

Furnishings Digest Newsletter

May 2018

Reading Time

22 minutes



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Celebrating 47 Years of Proprietary Furniture Research



The High Point Market... Were you as pleasantly surprised as I was that there were a lot of people attending? It was a most uplifting surprise. To be sure, not everyone was raving about great business but they were there to get business done. And there were a LOT of issues that we all need to be aware of including inflation in prices, the much-discussed proposed tariffs on China, the ongoing and growing internet threat (I spoke to one internet furniture retailer that complained that many of her internet competitors were only after sales, not profits, and were impossible to compete with!), boxed beds, internet-only beds, many of the mattress makers getting into retail and competing with their distribution, and the race to the bottom in pricing in almost every home furnishings product. A few large retailers are asking for a 3 month delay in deliveries, some factories are running short time and some have laid off workers, sad because not long ago they couldn't find enough.

The new products in High Point were impressive. I read that blue and white were popular but I was still seeing a lot of grey. Power in motion is no longer the exception, it is the norm at most price points. Some, like Flexsteel's new "Modern Motion Modulares" were smaller scaled with an infinite number of combinations. It would be difficult to imagine a room that it couldn't be used in. There was more upholstery from Vietnam and, as might be expected, more of everything designed and packaged for direct to consumer delivery. The wave of industrial furniture has obviously passed and Louis Phillippe styles were almost hard to find. More of everything---wood and upholstered furniture and accessories have the convenience of power and USB sockets. Small LED lights are finding their way into the design of lots of stuff, from inside drawers to under beds. Outdoor furniture is getting a lot more practical for everywhere. The fabrics are terrific and the styling is either fresh and lively OR very redundant selling only on price. Only on price? Of course, this is furniture after all.



Rumors about who is buying who at market were very entertaining. Can I name names? It would be quicker to name the few not rumored for sale. Retail expansion continues, thank heavens, a sign of confidence going forward. Back when I was learning the industry, there were agreements among the dominant furniture stores in each major city to not invade each other's territories. Can you imagine that now?

Back to the market, there were some wonderful events Sunday and Monday evenings. On Sunday night the City of Hope honored Samuel Kuo and Grace Liu, the founders of Samson International (Universal, Legacy Classics, Craftmaster, Baker, etc.), Kim Yost, the president of Art Van and the great Art Van Elslander who we lost earlier this year. The International Furniture Representatives Association honored AICO's Martin Ploy and Rachel Tronstein of Gardner White. There were others honored, too, and I am sorry I cannot remember them all, but I am blessed that all of these honorees are long term friends and people I care about. Unfortunately, I broke a component on my scooter that kept me from attending both of these events and I really missed seeing friends receive such great honors. All were well deserved.



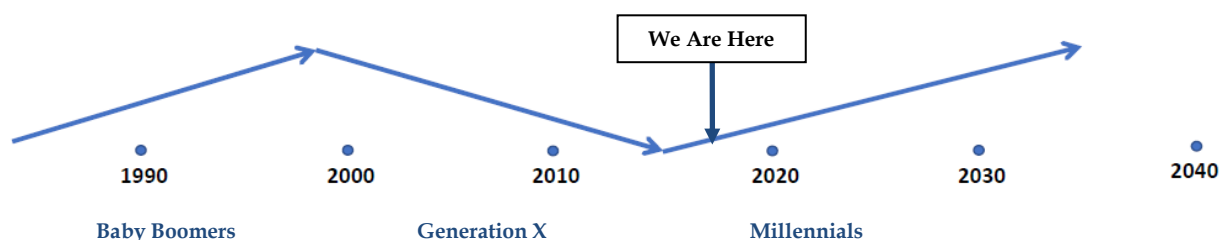
I hope everyone who visited High Point took the time to review all the new construction. The new addition at New Classics is breathtaking and Samson International has made its new Universal Furniture showroom (the former Hamilton Square building) into an inviting and comfortable location. On the eastern end of Wrenn is the new building for the H.T. Hackney furniture companies (Holland House, Step One, Folio 21, H. Home and others), still under construction but partially useable during market. The real jaw-dropper of a new building is under construction at Hamilton and MLK/Kivett Drive. This massive showroom complex will be the home for the Markor Companies, Caracole, A.R.T. Furniture and perhaps the recently acquired Rowe Furniture and Jonathan Charles. If you thought High Point was not growing, you were WRONG.

To summarize the High Point market:

- -attendance was excellent, given the recent disappointing sales at retail. The economy cannot be blamed. The indicators that have proven to predict furniture and mattress sales are doing fine, the best in this economic recovery, but consumers have not responded as normal, at least so far this year. We still have hopes for a strong second half. Remember, 55% to 57% of our sales occur in the second half of the calendar year.
- -despite some uncertainties, especially the proposed tariffs, we must plan for our future now. The promotional plans and advertising budgets that were shared with me were all upbeat and aggressive.
- -retailers have never had more options in terms of their floor mix from the largest popular priced assortment with rapid delivery to minimize inventory, Ashley; to large assortments available from multiple regional distribution points like Coaster, Acme or HomElegance; to mixed containers and other options. Advances in the total logistics package are making great improvements thanks to global communications; more shipping, freight and warehousing options; and even improved packaging.
- -although we are in a slow period, we must remember that we are only in the fourth year after the peak NEGATIVE influence of Generation X, the smaller generation between the huge Baby Boomers and their children, the Millennials. The Millennials have only just begun to get to the all-important 35-54 age segment that buys the most home furnishings. And their positive influence will grow every year until 2034. (Table 1)

Generation Domination

Table 1.



- -today, we are creating demand for home furnishings that will be met in the future, hopefully the near future.

Give Them Credit...

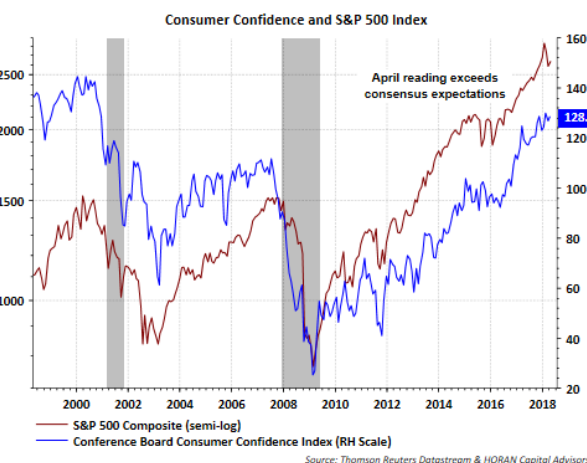
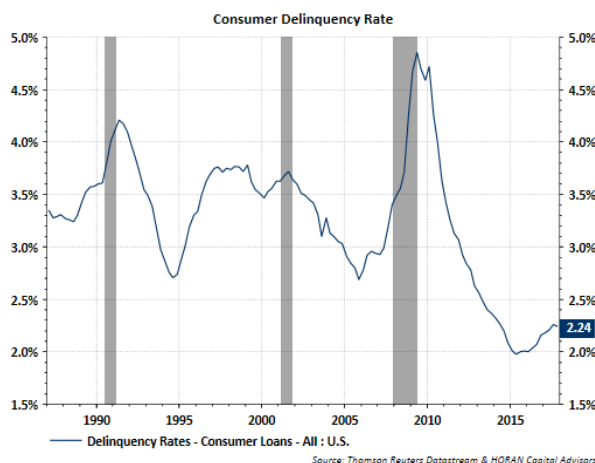
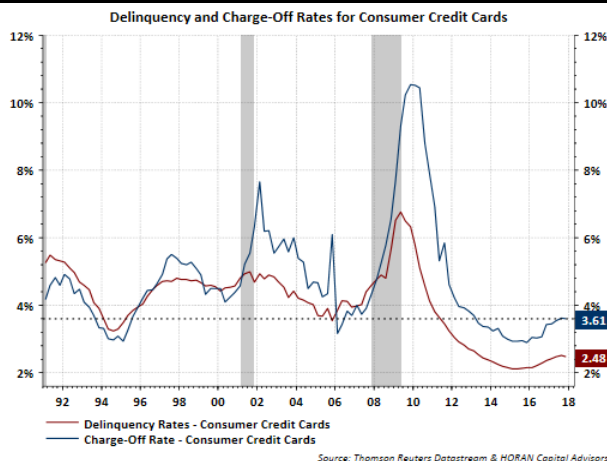
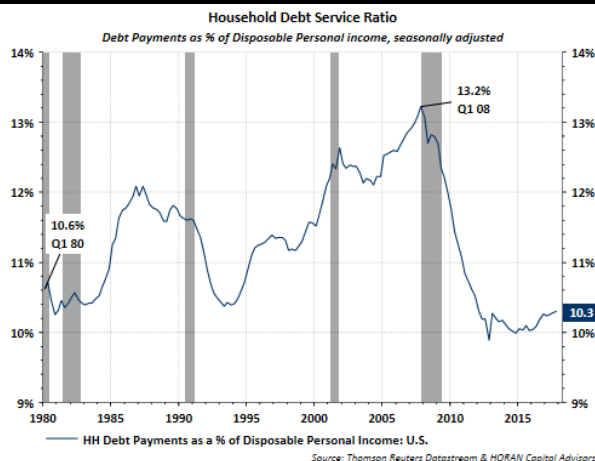
Understanding consumer indebtedness is a difficult task. First, there are so many types of credit these days; Second, some, like mortgage debt, is relative to the value of the asset; and Third, bankers love to talk in bankerese.

I just got a few understandable tables on how today's consumer debt stacks up to pre-recession levels and I thought they were worth sharing. These look very promising for continued economic expansion, with few worries about consumer debt restricting a continued recovery.



Quick Statistics

Table 2.



Then There Was College Debt...

Student debt in the U.S. grew from \$360 billion in 2004 to \$1.2 trillion in 2016, more than triple. Over the same period, home ownership among young Americans declined. Thirty-one percent of 30 year olds owned a home in 2004 vs. twenty-one percent in 2016. Even so, the average TOTAL debt for young Americans declined slightly and the composition of this debt changed dramatically. For the average 30 year old over this time period, home mortgage debt declined 28%, auto debt dropped 6% and credit card debt fell 36% BUT student loan debt exploded 174%. The student loan debt is hindering spending as has been the norm in the past, including buying a home.

Source: Federal Reserve Bank of New York (July 2017)



You Are Getting Sleepy.....

I enjoy looking for different new sleep related products and there are always a ton of them.

-I recently purchased Organica's Advanced Sleep Lotion, a bottle of pale blue lavender scented goo (not a lotion, but not a cream either) that is supposed to induce sleep when applied lightly to the face. I tried it and all three nights I went to sleep quickly. Honestly, I would have gone to sleep quickly anyway.

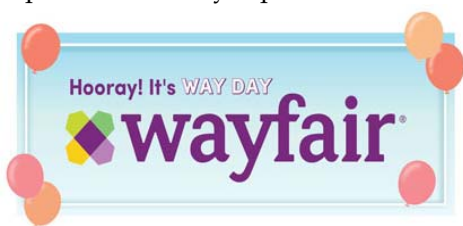
-The Cuddle Bed, only \$1,289 on Facebook, is a queen bed that has deep cuts into the mattress side to side, about 5 inches apart from head to foot. These side to side cuts into the mattress allow you to put your arm into the mattress and "cuddle" on your side with your sleep partner. How does this work with a sheet? They didn't say.



-Another new innovation that will supposedly revolutionize sleeping is a soft blue light to which you pace your breathing. It goes from quick to a slower and slower pace so if you slow your breathing accordingly, you will drift off to a peaceful sleep. I go to sleep faster if I close my eyes. Watching a light with your eyes open seems to discourage sleep for me.

Thank you, Wayfair!

For the last couple of months, Wayfair has been aggressively promoting its "Way Day", a special promotional day April 25th, like Black Friday is in November. This is a great idea, and one that the industry as a whole could support, although maybe not use Wayfair's name.



Our industry has had industry-wide sales days that have been successful in the past. Certainly, the various advertising media will support it as will the vendors if we can agree on the date and some details. I remember Bassett supporting a special promotion in September, if I remember correctly, and the Today show's weatherman, Willard Scott, was the spokesperson, back in the 1980's.

Today, we have numerous celebrities working among the vendors that we might ask to do single ads that we could use on TV, radio, online, in Social Media, in print and in the stores, all supporting the sale. If we could use humor and create some excitement, everyone should benefit. The key, to me, is to create interest through various media in terms of articles and news stories about a new holiday that could then support the paid media.

When should we have it? I feel like we need another promotional holiday in the spring, as Wayfair did, but that is just my opinion. The seed is planted. Please make it grow.

You Are Still Good -Looking (or attractive)

Outside interest in furniture and mattress companies continues, much to our delight. The private equity groups have record levels of cash to invest, interest rates remain low enough that we have affordable debt financing and there are a LOT of strategic options as everyone continues to adjust to today's consumer and retail environment. We may see more blending of the vendors and their suppliers, for example, or more foreign investment here in the U.S., and the combinations are really exciting. If you would like to discuss this further, please give us a call.

Frustrating

I was hoping that this far into the Trump administration some of the controversies would be resolved and we could go forward with a positive, compromised agenda for our nation, but no, there seems to be no end to the investigations, and worse yet, the confidence we all used to have in our "FEDS" and our TV talking heads has been blemished if not ruined. In some ways, it is good that J. Edgar Hoover is no longer around and that Walter Cronkite is off sailing on his much-loved sailboat in heaven. Did you ever doubt

Huntley or Brinkley? I didn't. Do I trust any news anchor today? I don't. All News is scripted today - written like the opinion pages.

SPECIAL STUDY

Be Scared, Very Scared...If you are Public

Before the Cycle Begins/Stage I: We are in a precarious time for public furniture companies. We are a cyclical industry, which does indeed have regular cycles that have events recur. The smart investors have learned to begin to invest in the public furniture companies when the stocks are out of favor, which is usually when housing activity is declining and interest rates are high or rising. (We are not there yet)

The Beginning of the Cycle/Stage II: When interest rates turn down, which is good for mortgage rates, and housing begins to turn upward, you add furniture stocks to your portfolio. This is usually before there is any recovery in the companies' earnings. The price to earnings ratio might be high (because earnings are low) but this is still a great time to buy the stocks.

The Cycle Progresses/Stage III: As interest rates decline and housing turnover begins to show improvement, the furniture stocks usually move upward in anticipation of higher furniture sales required for all the homes that are being purchased. The stocks have, in the past, all moved upward vigorously even though their earnings are not yet showing large gains. With the stocks higher but earnings not yet showing improvement, the price to earnings ratio is getting higher. Ignore it.

The Cycle Nears Maturity/Stage IV: Typically, by the time furniture sales are showing strong gains, and this is reflected in earnings, the stocks are nearing their highs, well before the peak of the furniture sales cycle which may be years away. Remember, the stock price rarely reflects the actual earnings in a cyclical stock. Price to earnings ratios are getting lower as earnings begin to show gains.

The Cycle Matures/Stage V: This is when they go public or sell stock. The earnings of the furniture stocks are showing strong gains, especially compared to the weak earnings a year earlier. There is nothing but good news for housing and, of course, interest rates and mortgage rates are still falling. It is not unusual for a furniture stock to be selling 4 to 10 times the price it was in Stage I. When everything looks great, take profits. Sell your furniture stocks. This is when the price to earnings ratio gets lower because the stocks are falling while the earnings are rising. Selling when the multiple is low sounds odd, but we are a cyclical industry. The stocks have moved nicely and the sector is getting some attention from the investment world. There is still some room for the stocks to go higher as inexperienced money gets into them. Don't be greedy.

The Cycle Defies Logic/ Stage VI: As housing and furniture sales continue to grow, typically for 3 to 5 years, the furniture companies continue to show strong earnings, but the stocks decline. Why? The stock market has moved on past housing-related investments to other sectors like capital spending, medical or technology. Housing sales are good and growing, and furniture sales are growing as are profits, but no one on Wall Street cares. The smart investing money will wait until the next cycle to come back to the furniture stocks, usually after the economic cycle matures and we are in another recession. Then we return to Stage I (above).

See How It Works?

Where we are today is in Stage VI where the companies are generally doing well but the earnings seldom reflect this performance. Imagine you are a top officer with a public furniture company that is showing record earnings, quarter after quarter, but your stock is going down. In some ways it balances out a few years earlier when your sales and earnings were weak but your stock was showing big gains. Does all this make sense? Read it again. I have studied this through five cycles, and it almost always follows the same script. Only in 2010, the interest rates were already low and housing was still dead but that had other reasons.

So Why Worry Now?

From 1971 to the mid-1990's, I helped a dozen furniture companies go public, some more than once (Stanley and Winston). Today, I could NOT recommend anyone go public if you have revenues of less than \$1 billion and earnings of \$100 million or less. Why? Below that level, stocks do not have adequate research coverage and attention to reach the investors you would like to own your stock. The various funds have gotten so huge they cannot invest in smaller stocks and ALL of our furniture stocks are "small cap" or worse, "micro cap" in today's world. You will never get the attention you need nor a fair valuation.

More importantly today, we have vulture investors who look for well capitalized, well run companies to invest in, take a position of 5% or so, then begin to demand a board seat or control of the board, and they make life miserable until you pay them and their attorneys to go away....or they get your company. Have more than 50% control of your stock? Who cares? In today's world, minority investors have rights that might surprise you---or shock you.

Today, almost all of our furniture stocks are down 20% or more below their highs, but earnings remain relatively strong, many times higher than in the 2009-2010 period. Almost all have excellent balance sheets, with almost no debt and many with LOTS of cash. Guess what the vulture investors love to find? This is why I say to be scared, very, very scared. So many of our public furniture companies have already lived through this like Ethan Allen a few years ago, and Bassett years before that. I hate to even consider what just happened to Stanley. Our mattress makers have been through this too.

Public Furniture Company Statistics

Table 3.

	Recent Cycle Stock Prices							Recent Valuation Indicators					
					%Change	Current	Change			Ent.Val	Price		
	Low	Year	High	Year		Price	from High	Revenues	EBITDA	/EBITDA	/Book	Cash	
Bassett Furniture Industries	\$ 2	'08	\$41	'17	1950%	\$ 29	-28.8%	\$452.5	\$41.4	6.9 x	1.7 x	\$47.4	\$3.7
Ethan Allen Interiors	9	'09	34	'16	278%	23	-32.2%	763.4	78.1	8.4 x	1.6 x	42.0	14.3
Flexsteel Industries	6	'8	54	'16	800%	39	-27.3%	468.8	45.5	5.8 x	1.3 x	37.5	0.0
Haverty Furniture Companies	9	'06	29	'13	222%	18	-36.7%	820.0	75.9	4.7 x	1.3 x	79.5	54.6
Hooker Furniture	9	'08	50	'17	456%	39	-22.9%	620.6	53.7	8.8 x	2.0 x	30.9	53.3
La-Z-Boy	1	'08	32	'17	3100%	29	-8.4%	1520.1	160.0	7.9 x	2.3 x	135.3	0.5

Note: Revenues, EBITDA, Cash & Debt in millions \$.

Source: Pitchbook

Go public?? I would much rather be happy.

If you missed our Spring Furnishings Digest, written for the High Point market, let us know and we will email it to you. Our new detailed 2018 Furniture Import and Export Study is also available for \$500 or as a part of a paid subscription. We are working on some exciting and new analysis on our economy, shifts at retail and more.

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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.