factors

Most Canadian converted wood products are protected by tariffs ranging from nine to 15 percent, whereas those in the United States, the European Community (E.C.) and Japan average between 2.5 and 7.5 percent. The relatively higher Canadian tariffs provide a measure of protection, particularly for the smaller, locally owned Canadian companies. The relatively lower U.S. tariffs are not a significant determining factor in Canadian export success.



Building codes can be complex, and are generally legislated and administered by local or regional, as opposed to federal, governments. There are considerable differences in building codes between countries, which can restrict trade in manufactured housing and components, particularly modular units which include electrical wiring and plumbing. Mobile homes are governed, both in Canada and the United States, by different product performance standards and certification procedures. Standards established for kitchen cabinets, windows, doors, pallets, etc., have not had a restrictive impact on trade.

Government procurement practices, import licensing and product-testing requirements have constrained exports of a few products such as windows and housing components to certain countries such as Japan and South Korea.

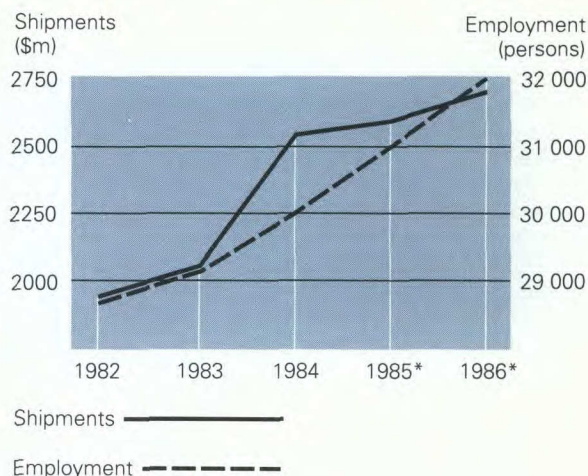
The applicable elements of the Canada-U.S. Free Trade Agreement (FTA) include elimination of all Canadian and U.S. tariffs over periods of either five or 10 years, depending on the products (i.e., kitchen cabinets and doors, five years; pallets, boxes, windows and manufactured housing, ten years). In addition, the agreement provides that efforts will be made to harmonize technical standards.

There could be a further delay in the tariff concessions on softwood plywood, waferboard and particleboard. This could result from a condition of the FTA pertaining to the use of U.S.-manufactured C-D grade plywood in Canadian housing. This U.S. C-D grade does not meet the Canadian Standards Association softwood plywood product standards as referenced in the *National Building Code of Canada 1985*.

Technological Factors

The productivity of plant equipment varies by sub-sector and company, but there have been recent trends to modernize Canadian production, including the use of new, technologically advanced equipment. With the exception of very large, highly automated foreign plants in such product areas as manufactured housing and kitchen cabinets, the application of technology to equipment and production flow in the larger and more progressive Canadian companies is on a par with foreign competition. While this technology is readily transferable, many of the smaller-volume companies lack the capital or management skills to implement such change.

Machinery and equipment research and development (R&D) is done mostly by equipment suppliers, but is often adapted in-house to the specific needs of companies. Major suppliers of state-of-the-art equipment are located in the Federal Republic of Germany, the United States, the United Kingdom and Italy.



Total Shipments and Employment

* Estimated.

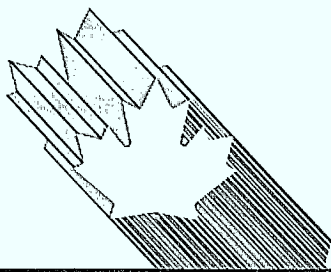
Other Factors

The industry is vulnerable to any major, unfavourable shift in the exchange rate relative to currencies of major trading partners. This was demonstrated by the strengthening of the Canadian dollar vis-à-vis western European currencies in 1980 which reduced the competitive position of a number of Canadian products, such as kitchen cabinets and doors, already established in the western European market. Since 1985, more favourable exchange rates have re-established a more competitive situation for these Canadian products.

3. Evolving Environment

The markets for most converted wood products depend on housing demand. New housing construction — in Canada, until recently, the largest single demand component — is projected to continue to decline over the next 15 years in response to changes in demographics, such as population and net family formation. Some 100 000 units annually are anticipated in the late 1990s, compared to 250 000 during the peak years of the 1970s. This trend will exacerbate the chronic structural difficulties associated with small-scale operations and underutilization of capacity.

Declines in new housing construction are being offset by continued growth in housing renovation, both contractual and do-it-yourself (DIY), which now exceeds in value the total expenditure on new housing, and is growing at a faster rate than the economy as a whole. Housing renovation will not benefit the various categories of manufactured housing or mobile homes, but will provide a growing market for windows, doors, kitchen cabinets, hardwood flooring, mouldings, etc.



Export markets should continue to provide growth opportunities for leading Canadian companies in such product areas as doors, manufactured housing, cabinets, flooring, strip panelling, fencing and other specialty re-manufactured items. Assuming exchange rates remain at approximately current levels in the range of US80¢ to 85¢, average growth of exports is anticipated to be about eight percent per annum. This compares to an estimated two percent per year overall industry growth rate over the next decade.

The overall competitive environment and demand scenario will bring about change in virtually every sub-sector of the industry. Required improvements in marketing and cost performance, and increased exposure to international competition, will result in industry rationalization, corporate restructuring, product specialization, increased average company size and further mechanization. The manufactured housing and mobile home sub-sectors are particular cases in point, having restructured drastically since the peak years of the mid-1970s leading to substantial improvements in quality control, design and the adoption of significant energy-saving technology. For these reasons, manufactured housing has a substantial growth opportunity vis-à-vis on-site construction.

Plastics, metals and other substitutes for wood used in these converted products are not expected to change significantly in the medium term, although there may be some possible exceptions, such as plastic-framed windows displacing wood windows.

Tariff elimination under the FTA, on balance, will leave many of the Canadian companies in the converted wood products sector in a more vulnerable position relative to the more competitive, larger-scale U.S. industry. The phase-in period will be five years for some converted wood products and ten years for others. The phase-in period will facilitate adjustment to a larger, more competitive market. It will also minimize the disruptive effects of increased imports, reduced production and job losses. A number of factors will be instrumental in the adjustment process such as strengthened marketing and management skills, altered distribution channels and modernization of production facilities for greater efficiency, increased investment and financial requirements.

In some sub-sectors such as kitchen cabinets, where the impact is expected to be more severe, the 15 percent tariff elimination over five years could result in major restructuring, given the dominance of small companies in this sub-sector. The strengthening of the competitive position of these sub-sectors relative to the U.S. industry will be important.

4. Competitiveness Assessment

The industry has evolved mainly to serve domestic markets and exists at present levels because of the protection offered by the tariff barriers of nine to 15 percent and an exchange rate with the United States that, in general, has been advantageous.

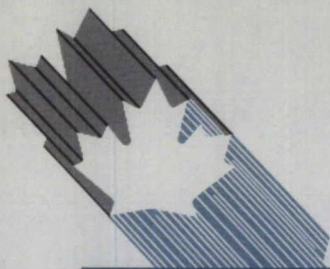
Despite this situation, there are a small number of companies in the kitchen cabinet, doors and modular homes sub-sectors which have established particular product lines in export markets and could survive increased international competition and benefit from improved access. These companies have a more stable financial base and are relatively aggressive in export market development. These exporters compete on the basis of quality, service and price, and because of their flexibility of production, are often better able than their competitors to supply niche-market opportunities. This is particularly the case in the rapidly expanding world market for renovation and do-it-yourself products.

On balance, because current Canadian tariffs are relatively high vis-à-vis the United States, the FTA will accelerate the process of restructuring and modernization now under way in the sector. In the final analysis, given the FTA, the overall converted wood products sector is expected to be smaller in terms of shipments, employment and number of companies. The companies that do remain, however, will be more cost competitive.

For further information concerning the subject matter contained in this profile, contact:

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PRINCIPAL STATISTICS

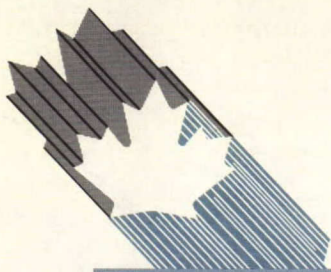
SIC(s) COVERED: 2541, 2542, 2543, 2549, 2561, 2599, 3244

	1973	1982	1983	1984	1985 ^e	1986 ^e
Establishments	1 180	1 878	1 965	1 808	1 880	1 900
Employment	28 134	28 770	29 128	30 000	31 000	32 000
Shipments (\$ millions)	842	1 923	2 062	2 540	2 580	2 700

TRADE STATISTICS

	1973	1982	1983	1984	1985	1986
Exports (\$ millions)	60	210	240	310	350	450
Domestic shipments (\$ millions)	782	1 713	1 822	2 230	2 230 ^e	2 250 ^e
Imports (\$ millions)	65	123	170	160	164	233
Canadian market (\$ millions)	847	1 836	1 992	2 390	2 394 ^e	2 483 ^e
Exports as % of shipments	7	11	12	12	14 ^e	17 ^e
Imports as % of domestic market	8	7	9	7	7 ^e	9 ^e
Source of imports (% of total value)			U.S.	Europe	Asia	Others
	1982	77	6	11	6	
	1983	78	6	10	6	
	1984	79	5	11	7	
	1985	79	5	10	6	
	1986	81	5	9	5	
Destination of exports (% of total value)			U.S.	Europe	Asia	Others (Middle East)
	1982	72	9	4	15	
	1983	86	6	3	5	
	1984	87	5	3	5	
	1985	92	4	1	3	
	1986	94	2	1	3	

(continued)



REGIONAL DISTRIBUTION — Average over the last 3 years

	Atlantic	Quebec	Ontario	Prairies	B.C.
Establishments - % of total	6	35	26	17	16
Employment - % of total	8	32	31	16	13
Shipments - % of total	4	30	33	17	16

MAJOR FIRMS

Name	Ownership	Location of Major Plants
Kitchen Cabinets		
Canac Kitchens Ltd.	Canadian	Toronto, Ontario
Citation Cabinets Ltd.	Canadian	Richmond, British Columbia
Kitchen Craft of Canada Ltd.	Canadian	Winnipeg, Manitoba.
Doors		
Sauder Industries Ltd.	Canadian	Vancouver, British Columbia
Premium Forest Products Ltd.	Canadian	Scarborough, Ontario
Gunther Doors Ltd.	Canadian	Vancouver, British Columbia.
Windows		
Robert Hunt Corporation	Canadian	London, Ontario
Dashwood Industries Ltd.	Canadian	Centralia, Ontario
Mason Windows Ltd.	Canadian	Pickering, Ontario
Lock-Wood Ltd.	Canadian	Scoudouc, New Brunswick
Donat Flammand Inc.	Canadian	St-Apollinaire, Quebec
Lowen Millwork	Canadian	Steinbach, Manitoba.
Manufactured Housing		
Atco Ltd.	Canadian	Calgary, Alberta
Viceroy Homes Ltd.	Canadian	Scarborough, Ontario
Nelson Homes Ltd.	Canadian	Lloydminster, Alberta
Kent Homes	Canadian	Debert, Nova Scotia and Buctouche, New Brunswick
Quebec Homes Inc.	Canadian	Abitibi, Quebec.
Other Converted Wood Products		
John Lewis Industries Ltd.	Canadian	Montréal, Quebec.

e Estimate.

Note: Statistics Canada data have been used, to the greatest extent possible, in the preparation of this profile.

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