Furnishings Digest Newsletter

April 2017

Reading Time
22 minutes



Jerry Epperson Managing Director



Celebrating 46 Years of Proprietary Furniture Research

SPRING Home Furnishings Overview

Come See Us!

 Sunday, April 23rd, <u>High Point</u>, <u>NC</u> - 9:00 AM, the N.A.H.F.A. Retail Resource Center, first floor, Plaza Suites building.

My partners Howard Armistead (<u>wha@maeltd.com</u>) and Jimm Mann (<u>jmm@maeltd.com</u>) will be at the market as well. Please contact them to discuss valuations, mergers, acquisitions, or our other services.

More honored than I can say... On June 15th, the *Anti-Defamation League* will be hosting a banquet, and I join friends Todd Wanek and Jenna Hall in being honored. Please join us at New York's Grand Hyatt and have a photo taken with me in a tuxedo, a truly rare sighting. For tickets and more information, please call Ms. Beth Katznelson at 212-885-7885.

<u>What a deal...</u> My firm was fortunate enough to play an important role in the recently announced sale of <u>Art Van Furniture</u> to Thomas H. Lee Partners out of Boston. The Art Van store concept is extraordinary, the management is exceptional, the back end is as good as it gets, and growth opportunities abound.



Kiplinger: 3/31/17

"2017 is still shaping up to be a decent year. GDP will grow by 2.1%...not spectacular, but modestly better than 2016's 1.6% performance." ".....consumers will do the heavy lifting in 2017, just as they have done for the past few years. With unemployment low and jobs seen as plentiful, shoppers will feel upbeat enough to open their wallets and spend liberally, despite a slow start to the year."

Reuters.com: 4/7/17

"U.S. consumer confidence surged to a more than 16-year high in March." "....buoyed by a strong job market that's near full employment. More consumers think jobs are plentiful than at any point since 2001, and many are also anticipating an increase in income."

Wall Street Journal: 3/10/17

"U.S. household net worth climbed to a record \$92.8 trillion in the fourth quarter of 2016, as the end-of-year surge in stocks and a steady climb in home prices added more than \$2 trillion of wealth to household balance sheets." "The figures are reported in nominal terms, but are also a record if adjusted for inflation or population. Since the first quarter of 2009 wealth has soared by \$38 trillion, driven by an

eight-year rally in stocks and a solid rise in home prices." "The gusher of household wealth should be expected to increase consumer spending," said Michael Feroli, chief U.S. economist of J.P. Morgan Chase & Co.

Kiplinger: 3/24/17

"Get ready for another weak first-quarter GDP report. It will be the third time in the last four years that the economy struggled in the opening quarter." "Consumer spending grew at a slower rate in the early months of 2017 after a surge at the end of 2016. The slowdown is no surprise. Lackluster first quarters have become the norm in recent years, a phenomenon that has left economists scratching their heads." "The year as a whole should still show modest growth, on the order of 2.1%...not a roaring economy, but better than last year's anemic 1.6% full-year increase."

University of Michigan Economic Forecast: 3/20/17

"Real GDP expanded by 1.6% in 2016, with the fourth quarter growing at a 2.1% annualized pace, slightly slower than the average since 2010. Final sales to domestic purchasers – a less volatile measure of the underlying health of the domestic economy – grew at a healthier 2.6% pace in the final quarter of 2016."

"Measures of consumer and business optimism skyrocketed in December 2016 and remain high. At 97.6 in March, the University of Michigan's Consumer Sentiment Index is the fifth highest monthly reading in the past 16 years. The National Federation of Independent Business's Small Business Optimism Index sits near levels seen only during two years out of the past thirty, in 2003-04."

"Investors are also optimistic. The main equity indices – the S&P 500, the Dow Jones Industrial Average, and the NASDAQ Composite– are near all-time highs."

"The housing sector continues to contribute to overall economic growth as higher prices spur an expansion in residential investment. Annual housing starts grow from 1.18 million units in 2016 to 1.26 million units in 2017 and 1.32 million units in 2018."

In Summary:

- Foot traffic in furniture stores does not reflect this improving economy;
- <u>Ad spending</u> including the internet, social media and all other (TV, radio, print, etc.) is the highest seen since before the recession;
- <u>Upgrades to retail displays</u> have been dramatic since 2014, encouraging consumers back into the stores. Vendors and great new merchandise have been a key; and
- <u>Home-related spending</u> is growing faster than other credit-reliant consumer spending (travel, jewelry, electronics, vehicles, etc.) driven by higher levels of new household formations and Americans changing residences at a pace not seen since 2004.

As of Spring 2017:

- More household formations
- Rising new home sales
- More existing home sales
- · Incomes are higher
- Consumer debit is down
- Credit is available
- · Greater job availability

- Household mobility is rising
- Inflation remains low
- Stores are opening
- Mortgage rates are great
- Wealth is rebounding because:
 - ▶ home prices are rising
 - ▶ the stock market is up
- Births are rising
- Home remodeling is increasing
- "Boomerang" kids are leaving parents
- · Migration has resumed
- More companies are profitable and expanding
- Wars are ending, troops returning



You cannot be angry when consumers do what you teach them to do, can you? We just need more big weekends! The first quarter was stronger than the first quarter of 2016, thanks partly to weather, no presidential election, and some diverse economic good news on employment, housing and inflation. The consumers responded in force for most Presidents' Day promotions, especially home related consumer durables. Some furnishings retailers mentioned 20% + gains versus 2016.

Unfortunately, once this big excitement passed, traffic went back to a low level. As a result, January for most furnishings categories grew 3% to 4%, followed by a 6%+ gain in February, but March was closer to flat year-to-year for many.

Retailers of all types (except consumables like groceries) have taught today's consumers to wait for the big holidays for the best prices and we have even created some new reasons to put off buying like "Black Friday" and "Cyber Monday." This is a problem shared by both bricks and mortar and internet retailers. Truthfully, there are many reasons consumers have to buy home furnishings (**Table 1**) throughout the year. Some retailers are finding a new focus on one weekend every month and promoting it more heavily. Another way is to find a separate product category or price segment to promote on offweekends instead of having whole-store sales every weekend, which no consumer believes. Perhaps some vendors could promote certain dates like Bassett used to do "Bassett Days" four times a year (remember Bob Keiningham?) or support vendors' "trunk sales" that remain popular in fashion.

Remember Why Peop	le Buy New Furniture			Table 1.
Change Homes	Marry	Natural Disaster	Fire	Inheritances
Bonus	Remodel Home	Move in Together	Health Related Issues	Relative Moves In
Child Leaves Home	Promotion	Add a Room	Graduate College	New Technology
Want to Entertain	Working at Home	Tax Refunds	Have a Child	First Apartment
Keep up with "Jones"	New Electronics	Change Color Scheme	Buy Vacation home	Gain Weight
Divorce	Worn out/ Ugly	Comfort	New Pets/ Dog	Children Ruin Stuff

Mattress sales did better due to huge promotions as the industry's elephants continue to sort things out. Mattress Firm was moving out the Tempur-Pedic, Sealy, and Stearns & Foster merchandise in huge sales that carried over into April. Confusion reigns as to what brands will replace them, although a new long-term arrangement has been signed with Serta-Simmons, that has announced a significant capacity expansion at its current facilities.

Power motion and recliners, popular priced stationary upholstery, occasional tables, curio's, casual dining and accessories seem to be doing better than some other categories currently. There is a lot of enthusiasm in the outdoor category as well. Look outdoors!

Table 2 shows the latest monthly and quarterly statistics as to how our industry is performing. Generally speaking, we are growing but there remains inconsistency among products, vendors and retailers.

Pricing has firmed in the wood categories. Some upholstery segments are pushing capacity. We are pleasantly surprised at how many upholstery factories are expanding or building. Hopefully, the labor is available.

In upholstery, both imports and domestic production are growing nicely, with imports about 46% of the total. In wood, 86% is imported. Mattresses have about 8% imported but imports are growing rapidly.

Monthly Trends											Та	ble 2.
% Change y/y	2017											
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Total consumption of furniture & bedding (a)	3.2%	3.1%										
Furniture stores sales (a)	2.8%	1.4%										
Mattress factory shipments (b,d)	N/A	N/A										
Furniture factory shipments (c)	2.0%	N/A										
% Change y/y	2016											
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Total consumption of furniture & bedding (a)	4.2%	6.3%	3.8%	5.0%	3.0%	4.2%	2.9%	2.0%	1.8%	1.9%	2.0%	1.0%
Furniture stores sales (a)	1.8%	9.8%	6.4%	4.0%	0.2%	5.3%	0.0%	4.0%	5.7%	(0.6%)	5.9%	1.4%
Mattress factory shipments (b,d)	N/A	N/A	0.2%	N/A	N/A	5.5%	N/A	N/A	(2.5%)	N/A	N/A	4.3%
Furniture factory shipments (c)	(1.5%)	2.5%	3.7%	(3.1%)	(0.7%)	1.6%	(9.5%)	6.2%	6.1%	(6.0%)	4.5%	15.0%
C												

Sources:

(a) U.S. Department of Commerce (b) International Sleep Products Assoc. (c) "Furniture Insights" a monthly publication by Smith Leonard (d) quarterly shipments



WHY DO YOU WANT TO SELL HOME FURNISHINGS?

- 1. **Demand:** The largest spenders on furniture (and mattresses, too) are 35-54. Over the coming 20 years that universe will grow 45%, creating demand for both homes and furniture.
- 2. **Capability:** This group will be maturing in their employment with higher incomes, having children, and will be inheriting more than \$10 trillion from their parents who own homes, have investments, life insurance and other assets
- 3. **Growing Interest**: As more people work, study, entertain and do more from their homes, the interest in various furnishings options will grow like our power motion sofas, power recliners and electric adjustable beds all of which give greater comfort and efficiency for using all the new consumer electronics including HDTV's, laptops/tablets, smart phones and all the other new electronics.
- 4. **Exciting Products:** There is an infinite array of sofas, chairs (including those with power and both USB and electric hookups), bedroom, dinettes, entertainment furniture, home office, youth furniture, tables, storage units, formal dining, outdoor furniture and, of course, mattresses all at good prices from which to choose to meet the needs of your individual customer. All are available in different styles, colors and scale, too.
- 5. **Opportunity:** The largest furniture stores including Ashley HomeStores, Rooms to Go, Value City, and most others have to go for the broad, main-stream of consumer demand just to get adequate volume, and because of their size, they are limited to sourcing from the largest factories here and abroad. The greatest opportunity today is to offer exciting merchandise that these huge stores cannot----and that gives a lot of options. Another plus is the ability to merchandise your store to your local market in a way the larger stores cannot.
- 6. **Profitability:** There are few merchandise categories that offer the 42%-50% retail add-on margins that can still be found on furniture and mattresses. In addition, many vendors offer rapid delivery of smaller quantities so the inventory requirements are minimal and are always minimal in mattresses. Another plus is the variety and availability of consumer credit programs today, which give more options than ever for high close rates.
- 7. **Longevity:** Because the lengthy, deep 2008-2009 recession impacted the banks, housing and the consumer so severely, home-related products were late recovering this economic cycle with housing sales gaining consistency finally in 2014. The result is both a record level of deferred demand for homes and home related products like furniture, which should allow the cycle for home sales to last longer than usual.

8. **Message:** Our industry has a great story to tell:

- ❖ Value: Prices have risen only 2/3 of U.S. consumer price index (CPI) for the last 40 years!
- ❖ Life: Lasts longer than almost every other purchase
- ❖ Investment: It adds value to your largest investment, your home
- ❖ Improvements: Today, we have better covers, improved finishes, safer furnishings
- ❖ Personalize: Have what you want millions of choices!
- ❖ Cost to Use: The correct paint, rugs, wall décor don't cost more than neutral colors, textures, tones, or styles
- ❖ Pride: Beautiful homes give a sense of accomplishment
- **Security:** Home is the most special retreat for everyone
- * Adventure: Find what excites you
- ❖ Time Value: Where do you spend more time than at home?
- ❖ Craftsmanship: It is available at the best prices today
- ❖ Memories: The best memories are made at home, not at some theme park
- **Luxury:** Available at very affordable prices
- **Comfort:** Nowhere is more comfortable than home

And much more.....



ENDLESS CHOICES FOR YOUR STORE

The High Point market has it all. There is a tendency to focus on the larger categories (**Table 3**) and (**Table 4**), almost all of which are growing nicely, but exploring the <u>variety</u> of merchandise, often undefinable, is a key element in appreciating High Point.

Furniture & Mattre	ss Re	tail Sa	ales by	Segment						Tab	ole 3.
(\$ in billions)											
Wood	2010	2016	CAGR	Upholstery	2010	2016	CAGR	Mattresses/ Other	2010	2016	CAGR
Master Bedroom	\$8.6	\$10.9	4.0%	Stationary Sofas/Sleepers	12.4	16.0	4.3%	Mattresses	11.6	15.4	4.8%
Youth, Other Adult Bedroom	4.9	6.1	3.7%	Stationary Chairs	1.7	2.2	4.4%	Infant Furniture	1.0	1.3	4.5%
Casual Dining	4.0	5.3	4.8%	Reclining Chairs	3.8	4.8	4.0%	Outdoor Furniture	4.6	4.5	-0.4%
Formal Dining	5.6	6.8	3.3%	Swivel/ Glider Rockers	1.2	1.5	3.8%	Other	1.2	4.0	22.2%
Entertainment Furniture	5.4	6.9	4.2%	Motion Sofas	3.7	4.9	4.8%				
Occasional Tables	4.3	5.5	4.2%	Futons	1.8	2.2	3.4%				
Home Office	5.2	6.5	3.8%								
Totals	38.0	48.0	4.0%	Totals	24.6	31.6	4.3%	Totals	18.4	25.2	5.4%
Totals	\$82.5	\$104.8	4.1%								

Source: Furniture Today

Furniture Today's product analysis, released every year in its Retail Planning Guide, gives some "big picture" insight. Remember that wood furniture declined more sharply in the 2008-2009 recession than other categories.

The trends usually start with the smaller vendors. When something new and different catches the designers' eyes and begins to get traction among consumers, then the larger

Factory Shipment	Table 4.		
(\$ in millions)	Shipments (domest		
Category	2010	2015	CAGR
Wood	\$14,858	\$16,030	1.5%
Upholstery	11,436	15,088	5.7%
Metal & Other	7,551	10,210	6.2%
Mattresses	6,227	8,720	7.0%
Totals	\$40,072	\$50,048	

manufacturers and vendors roll out their versions. And trends for upholstery, metal and wood furniture can begin with new looks, textures and shapes in textiles, lighting, tabletop, wall-décor or even rugs. Homemade and crafts often lead to major style trends.

Seek out the smaller showrooms at Market Square Suites; the Interhall and floors 2 and 4 of the IHFC and throughout Showplace and Market Square. These are available for the upper end in the Hamilton-Wrenn area and elsewhere. Finding new treasures makes your feet hurt less, too.

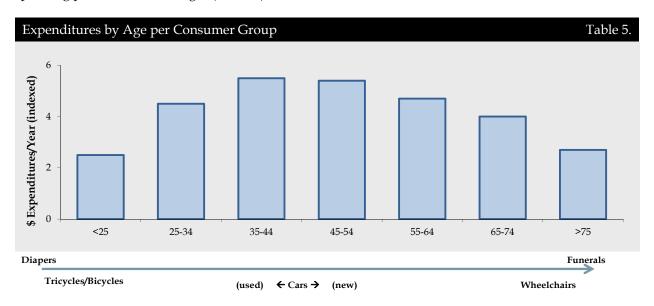
Just a few thoughts to ponder:

- 1. The mattress sector has taught our industry to step consumers up from the basic item to similar pieces with more features and benefits for a larger ticket. This is very popular today with sofas and recliners as they add power and other features. It works well elsewhere too.
- 2. Buy the accessories to coordinate with your furniture purchases, especially with a theme like beach house, mountain lodge, rustic, modern, urban apartment, etc.
- 3. Price home furnishings as to their value, not by some standard formula. No one knows accessory, wall décor, rug and tabletop prices. In every showroom, you will hear, "Are these tags wholesale or retail?"
- 4. Flow merchandise from least expensive up to the most, with features on style/scale/construction, differentiating each level. Never put the most expensive next to the least. It makes the least expensive look cheap and the best look over-priced.
- 5. The fashion in a home is driven by stationary upholstery (colors, scale, texture).
- 6. Do not rely on your own taste level. Garish and gaudy to you may be stylish and exciting to another. You should always experiment with new styles on your retail floor.
- 7. Related to the prior point, always test higher priced merchandise. Customers will pay if the value is there.
- 8. Always have something to sell with every major purchase a rug with a sofa; an adjustable base, pillows or bed top with a mattress, etc.
- 9. Bring "fresh eyes" with you to market. After about 10 years, you are jaded and feel like you have seen it all, but you haven't.
- 10. Every community in the U.S. has a diverse population, more so than in the past. Encourage traffic by bringing in different styles and looks.

<u>Have fun!</u> High Point should be like a playground where we all seek the new and exciting. Go to at least three new, different showrooms every market.



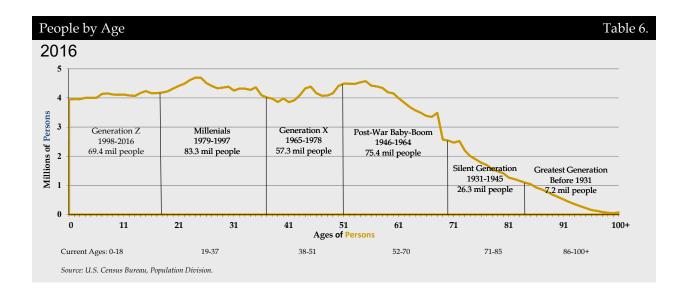
Over the last decade, the 57 million people in Generation X have not been able to support the retail base that had been established to serve the massive 78 million post-war Baby Boomers. Overall household spending peaks in the 35-54 ages (**Table 5**) and in 2017, the Generation X'ers are 39-52.



Likewise, home furnishing spending peaks at 35-54 although it might differ somewhat by furnishings category.

In addition to the lack of households in the key spending years, two additional critical elements developed:

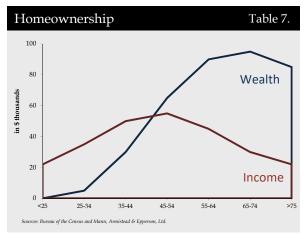
- The internet added significant retail capacity at a time we were over-stored in brick and mortar terms;
- The massive Baby-Boom generation, once almost 78 million persons, began to reach retirement age or, in some cases, dying. This is the generation American retailers have been serving for the last forty years, and now their priorities are changing as are their incomes. Now 52 to 70, they are still spending but not like they were in the 1990's when they were mostly 35-54 (**Table 6**).



The younger Baby Boomers were more numerous than the older ones, so even though their incomes began to slow overall, their accumulated wealth continued to grow lessening the impact of them aging (**Table 7**).

So what is going to change? The <u>children</u> of the Baby Boom generation will be emerging to have an even larger impact on our retail and our economy than the original Boomers did in the 1970's to 1990's.

These Millennials, as they have been labeled, are now 19-37 and there are 83 million of them (**Table 6**).



As they age into the key 35-54 age segment, they will have a growing impact on home furnishings sales, housing and almost everything else...and the impact is larger every year, as seen in home ownership (**Table 8**).

By 2025.	they will	be 29-47	and control	Our	economy.
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**	Having never known a home or classroom without a computer, they will
	be the most technologically savvy, productive, entrepreneurial and
	efficient generation ever.

- The Millennials are the first generation where women and minorities have had, theoretically, the same educational and occupational opportunities as white males. The implications for household incomes and achievement are significant.
- ❖ These are the children of the wealthiest generation, the Baby Boomers.
- According to Kiplinger (Personal Finance, November 2015, pages 35-37), \$30 trillion is expected to pass from the Baby Boomers to their heirs in the coming 30 to 40 years.

Our economy and retailing was dominated by the 78 million post-World War II Baby Boomers for forty years, from 1970-2009. Today, our retailers have <u>three</u> large and very different consumer markets: the aging Boomers, the smaller Generation X and the emerging Millennials.

Homeownership	Table 8.
Under 25	21.7%
25-29	32.7%
30-34	47.1%
35-39	56.0%
40-44	63.2%
45-54	70.7%
55-64	76.3%
65 and older	79.9%
Homeownership in 2004	69.0%
Homeownership in 2014	64.5%

Source: Census Bureau

In each coming year, the Millennials will have a greater impact and create the communities that they desire. And their "Baby Boom" parents will probably help their children and grandchildren along the way.



THEY LIKE US....THEY REALLY LIKE US!

If you needed additional evidence of the home furnishings industry's improving future, consider all the acquisitions already in 2017, almost one a week. Asian entities have acquired Theodore Alexander, Lexington and Baker, while U.S. private equity groups have acquired Innocor, Klaussner, Brown Jordan and Art Van. Other smaller deals occurred as well.

Since mergers and acquisitions are our business, we can assure you:

- 1. There are more to come;
- 2. The interest among private equity groups, foreign entities and strategic acquirors remains high, and
- 3. Funding remains affordable and well-priced to finance more transactions.

Please contact us for more information.

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