LEFCO WORTHINGTON

INDUSTRY OVERVIEW

The domestic pallet and wood container market is a $7 billion industry consisting of over 3,000 companies and employing over 50,000. Virginia Tech University estimates the new pallet market at 500 million units, with an estimated 300 million of used pallets in service. High supply chain costs and JIT expectations have forced the regionalism of the industry. Consequently, the industry is highly fragmented with smaller producers that normally have less than $10 million in sales and service areas with a radius of approximately 150 miles. Many of these businesses focus on standard pallets such as the Grocery Manufacturers of America (GMA) standard 48 x 40 inch pallet. While standard pallets comprise the majority of revenues for most pallet manufacturers, many companies also produce related products, such as wood crates and other shipping containers.

The wood products packaging industry has recently undergone consolidation. The spike in raw material prices in 2002 - 2005, driven by devastating hurricanes and spikes in home building, increased raw material costs. A shrinking domestic labor force coupled with additional environmental and governmental regulations has made the standardized pallet industry challenging. As a result, many small producers exited the business, or sold their pallet operations to larger producers. For example, the proliferation of competing Amish artisans, particularly in the Midwest, was reversed as these individuals found it difficult to compete in the due industry due to the increasing capital costs needed to automate and comply with increased regulatory requirements, including ISPM-15 (heat treatment) standards.

EVOLUTION OF THE INDUSTRY

Since the 80s, technology has contributed to production and design improvements. Throughout the 80s, most wood products manufacturers used hand-held nailers and semi-automated equipment to manually assemble milled lumber into the desired end products. By the 90s fully automated assembly systems made it possible for companies to achieve significant labor advantages, in some cases using as few as two laborers to assemble over 1,200 pallets in a day (at least four times the rate of production by hand).

In the mid-90s, a computer-assisted Pallet Design System (PDS) developed by the National Wooden Pallet & Container Association (NWPCA) enabled manufacturers to systemically analyze product pallet requirements and to build product-specific pallets. For example, company could now save money using pallets made from less expensive wood and by customizing pallet specifications to match their specific requirements. Automated assembly and the PDS system produced efficiencies during the 80's and 90s that more than doubled production gains. Also during the 90s, the pallet industry began to focus on recycling of used pallets. Recycling became a more common low-cost alternative as competition from non-wood pallet producers began to increase.

FUTURE TRENDS

Several trends are expected to affect the pallet industry in the next several years. Continued pressures on costs and environmental concerns are expected to fuel additional growth in recycling and leasing pallets. The severe reduction of housing starts, and the broader US economy's recession has proven difficult, as users of pallets and related wood crates have reduced production and shipping demands, consequently using fewer pallets and crates. Producers will continue automating design and manufacturing processes to seek efficiency gains. Non-wood packaging manufacturing firms will continue to attempt to sell the benefits of plastic components over traditional wood pallets and crates. Despite substantial industry investments over the past several years, plastic and composite materials have not gained significant market share, due primarily to the high unit cost and high freight cost to return the pallet for repeat use. We do not forecast these raw material components to significantly change in price, so the competitive plastics vs. wood landscape should remain unchanged for the next several years at least.

Furthermore, industry consolidation has shown signs of recently slowing. The surviving companies have gained market share over the past several years and have been forced to find ways to make their production processes more efficient as well as reduce and control costs. Joint ventures and strategic alliance activity has increased as more companies are forced to be creative because of the slowing economy. The reduction of business across the US has forced many companies to scale down operations, reduce overhead, and search for opportunities they would not normally produce in order to survive.

WHAT'S NEXT

LEFCO Worthington is positioned to take advantage of apparent market slowdowns by doing the following:

1. Purchase new equipment to make its operations more efficient and safe
2. Use its ISO 9001-2008 certification to ensure that it has a consistent quality process, providing a sustainable competitive differentiator
3. Provide additional quality training to its employees to ensure that processes are being administered correctly throughout the entire production system
4. Increase its customer acquisition activity in order to take advantage of potential competitive weaknesses
5. Focus heavily on selling to the US Government and its military service depots
6. Aggressively seek acquisition opportunities in additional markets to further grow the company
7. Seek opportunities to sell additional products into established distribution channels

To talk more with LEFCO's management about its strategic direction and how LEFCO can work with your company to help it become first-in-class, please contact us directly at LEFCO Worthington T: 216-432-4422.