RESPONDING TO THE CHALLENGES IN THE U.S. TILE MARKET AND BEYOND

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ABSTRACT

This debate forum is being developed for Qualicer 2008 in an effort to provide a report for the Congress pertaining to how the leading American Association's in the tile industry are responding to the challenges that exist today to increase the consumption of ceramic tile in the United States.

A debate identifying the major challenges to the American tile market was presented at Qualicer 2006. Much has changed in the United States in the last two years, especially in relation to the economic conditions as it relates to housing and construction spending.

The panelists will review the challenges as presented in 2006 and report on the progress made to overcome them. In addition, new challenges that have surfaced recently will be presented and debated by the panelists.

The lively discussion in the first stage of the Debate should provide invaluable insight into the United States Ceramic Tile Market and help to contribute to new ideas, strategies, and solutions to meeting the challenges that could prevent the tile industry from meeting and exceeding the projections for growth.

1. BRIEF SUMMARY OF GENERAL CONDITIONS OF UNITED STATES TILE MARKET

Since 2000, ceramic tile consumption has grown at an average rate of almost 9% annually in the United States. In our report in 2006, forecasters were predicting a steady growth rate of approximately 7% annually if economic conditions remained consistent. Unfortunately, a building recession emerged in the United States in the second half of 2006 and has carried into 2007. At the end of August, 2007, existing home sales hit a five-year low, the inventory to sales ratio hit an alarming sixteen-year high, and housing prices posted their biggest drop since 1987. Most experts anticipate this recession to continue well into 2008 before significant rebounding will occur.

The unsustainable housing boom was stimulated by historically low interest rates and overly aggressive mortgage lending practices, and reversals on both fronts have contributed to this housing recession. The low interest rates and aggressive lending enhanced affordability, stimulating demand and increasing homeownership, and favorable financing along with rising house prices attracted large numbers of investors/speculators, putting inordinate upward pressure on sales, prices and production.

Major downward corrections occurred in housing markets in 2006, and further significant adjustments for 2007 are expected, lasting well into 2008. The timing and strength of recovery in particular state and local markets depends importantly on the height of excess reached in the boom years and the extent of correction achieved in 2006. Some markets have been aggressively overbuilt, with model and spec homes sitting vacant. Parts of the country, like the Pacific Northwest and Iowa, have done very well, while impact states such as Florida, Nevada, Michigan, Arizona, Maryland and California have been negatively impacted.

Builder confidence in the condominium housing market has also eroded significantly in the first part of 2007, due to heavy excess inventory and the instability of the subprime mortgage market. Investment in commercial development and remodeling is not significant enough to offset the decrease in the residential housing situation. At the end of August 2007, non-residential construction was holding steady, up 0.6% from the previous year. Private office construction, lodging, private health care, and education were all holding steady, showing slight increases.

For the purpose of this debate, our panelists will discuss how serious this recession has affected the tile industry. They will examine overall tile statistics and will discuss reports submitted from key distributors, retailers, home centers and contractors from carefully selected geographic regions of the United States. In addition, they will discuss the value of the US Dollar to the Euro and how this is changing the landscape of US import decision-making by distributors and retailers. Attention to new construction, remodeling and commercial construction will be examined.

In addition, survival techniques will be examined, including the consideration of some companies to further diversify their product or service offerings. Marketing and advertising strategies will be discussed, including whether cutting costs or increasing them in this area is the right decision to make. Adding products or services in related industries will also be discussed.

This will be the first objective of the debate.

2. STRATEGIES TO GROW THE TILE MARKET IN DEPRESSED ECONOMIC CONDITIONS

The panelists will debate ideas and strategies that are currently being implemented and considered by various segments of the distribution chain. Discussion will center on the following topics:

- Pricing and Gross Margin

  Should you lower prices to compete in today's competitive environment?

- Inventory Management and Overhead Costs

  Decrease imports and focus on buying products on a special order basis, decreasing overhead and inventory costs? How does this affect gross margins and net profit?

- Sales and Marketing

  A. Retail (Increase strategies to sell retail or direct to the consumer?)

  B. Wholesale (Drop prices to the wholesale trade or diversify product offerings at higher profit margins?)

  C. Architect/Design (Focus more on specifications of high end or large quantity commercial projects?)

- Competitive Products (What are they doing to combat housing crisis? What can we do to convince consumers to choose ceramic tile over other alternatives?)
- Trends in housing construction (How do we as an industry exploit housing trends to our advantage over competitive products?)
- Exterior Living Spaces (Can we safely and effectively begin to increase marketshare in exterior applications, such as decks, swimming pools, patios and balconies?)
- Significantly Increase Per Capita growth of the U.S. Ceramic Tile Market
- Exterior Facades (Is there a serious opportunity to increase the use of ceramic tile on exterior facades? If so, how does the industry exploit this?)
- Consumer Awareness Programs

This will be the second objective of the debate

3. THE QUALITY AND AVAILABILITY OF LABOR IN THE UNITED STATES

The panelists will discuss previous reports on issues relating to the following topics concerning the quality and availability of labor in the United States.

- Availability of qualified installers

  As the tile industry has experienced significant growth in the United States up until the housing slowdown in the latter part of 2006 and all of 2007, an alarming statistic that has caught the eye of the entire industry has emerged. The number of professional installers who install ceramic tile continues to decrease.

- Quality of present training programs

  In the United States, the tile industry is highly fragmented. A large percentage of installers are not affiliated with a labor union. Those that are in a union are offered quality training opportunities. Many states are considered "Right to Work" states, with little or no union participation. Training for individuals in these geographic areas has been sparse, if available at all. A small percentage of proactive organizations have initiated training programs for their employees. Currently, most training that exists today is incremental or proprietary in nature with an assumption that basic skills necessary to successfully install ceramic tile have been mastered. This is a dangerous assumption.

- Development of Apprenticeship Programs

  In addition to union certification programs, the National Tile Contractors Association offers an Apprenticeship Program for sale to contracting c companies in the United States. The program has been approved by the U.S. Department of Labor and takes three years to complete. It is designed to be taught in vocational or technical schools or implemented by a sponsoring company for their own employees. It involves classroom and field experience.

- Development of Certification Programs

  The most important development in the tile industry in recent years will be the introduction of the Certified Installer Program, offered by the Ceramic Tile Education Foundation. Key supporters and participants in the program include the Tile Council of North America and the National Tile Contractors Association. Ascer, Confindustria and the Ceramic Tile Distributors Association are represented on the Board of Directors, along with several privately held companies doing business in the United States. The goal or mission of the Certified Installer Program is to raise the level of quality of installation and to establish a criteria of skills necessary to perform certain aspects of ceramic tile installation. Various levels of certification will be offered in numerous geographical locations, creating the potential to rapidly improve the craftsmanship of installation, creating a positive image to the consumer making the decision on whether to choose ceramic tile or a competitive product. Presently, consumers rank concerns with installation as a major determining factor when deciding on floor or wall covering choices.

- Development of Inspection Programs
- Assistance in Specification of Materials
- Recruitment Strategies
- Training beyond the United States (Mexico)
- Common reasons for installation failure and the negative consequences resulting from them

This will be the third objective of the debate.

4. THE GREEN BUILDING MOVEMENT AS IT RELATES TO CERAMIC TILE IN THE UNITED STATES.

There has been mounting support of initiatives to promote the specification and construction of energy-efficient and environmentally friendly buildings in the United States. Initially, this effort focused on commercial construction, but is moving swiftly into the residential arena.

According to the National Association of Home Builders, more than 100,000 homes have been built and certified by voluntary, builder-supported *green* building programs around the country in the past ten years. In addition, the Association, whose members currently build approximately 80% of all new homes in the United States, says over half of its members will be incorporating green practices into the development, design and construction of many of these new units.

The Association is also collaborating with the International Code Council to bring uniformity to sustainable building by developing the first and only national consensus-based residential green building standard that will be certified and accredited by the American National Standards Institute. This National Green Building Standard is earmarked for completion in early 2008.

The U.S. Green Building Council, a non-profit corporation developed in 1993, has been the front runner in the proliferation of green design awareness, advocating in the early days for an across-the board ratings system. That green building rating system, in which buildings are awarded points based on various factors, came to be known as the Leadership in Energy and Environmental Design (LEED).

But what constitutes *green*? How does ceramic tile, natural stone and the allied products used to install them compare with competitive products? What are the opportunities for our industry to take advantage of this growing movement? What are some challenges that we may have to overcome to be the primary product of choice in both commercial and residential construction.

This will be the fourth objective of the debate.

The panelists will summarize the most important points of the four objectives of the debate and will identify strategies to employ to continue to meet the challenges facing the United States tile industry in relation to growth. They will open the debate to the audience and would welcome questions, comments and participation.