

You may find rays of hope in high fuel prices, in housing demand, in rich and poor markets and with the stay-at-homes. There's always opportunity in adversity.

A silhouette of a person stands in the foreground of a long, arched tunnel. The tunnel is illuminated by a series of lights along the ceiling, creating a strong perspective that leads to a bright light at the far end. The person is facing away from the camera, looking towards the light.

Run to the light

Unemployment rates increased across the country • more pain for banks • income fell 81% • wider fourth-quarter loss • home prices are down about 25% • institutions saddled with losses from housing • foreclosures or “distressed” properties • consumer confidence sank • mounting defaults • home prices later collapsed • huge budget deficit. These are just some of the troubling phrases among many others found in a single recent issue of *The Wall Street Journal*.

A cursory scan of any current financial periodical makes it clear that the adversity part of the old saying, “There is opportunity in adversity” is irrefutable. The question remains: Is there the concomitant opportunity part as well? For the hearth, patio and barbecue business sectors the answer is a guarded “yes.” It certainly will not be business as usual anytime in the near future but, due to the character of our commerce, there are opportunities that have been brought about by the current state of affairs.

We spend much of our time at home; we need heat in North America; and the majority of us are looking for ways to economize in these tough times. Hearth, Patio and Barbecue – products for the home, products that provide heat and, very significantly, a host of products that offer cost savings such as high-efficiency heaters, zone heaters and biomass-fueled heaters. Opportunities for hearth, patio and barbecue businesses seem almost self-apparent.

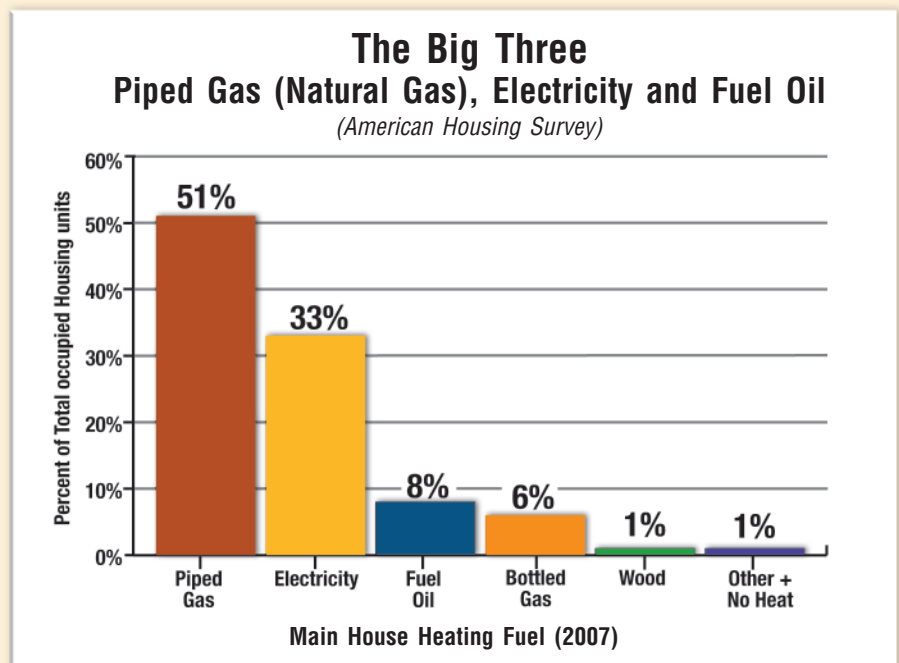
High Fuel Prices May Fuel High Sales

Ninety-two percent of all occupied housing units in the United States use piped gas (aka utility or natural gas), electricity or fuel oil as their main heating fuel. Time in and time out we have seen that, when there is a rise in cost in one or more of these traditional fuels, consumers look to alternatives such as cordwood- or pellet-fueled devices.

Similarly, time in and time out, when there is a rise in fuel costs, we have seen renewed interest in higher-effi-

ciency models and the use of zone heaters to supplement central heating systems. Over the last decade the cost of The Big Three (natural gas, electricity and fuel oil) has risen substantially. While there have been short-term spikes in costs followed by significant drops

ing short-term peaks and valleys in prices, but one gets the sense that, this time, consumer confidence has been shaken pretty substantially and, coupled with consumer belt tightening in response to the recession, the time may be right for alternatives.



The Big Three – natural gas, electricity and fuel oil – are used to heat 92 percent of the nation’s housing units.

– such as the notable reprieve in fuel oil costs we are enjoying at the time of this writing – over the last decade the overall trend has been clear; prices of The Big Three continue to climb.

Clearly, there has been some vacillation in consumer attitudes follow-

Different Strokes for Different Folks

When offering heating alternatives, the hearth industry needs to reflect on the historic regional differences in home heating practices. The fuel oil distribution infrastructure of New England,

the natural gas distribution network of the Midwest which capitalizes on nearby Canadian prairie gas resources, and the success of the Tennessee Valley Authority's electrification of the South, have made a real difference in how Americans heat their homes in these regions.

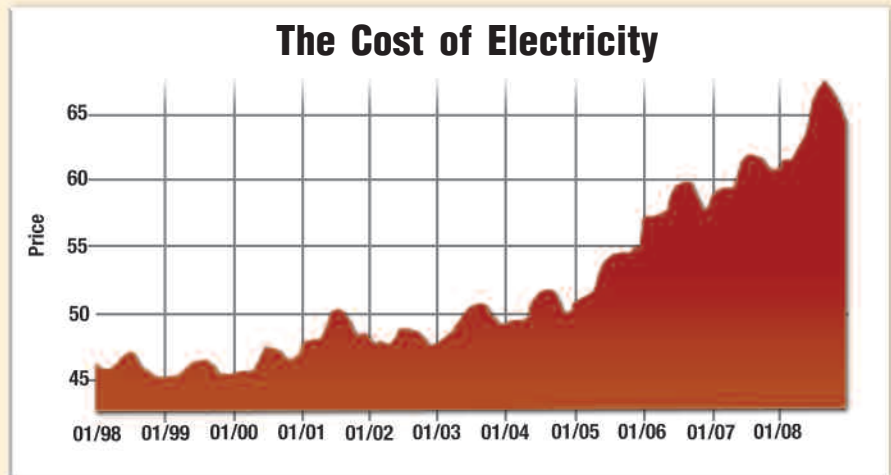
Promoting the installation of a natural gas zone heater, such as a fireplace insert, makes most sense in the Midwest where 78% of households already use natural gas as a heating fuel.

For example, replacing fuel oil furnaces with pellet furnaces makes more sense in the Northeast where 32 percent of households use fuel oil as a source of heat in contrast to the West where only one percent use fuel oil. Similarly, promoting the installation of a natural gas zone heater, such as a fireplace insert, makes most sense in the Midwest where 78 percent of households already use natural gas as a heating fuel and are connected to the natural gas grid.

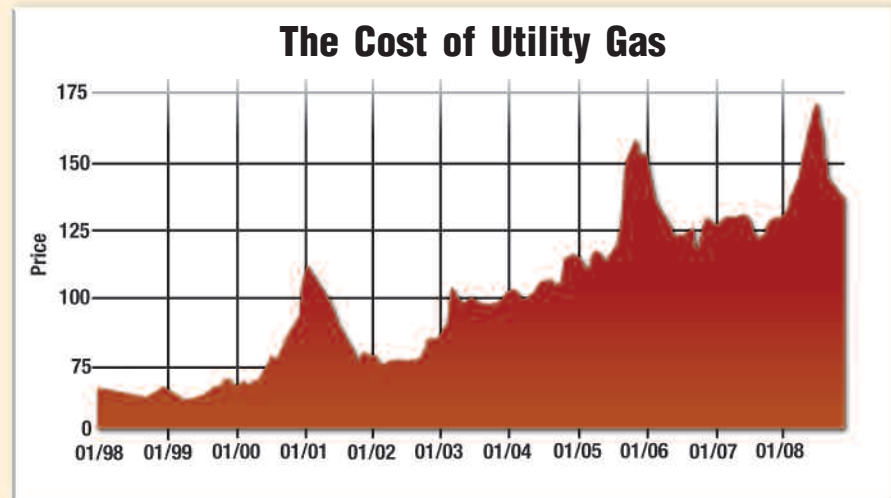
Where Are We All Going to Live?

If one follows trends in population growth and housing starts over the last decade, the two go, more or less, hand-in-hand until 2006, when housing starts plummeted. Eventually, housing starts will have to catch up and their attendant fireplaces, chimneys and Outdoor Rooms will follow. But this may take a while. According to a Jan. 20, 2009 *Economic Outlook* published by the National Association of Home Builders (NAHB), single-family housing starts, which fell 40 percent to 617,000 in 2007, dropped about 441,000 in 2008 – the lowest since records have been kept. Among the litany of reasons listed by economists are: (1) a backlog of unsold homes brought on in large part by extensive job losses, (2) foreclosures continuing

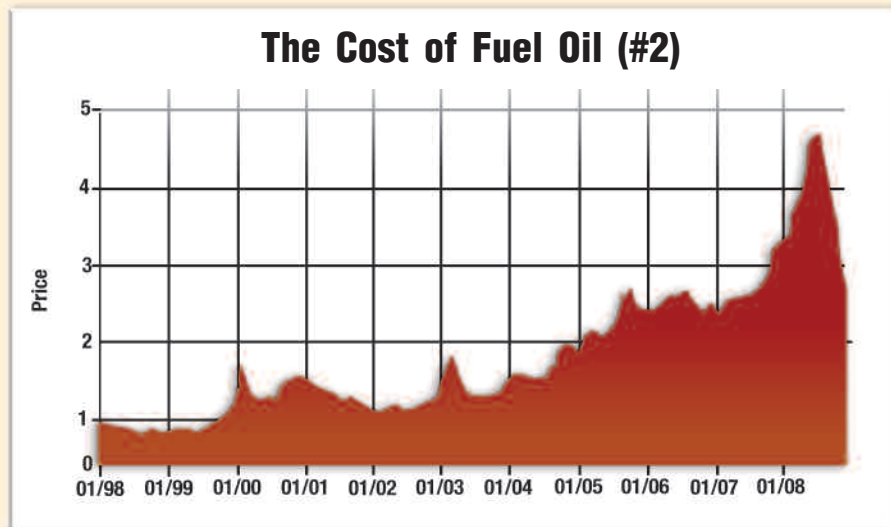
Average Price for Common Heating Fuels
U.S. city average consumer price indexes for common heating fuels.



The cost of electricity has steadily risen over the last decade with only modest short-term fluctuations – dollars per 500 KWH.



The cost of utility gas has risen over the last decade with significant short-term fluctuations – dollars per 100 Therms.



The cost of fuel oil (#2) has risen over the last decade with a notable spike and subsequent drop in 2008 – dollars per gallon (Bureau of Labor Statistics CPI data).

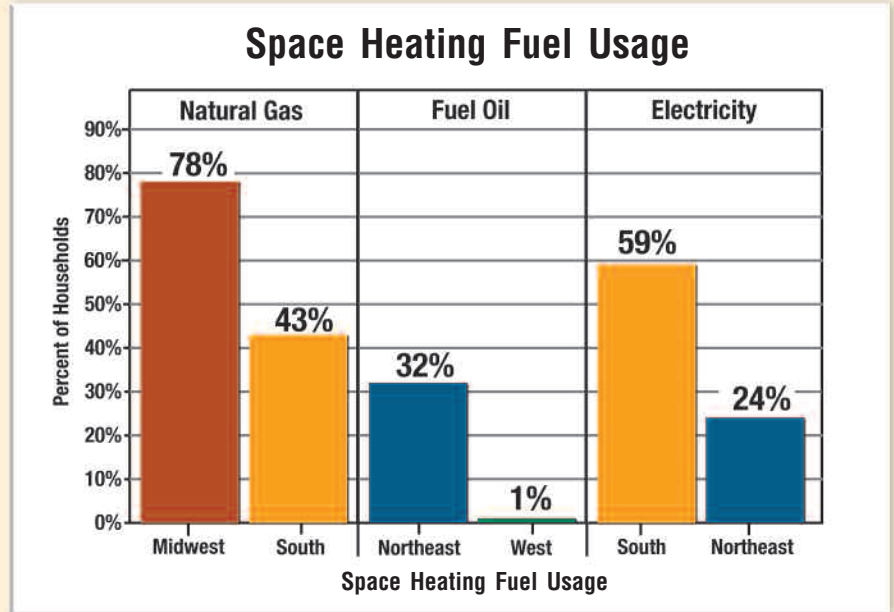
to put more homes on the market, (3) a continued increase in unemployment, and (4) the “tightness” of lending making it difficult for prospective home buyers to take advantage of declining housing prices and mortgage rates.

There does seem to be some light at the end of the tunnel, as a recent article in *The Wall Street Journal* on the housing industry concluded: “Demand by the children of baby boomers is expected to fuel home sales over time, as is overall population growth.” Mark Twain had purportedly recommended investing in real estate because God stopped making land but was still making people. The same reasoning with a minor twist applies here.

The Two Americas – Heaters for the Masses

John Edwards was right, there are two Americas. Even in 2007 before the recession was in full swing over 14 million households in the United States reported a household income below the poverty level. The median annual income for that group was \$6,878. Approximately 5.5 million households had members that received food stamps in 2007. The situation is unquestionably worse today.

The jobless rate in November 2008 was 6.7 percent – the highest in 15 years. It has been predicted that by the end of 2009 the unemployment rate will



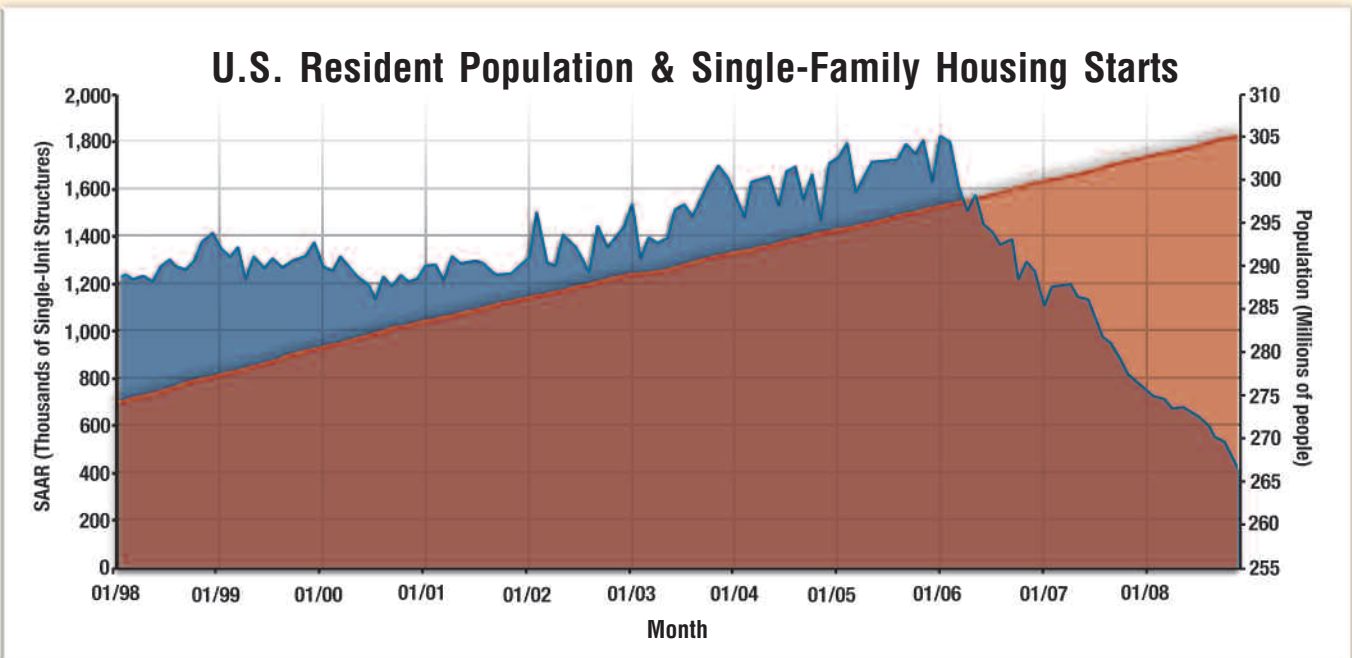
Space heating fuel usage is different in different regions of the country – percent of households using fuel type (main plus secondary) by census region (Energy Information Administration, 2005 data).

exceed eight percent. Personal net worth was down more than 11 percent in the third quarter of 2008 compared to a year earlier, primarily due to the loss of wealth from the decline of stock in retirement plans and home prices.

On average, the basics of food, utilities and health care consumed 63 percent of the after-tax income for families in the bottom 20 percent income bracket.

When housing costs are thrown in, this group on average operates at a net deficit with the balance being made up by family, public or private assistance.

While it may not be a high-profile market, low-cost, no-nonsense, utilitarian heaters are needed. All of us have seen them at Big Box stores. These models are generally not the flagship models for most manufacturers, nor do



The population continues to increase but the number of new houses for residents to live in has not kept pace. (Blue line is housing starts, red line is population; single-family housing starts shown are seasonally-adjusted annual rates, U.S. Census Bureau data).



COURTESY OF THE FARM SECURITY ADMINISTRATION (CIRCA 1936)

Could things get this bad again?

they usually show up in full-color, glossy advertisements. But they are needed and there is a market for them. Solid, efficient, low-emitting, no-frills heaters can be made and sold. Now would be a good time for the hearth industry to expand its presence in that market, accompanied by educating consumers on potential cost savings and with creative financing options.

For example, it is a “no brainer” that a low-cost, certified cordwood stove is an attractive option for many citizens in rural areas of the Southeast where cordwood is readily available – if they can afford the initial investment. Similarly, the selected and minimal use of an oil-fired zone heater could provide long-term cost-savings to an urban New England resident who already buys fuel oil for his centralized furnace, which would then be used less.

The Prius Phenomenon

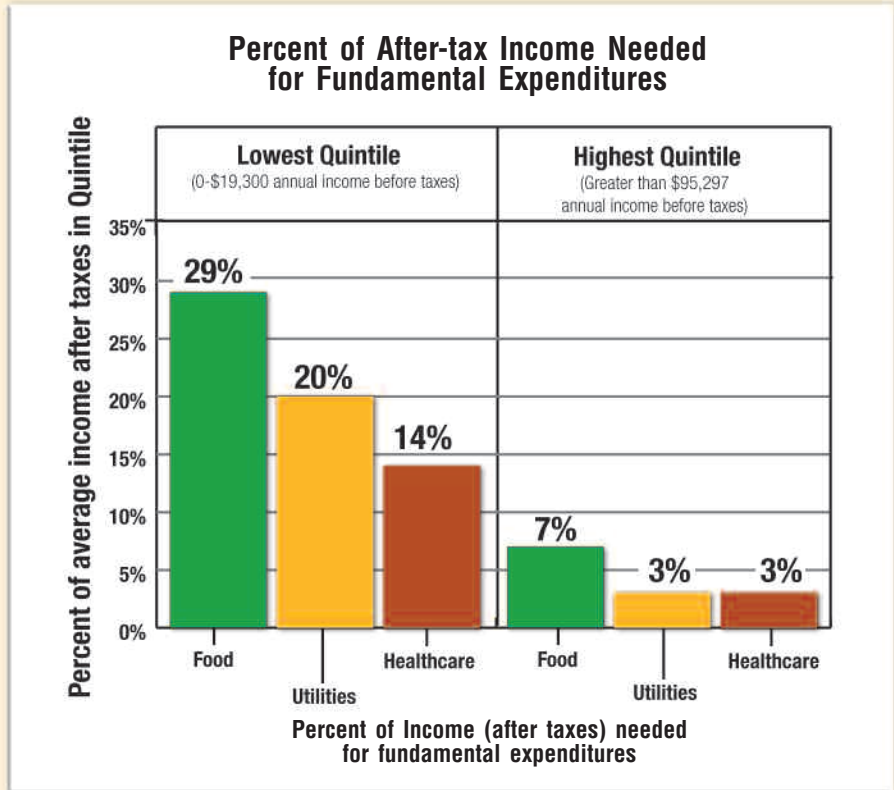
The operative word in the phrase, “Two Americas” is “Two.” The households in the top 20 percent income bracket had an average after-tax household income of \$150,927 in 2007. The fun-

damental necessities of food, utilities and health care only consumed 13 percent of their after-tax income. Certainly, the downturn in the economy has hit the members of this group, like everyone else, and has influenced their buying practices, but they are more likely to have money for discretionary spending and major purchases.

They have the luxury of buying higher-priced products that not only are often considered Green, but also can provide a cost savings in the long run. The wolf is not at the door. The proliferation of hybrid vehicles is a case in point. The purchase price of a new vehicle, particularly a hybrid vehicle, is significant for most, even those in the top income quintile. What these products offer is a Green image and a financial benefit, even though

The message here is clear. There still will be a market for upscale products, particularly if associated with an economic benefit, even if the payback time is long. Also, a segment of the population can still afford discretionary spending for such products as patio furniture and upscale barbecues. Discretionary spending may be down but it is not out.

Another interesting observation concerns the roller coaster rise and fall of hybrid vehicle costs, almost on a daily basis, due to the emotional response to gasoline prices – something worth remembering for the astute business persons among us. Arguably, the recent high demand for pellet heaters during the last heating season was similar to the hybrid phenomenon.



The Two Americas – the percent of after-tax income needed for fundamental expenditures for Americans in the lowest 20% (quintile) and the highest 20% income brackets. (Utilities include natural gas, electricity, fuel oil and other fuels, Bureau of Labor Statistics, 2007 data).

the payback period beyond the price paid for a comparable, traditional gasoline vehicle is substantial. (According to the U.S. EPA, the payback period for the popular Prius model is 9.4 years when gas is at \$1.66/gal. and 3.5 years when gas is at \$3.61/gal.)

Cocooning

As the economy worsens, many consumers have been showing an increased interest in the home. The trend, known as “cocooning,” is characterized by consumers wanting to go out less because of the high cost of gasoline, restaurants,



“The first six months of '09 will be very painful, the second six months will just be painful, and 2010 will be uncomfortable.”

– Mark Zandi,
Chief Economist
Moody's Economy.com
as quoted in the *The Wall Street Journal*, Dec. 23, 2008

“The trick is to make sure you don't die waiting for prosperity to come.”

– Lee Iacocca
Former Chrysler CEO
as quoted in *Forbes*, Dec. 8, 2008

“If money isn't loosened up, this sucker could go down.”

– George W. Bush
Former President

entertainment, etc., and stay at home more with family and friends. Spending more time at home usually corresponds to consumers spending more money on their homes.

To be realistic, with the current state of household finances, it is unlikely more money, on average, is actually being spent now than before the downturn in the economy occurred, but the decrease may not be proportionally as large as in other arenas. Notably, home expenditures would include patio, barbecue, fireplace and heater associated merchandise. There has been some suggestion that home renovations and remodeling also have become more popular, not only due to the cocooning trend, but because new homes for many consumers are now out of reach and contractor labor is currently a bargain.

A related trend to cocooning was noted in a recent article in *The Wall Street Journal* entitled, “The Comforts of Home.” In that article the author suggested an alternative to the old adage that, when bad times threaten, women's hemlines go down. The new adage suggested is, when the economy goes south, sofas get overstuffed.

The premise of the article was that the clean, modern, uncluttered look is now being replaced by “homeyness” – the tufted, floral and cluttered. The article succinctly put it, “When thermostats go down and anxiety goes up, they (consumers) are likely to choose soft cushions and inviting chairs instead of gleaming spotless kitchens.”

Another custom furniture retailer

Stay in the Game

If you don't stay in the game you will never be a winner. If you review the leading financial periodicals, such as *The Economist*, *Fortune*, *Forbes*, *The Wall Street Journal*, *Kiplinger's*, and *Money*, an overriding theme emerges – things will eventually get better. John D. Rockefeller was right in 1929 when he said, “Prosperity will return again.” Essays on who survived the Great Depression cite efficiency, innovation, diversification and the ability to be proactive as traits seen in the survivor companies.

Ford, Goodyear, General Electric, Proctor & Gamble, General Mills and Quaker Oats are among many companies that survived the Great Depression and, amazingly, Anheuser-Busch survived prohibi-



The fact that consumers are going out less and staying at home more presents an opportunity for all those selling hearth, patio and barbecue products.

provided a similar observation, “(Consumers) are looking for the kind of craftsmanship that makes them feel warm, safe and secure, the way they did when they visited their grandparents' home as a child.”

Adjusting product lines and marketing to cater to the cocooning trend is not rocket science. For example, last summer Wal-Mart launched an “American Summer” campaign featuring tents, grills, coolers, wicker furniture sets and inflatable pools; the message was that a summer getaway is “as close as your own back yard.”

tion. Each is currently a major corporation. It is not a time for the complacency of business as usual, but neither is it a time for panic. “Remember that there is nothing stable in human affairs; therefore avoid undue elation in prosperity, and undue depression in adversity.” – Socrates, 469-339 BC.

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