

Furnishings Digest Newsletter

Spring 2018

Reading Time

24 minutes



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Managing Director

Celebrating 47 Years of Proprietary Furniture Research



Come See Us !

- Sunday, April 15th, High Point, NC – 9:00 AM, the H.F.A. Retail Resource Center, first floor, Plaza Suites building.

Mann, Armistead & Epperson is proud that we were the long-term advisor and banker to *Kingsdown*, the Mebane, N.C.-based premium mattress manufacturer, in its recent transaction. This is our second major mattress-sector transaction in the last several years after the recapitalization of *Corsicana Bedding* in 2016. We announce proudly our larger transactions but a lot of our activity as advisors, doing valuations and smaller transactions is confidential.



My partner Howard Armistead (wha@maeltd.com) will be at the market as well. Please contact him or me to discuss valuations, mergers, acquisitions, or our other services.

High Point Furniture Show

You could almost sense a furniture show was near because the stock market started 600 point swings, along with lots of uncertainty about a trade war with China, speculation about the deficit and the temporary federal budget and, of course, global conflicts. Let's face it, if it isn't Syria, it's Iran, Russia, North Korea or ????. Every day the news could open with the same "breaking news" with the lead "This morning the world is concerned with increasing tensions with _____". It's the global soap opera.

The Spring High Point market is a necessity for planning the important second half of this year and looking for sales ideas that will carry into 2019. Remember, 55% of retail furniture sales are in the second half of the year. It is necessary to compare vendors---always a necessity unless you are completely satisfied with the status quo. Prices are rising in raw materials that will be passed on by the vendors and some countries, like China, have seen the relative currency issues force prices higher in recent months. All must be considered to plan your year.

A secret about High Point is that you will never see it all. I have been going steadily since the early 1970's, and seen many of the building constructed but there are still nooks and crannies I have not explored. Make an effort to find something new either in merchandise or in promotions at every market. Learn at the seminars and speeches (99% are free). Meet other retailers, share ideas. High Point is very entertaining and can be fun as you learn more, know more people, and see how it all works. Finally, wear comfortable shoes.

The Crisis Du Jour

For the last several weeks, our retailers and vendors with a large import or export component were sitting on hot coals worried about if, when and how much the home furnishings sector will be impacted by the much discussed new tariffs on China. I was told there was an article that mentioned furniture but I have not been able to find it, and thanks to the American Home Furnishing Alliance's Andy Counts, I have a thick copy of the "Under Section 301 Action, USTR Releases Proposed Tariff List on Chinese Products". The USTR is the U.S. Trade Representative, and this release mentions that President Trump has proposed tariffs on approximately \$50 billion worth of Chinese imports. The list includes about 1,300 line items on 57 pages that are not fun to review (wait for the movie). In it, I found furniture mentioned once, but it was related to technology and seating mentioned but it was for aircraft. Residential furniture and mattresses did not make it, thank heavens.



Remember, there are already lots of tariffs in place that are not part of this proposal and will likely remain. Second, this is a proposal and we hope just a first effort to get legitimate negotiations with the Chinese on important trade issues. Third, this list is not set in stone, yet. As we understand it, just because we did not make this initial list does not mean we cannot be added at another time. In fact, if a line item is deleted through negotiation or other reason, other products (perhaps ours) could be chosen to replace it to make the targeted \$50 billion in tariffs.

As we go to print, President Trump has just threatened China with another \$100 billion in tariffs. Autos were mentioned. Do we buy cars from China?

We complain about our low profile in Washington. Trust me, right now we want a low profile!

2018- Retail

Five out of the last six January to March quarters have been disappointing, which is a nice word for business stinks. Yes, it is better where there was hurricane, flood or fire damage to a significant number of homes, but excluding that, retail sales of furniture and mattresses have not lived up to the level that should be expected given the performance of economic growth, housing turnover, and gains in consumer income, job growth, and consumer confidence. This year as in three of the prior five first quarters, we can blame weather across mid-America and up into the heavily populated Northeast. Does that make us feel better? No. It just makes me wish more furniture stores sold snow shovels and snow blowers.

Early attitudes at the Las Vegas market, the Nationwide Marketing Group's "PrimeTime" in Orlando and



ISPA's EXPO in Charlotte were much more upbeat than the results so far at retail. Major home furnishings retailers have spent the big coin on old style TV, radio, newspapers, etc. and on new websites, e-mail-text-tweets-and different social media. I like what I see on Facebook from some furniture stores and vendors. Hooker does a really good job, just to name one. I even like how Wayfair, Houzz and a few more take time to send me emails on what they have on sale while giving me decorating tips. It is informative and entertaining, albeit somewhat redundant but that's why computers have delete buttons.

So what is the problem? Traffic. The numbers are deplorable with some stores saying traffic is down 20% versus a soft first quarter of 2017. Some websites/etailers say it is disappointing as well while being a bit less specific on the degree. Are there so many electronic distractions and attractions that consumers no longer have the time to shop? My wife just told me a niece put 71 postings on Facebook in one day, so many that my wife may unfriend her or however you ignore someone on Facebook. And Facebook is old school. She must be burning up Snapchat, Twitter and Instagram.

How bad is it? Some of the larger retailers are requesting that container-load deliveries be delayed for 3 months or so. Some upholstery factories are taking some downtime. The first quarter's only big promotional weekend, Presidents' Birthday, was not just disappointing, it was a bust for too many retailers, leaving them not just over-inventoried but under-funded in terms of ad spending for the coming weeks.



A few retailers had a spring sale for the first of April that did ok, not great. I heard a lot of furniture stores, bedding shops, auto dealers and appliance stores asking consumers to come by (buy?) with their tax refund checks, but few home furnishings stores felt this performed in 2018.

The average household is getting about \$90 a month more thanks to tax cuts, and some got \$1,000 bonus checks. That didn't happen last year or earlier. Some blamed uncertainty over North Korea, but that appears somewhat off the table for the near term. Corporate profits have been strong and improving, and corporate spending for capex has been way up, which should lead to future job growth. It was reported last week that we have more job openings than ever before and the number of people claiming unemployment benefits is down a lot.

On some level, many see a bright future. New furniture stores are opening, chains are going into new territories (like City going into Orlando, Bob's going into Los Angeles, or Art Van marching into Pennsylvania), and money is being spent to upgrade and refresh furniture stores. There is going to be a fight over who gets all the better Toys R Us locations, we expect.

We continue to see many reasons for a brighter future, especially for the "survivors" who upgrade and go aggressively after the business. I am hearing several store chains investing in facial recognition technology so stores can greet and be familiar with returning customers. Others are broadening their product mix, or just increasing the assortment and variations in their mattress department to differentiate themselves from all the stores and etailers now selling mattresses. Speaking of mattresses.....

Mattresses

Few of us really appreciate the dramatic changes that have hit the mattress sector. Think about having the largest mattress retailer breaking up with its largest vendor early last year, impacting almost 25% of the dollar volume of mattresses sold. It was like a large meteor hit Mattressland with almost every vendor and retailer jockeying for position trying to get the best combinations going forward. I think it will be another year before it all shakes out. In my opinion, the average ticket last year dropped noticeably as stores promoted out the old lines and spent to introduce the new "better" mattresses and train the sales force on the new features and benefits. I also think the better mattresses, \$2,000 and up, were especially hard hit by all this change.

Try to evaluate the impact of the mattress internet newbies by the names Yogabed, Nectarsleep, Allswell, Saatva, Loom & Leaf, Novosbed, Helix, Leesa, Tuft & Needle, Purple, Nest, Nomorsnorstore, Owls & Larks, Bear, Lull, and, oh yes, Casper, the friendly GhostBed. Given a little time, I could probably expand the list by another hundred or so. By the way, one or more names are bogus. How big has the impact of these many, many Casper-clones been? I am concerned less about them bringing new mattresses to market than their tactic of bad-mouthing all of the mattress and furniture stores and making fun of our sales persons. Their claims are questionable, where these mattresses are made is often a mystery and their reviews are, well, often like a bad library. The fiction and non-fiction aren't separated.



Related to the internet mattress retailers is the now-omnipresent boxed-bed. They're everywhere! They're everywhere! Every traditional mattress manufacturer or foam maker has a version, some etailers have ones they make or import, and now almost every store has them. And since they are shrunk down, they are easy to import.

Speaking of imports, our new 2018 Import/Export Study is about to be released (\$500, contact jsk@maeltd.com or call 804-644-1200). A decade ago mattress imports were about 3% of all mattresses sold in the U.S. in dollar terms. In 2016, imported mattresses were 8.8% of all mattresses sold, and in 2017, imported mattresses were 13.2%. Again, imports were 13.2% of the dollars spent on mattresses. Since most of the imported mattresses are less expensive, sometimes much less expensive, this 13.2% of the dollars could be 20% or more of the units! Compressed foam or innerspring mattresses can be 800 or more per container. Is it too late to build a wall?



Please don't read any disrespect into my making modest fun of the internet-only mattress retailers nor the boxed bed folks. They have discovered a need in the market and met it, and for that I applaud them. But in the mattress industry, whenever something great and nicely profitable is introduced, everyone jumps on it like it's a fumbled football and there is a race to the bottom in pricing. That is why you can purchase \$399 full depth queen memory foam mattresses today at retail.. We just could not keep something nicely profitable for very long. The same will occur as we get too many servicing the same market, and our natural propensity to make everything cheaper and cheaper. I can see it happening already, can't you?

Speaking of Imports

In 2007, the domestic residential wood furniture manufacturers shipped \$ 7.9 billion but in 2017 it was down to \$2.8 billion. You can name the names just like I can of all the closed wood furniture vendors. Imported wood furniture grew 8.8% in 2017 to \$12.7 billion, before added shipping and agency fees to get it to the U.S. Imports are now 89.0% of all wooden furniture sold in the U.S.

Percentage of household furniture shipments by product category that are imported

Table 1.

Year	Total	Wood	Upholstered	Metal	Mattress
2017	75.5%	88.9%	49.3%	95.3%	13.2%
2016	72.3%	84.9%	45.7%	93.9%	8.8%
2015	73.6%	86.1%	46.3%	94.2%	7.8%
2014	70.8%	82.3%	44.1%	91.5%	6.9%
2013	66.6%	74.4%	42.2%	89.1%	6.7%
2012	64.4%	71.5%	40.2%	86.9%	6.6%
2011	62.7%	69.8%	37.9%	85.4%	5.6%
2010	63.4%	70.6%	39.5%	85.5%	5.3%
2009	59.3%	68.2%	34.2%	78.7%	3.9%
2008	59.7%	67.8%	34.4%	79.0%	4.2%

Sources: ISPA, USITC

U.S. made "metal and other" residential furniture is getting hard to find. In 2017, domestic shipments dropped 8.2% to \$1.3 billion while the imports grew 7.3% to \$10.5 billion, now representing about 95% of all "metal and other" furniture sold in the U.S.

There is a battle in the world of upholstered furniture, however, with no prisoners being taken. Huge Chinese upholstery exporters have added large new factories, often having gone public and having new

access to lots of \$\$\$ (my computer doesn't have the yuan). Majors like Kuka, ManWah, and New Classic are public in China and Shayne will likely be public soon. Since 2012, imports have been ranging between 40% and 46% of all upholstered furniture sold in the U.S., but in 2017 it reached 49.2%. For those of you not quick with math, U.S. upholstered furniture manufacturers made 50.8% of all sold in the U.S. China makes 71% of all the imported upholstered furniture brought into the U.S. One other thought, a HUGE portion of global upholstery fabric is now manufactured in China, maybe 80%.

Break (Brake?) Up Amazon?

President Trump recently ranted against Amazon. This has been discussed before and it does seem like Amazon is getting into everything. They are now providing nursing care and home cleaning services.



Let's just remember:

- Early in the 1950's, there were discussions that the "five and dime" stores were taking over all retail. Remember Woolworth, Grant's, Rose's, Kress?;
- Sears was getting too powerful by the mid-1960's, and was accused of putting other retailers out of business. Thank heavens J.C. Penny was there to keep it in check;
- Department stores, who have been around forever, complained loudly about the catalog retailers like Best Products and Service Merchandise who claimed their membership allowed them to offer lower prices;
- A decade later the same people threw stones at the warehouse clubs, Price Club, Costco, B.J.'s Wholesale Club, etc., as using their membership status as unfair retailing;
- Some forget that the more than 70 major department stores in larger cities put more other retailers out of business in the last century than any other concept; and
- Amazon is the 500 pound gorilla at retail TODAY. Wait a while and see what develops next!

The internet is NOT the ultimate retail scenario. We have said before that the future has each of us having our own website listing what we want and what we need. It will be up to the retailers to seek us out and show us their best offer---price, terms, when, etc. Why should we waste our time going site to site or store to store? After that there is.....

The Economic Future ...better and better?

Looking at all the normal economic elements that we are taught to do like housing turnover, disposable income, migration, employment, consumer confidence, debt levels, inflation, mortgage rates, and all the others, we are making progress within the U.S. If you look, the global economy is growing too, and in the best shape in a long time. Even so, there is a tendency to overlook other important factors:

- Consumer wealth has recovered since the recession from \$54 trillion to a record \$96 trillion thanks to home prices, the stock market and lower indebtedness;
- Cash rich corporations are investing in new equipment, technology and facilities at the best pace since the 1990's, our best decade ever---and corporate America had accumulated over \$2 trillion in cash, a record;
- Banks are healthy and lending plus we have new consumer credit sources, often funded by private equity, that are giving retailers more ways to finance our customers;
- The lack of new home construction over the last decade has created a demand that will keep housing strong for at least the next two decades as we need at least 1.2 million new homes built per year based upon population growth, new household formations and the loss of older homes due to fire, disasters, structural weaknesses and other reasons; and
- We need to remember the proportion of spending that changes with both age and income as seen below. For example, when the 25-34 year old households (a household is a person or persons with a residence and an income) age into the 35 -44 age group, its share of all pretax income grows from 15.7% to

21.0% and the share of furniture spending grows from 17.9% to 21.5%. It increases again when they reach 45-54. As they mature, the % spent on furniture and mattresses grows, too. This is why the 83 million Millennials, now 19-37, are going to offer so much potential that will improve year after year until 2034.

Mattress and Furniture Expenditures by Age and Income

Table 2.

2016

	% of Households	% of After Tax Income	% of Mattress Spending	% of Furniture Spending
by Age				
<25	5.4%	2.8%	3.9%	3.8%
25-34	16.4%	15.7%	15.8%	17.9%
35-44	16.7%	21.0%	21.2%	21.5%
45-54	18.5%	24.3%	21.6%	21.6%
55-64	18.6%	20.2%	18.4%	18.9%
65+	24.4%	16.0%	19.1%	16.2%
Total	100.0%	100.0%	100.0%	100.0%

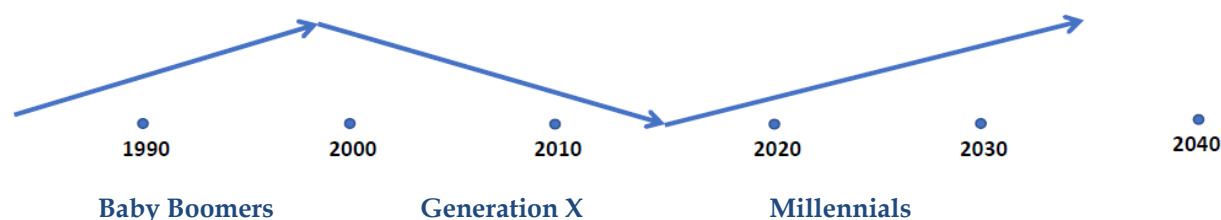
by Income				
<\$15	17.9%	1.9%	6.1%	7.4%
\$15-24	12.5%	4.3%	7.1%	5.5%
\$25-34	10.7%	5.4%	7.4%	7.7%
\$35-49	12.5%	8.5%	9.2%	8.5%
\$50-74	15.1%	14.4%	15.6%	13.4%
\$75-99	10.3%	13.4%	12.4%	11.9%
\$100-124	7.2%	11.8%	12.2%	11.3%
\$125-150	4.1%	8.1%	5.7%	6.7%
\$150+	9.7%	32.0%	24.1%	27.6%
Total	100.0%	100.0%	100.0%	100.0%

Produced by: Customer Analytics - Verona, WI
Source: US Bureau of Labor Statistics, Consumer Expenditure Survey Microdata (2014-2016)
Notes: Weighted Average of 2016 (x3), 2015 (x2), and 2014 (x1)
Limited to Consumer Units with Known Income
After Tax Income subject to Top Coding at \$200,000+

We also need to look at the economic impact as these generations pass through time. Studies and statistics prove household spending on furniture and mattresses peaks with the 35-44 and 45-54 age groups. The large 76 million Baby Boomers had its influence peak in the 1990's as they dominated these age groups (**Table 3**), then the much smaller Generation X (56 million) were a key reason our economy and retailing suffered through the 2000-2015 period when they dominated the 35-54 age segments. Beginning in 2016, the influence of the largest generation, the 83 million Millennials began and will not peak until around 2034.

Generation Domination

Table 3.



But there are other reasons to be confident in the future:

- The Millennials will receive an estimated \$30 trillion in inheritances from their parents, the wealthiest generation ever, the Baby Boomers, now 53-71. This wealth comes from savings that were reinforced by 401-K's, IRA's, profit sharing plans and other retirement programs; a stronger stock market; higher real estate prices; real life insurance not just burial policies as in the past, and better healthcare.



- Both women and minorities are seeing strong income gains because they now have the educational and employment opportunities once only open to white males, theoretically. Women now receive over 60% of the college degrees, for example.

Making Progress

Over the last decade and certainly since the massive 2009 recession, our industry has made solid progress, despite a painfully slow-growth economy in the U.S. This is shown in **Table 4**.

U.S. retail furniture consumption & factory shipments by product category											Table 4.
USD millions											
Year	Retail (a)	Domestic & Import Shipments (b)									
	Furniture Consumption	Household Furniture		Wood Furniture		Upholstered Furniture		Metal Furniture		Mattress Products	
2017	\$118,482	\$45,250	4.7%	\$17,170	3.9%	\$17,041	4.8%	\$11,040	5.9%	\$9,225	1.2%
2016	114,041	43,208	4.5%	16,520	3.0%	16,259	7.8%	10,429	2.1%	9,114	4.5%
2015	109,638	41,332	7.0%	16,038	5.2%	15,084	8.5%	10,210	7.6%	8,719	7.9%
2014	100,820	38,637	2.0%	15,248	-1.8%	13,900	4.5%	9,489	4.9%	8,080	8.3%
2013	95,455	37,886	4.3%	15,535	2.1%	13,307	6.5%	9,044	4.9%	7,463	2.2%
2012	93,073	36,334	5.4%	15,215	3.5%	12,501	7.6%	8,618	5.7%	7,305	8.7%
2011	89,053	34,461	1.8%	14,694	-1.1%	11,614	1.6%	8,153	8.0%	6,721	7.9%
2010	85,866	33,844	11.1%	14,858	10.3%	11,436	13.0%	7,551	9.8%	6,227	5.7%
2009	83,239	30,467	-18.8%	13,469	-21.6%	10,120	-15.1%	6,878	-18.6%	5,892	-2.1%
CAGR	4.5%	5.1%		3.1%		6.7%		6.1%		5.8%	
Total % Δ '	42.3%	48.5%		27.5%		68.4%		60.5%		56.6%	

Notes

Household Furniture column includes residential furniture but excludes bedding shipments regardless of nation of production

CAGR refers to compound annual growth rate

Sources

(a) U.S. Department of Commerce, Bureau of Economic Analysis. Series includes furniture & mattresses.

(b) MAE calculation, refer to Figures 7-11, shipments include imports + domestic production but are net of (excluding) exports

The Public Companies

This is also shown by the public furniture and mattress companies, as seen in **Table 5**.

Public Furniture Recent Annual Revenues

Table 5.

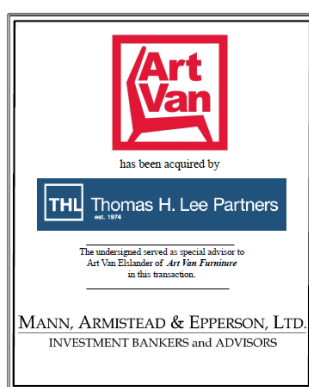
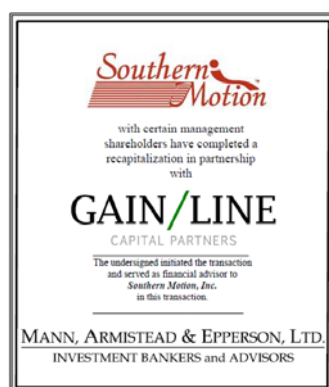
Furniture Manufacturers	Year Ended	Revenues					% Change
		2017	2016	2015	2014	2013	17/13
Bassett	11/25/2017	\$ 452.503	\$ 432.038	\$ 430.927	\$ 340.738	\$ 321.286	40.84%
Ethan Allen	6/30/2017	763.385	794.202	754.600	746.659	729.083	4.70%
Flexsteel	6/30/2017	468.764	500.106	466.904	438.543	386.189	21.38%
Hooker	1/28/2018	620.632	577.219	246.999	244.350	228.293	171.86%
La-Z-Boy	4/29/2017	1,520.060	1,525.398	1,425.395	1,357.318	1,273.877	19.33%
Stanley	12/31/2017	45.178	44.574	57.364	60.623	58.559	-22.85%
Totals		3,870.522	3,873.537	3,382.189	3,188.231	2,997.287	29.13%
Furniture Retailers							
Conn	1/31/2018	1,516.031	1,596.848	1,613.178	1,485.218	1,193.769	27.00%
Haverty	12/31/2017	819.866	821.571	804.870	768.707	746.410	9.84%
Pier 1	2/25/2017		1,828.446	1,892.230	1,884.600	1,791.400	N/A
Restoration Hardware	2/3/2018	2,440.174	2,134.871	2,109.006	1,867.422	1,550.961	57.33%
Totals		4,776.071	6,381.736	6,419.284	6,005.947	5,282.540	-9.59%
Internet Retailers							
Wayfair	12/31/2017	4,720.895	3,380.360	2,249.885	1,318.951	915.843	4.155
Bedding Companies							
Select Comfort	12/30/2017	1,444.497	1,311.291	1,213.699	1,156.757	960.171	50.44%
Tempur-Sealy	12/31/2017	2,754.400	3,127.300	3,151.200	2,989.800	2,464.300	11.77%
Totals		4,198.897	4,438.591	4,364.899	4,146.557	3,424.471	22.61%

Source : U.S. Securities & Exchange Commission and Pitchbook

Note: Data is as reported in the company annual report

More Transactions are Coming!

Private equity and strategic buyers both here and abroad still have a healthy appetite for companies in the furniture sector. The banks are ready to finance them as well. We are busy and would love to talk to you about our view of today's market. Give us a call or email us!



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About the Furnishings Digest Newsletter

Driven by founding partner Jerry Epperson's respected insight and long-term commitment to the furniture and mattress industries, Mann, Armistead & Epperson, Ltd. publishes the monthly Furnishings Digest Newsletter in addition to various manufacturing, retail, distribution, strategy and demographic reports that are available for purchase individually or by annual subscription. For more information, please email research@maeltd.com or call (804) 644-1200.