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*The A.H.F.A  
Manufacturing Summit*

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*W.W. “Jerry” Epperson, Jr. C.F.A.*

*of*

**MANN, ARMISTEAD & EPPERSON, LTD.**

**INVESTMENT BANKERS and ADVISORS**

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**Imagine You Went to Sleep in 1998  
And Awoke in 2009?**

**Furniture/Today Top 10 Furniture Stores:**

	<b>1998</b>	<b>2008</b>
1	Heilig-Meyers	Ashley HomeStores
2	Ethan Allen	IKEA
3	Pier One	Rooms to Go
4	Rooms To Go	Berkshire-Hathaway
5	Levitz	Williams-Sonoma
6	HomeLife	American Signature <sup>1</sup>
7	La-Z-Boy	Raymour & Flanigan
8	Havertys	Pier 1 Imports
9	Value City <sup>1</sup>	Ethan Allen
10	Art Van	La-Z-Boy

**M.I.A. From 1998 Top 100 List (1998 Rank) As of May, 2009:**

Heilig-Meyers (1)	Krause's (34)	Kirschman's (74)
Levitz (5)	Homestead House (35)	Domain (75)
HomeLife (6)	Leath/ModernAge (52)	Sofa Express (85)
Breuners (13)	Storehouse (53)	Mastercraft (90)
Bombay (14)	Rose (58)	Benchmark (94)
Seaman's (16)	Bedroom Superstore (61)	Arnold's (d.b.a. Breuners)
Wickes (18)	Rockaway Bedding (62)	Good's of Pennsylvania (d.b.a. Breuners)
Nationwide Warehouse (26)	Workbench (63)	Huffman-Koos (d.b.a. Breuners)
Roberds (28)	Leather Center (64)	Reliable (d.b.a. Heilig-Meyers)
This End Up (29)	Wood-Armfield (67)	Rhodes (d.b.a. Heilig-Meyers)

***Notes:***

- *Five of the 2008 Top 10 were single brand stores; only two were in 1998*
- *27 of the 1998 Top 100 have been closed/absorbed since 1998.*
- *d.b.a denotes companies "doing business as"*
- <sup>1</sup> *American Signature and Value City are both furniture retail operations of Shottenstein Stores*

***Source: Furniture Today***

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**U.S. Residential Furniture Shipments**  
*(billions of dollars)*

	<b><u>1999</u></b>	<b><u>Peak ?</u></b>	<b><u>2008</u></b>	<b><u>CAGR</u></b>	<b><u>Total Change</u></b>
Wood Furniture	\$12.996	\$12.996 ('99)	\$6.490	-7.4%	-50.1%
Upholstered Furniture	9.601	10.199 ('02)	8.325	-1.6%	-13.3%
Metal Furniture	3.333	3.616 ('01)	2.550	-2.9%	-23.5%
Mattresses	4.370	6.726 ('06)	5.774	3.1%	32.1%

*Source: AHFA*

## Residential Furniture Imports

*(billions of dollars)*

	<u>1999</u>	<u>Peak ?</u>	<u>2008</u>	<u>CAGR</u>	<u>Total Change</u>
<b><u>Wood Furniture</u></b>	\$5.303	\$10.872 ('06)	\$9.609	6.8%	81.2%
<b>China</b>	1.141	5.156 ('06)	4.223	15.6%	270.1%
<b>Canada</b>	1.182	1.368 ('00)	0.930	-2.6%	-21.3%
<b>Vietnam</b>	0.002	( '08)	1.259	WOW!	HUGE!
<b><u>Upholstered Furniture</u></b>	0.986	3.262 ('07)	2.928	12.9%	197.0%
<b>China</b>	0.101	2.197 ('07)	2.093	40.0%	BIG!
<b>Mexico</b>	0.153	0.357 ('05)	0.199	3.0%	30.1%
<b>Italy</b>	0.416	0.566 ('03)	0.155	-10.4%	-62.7%
<b>Canada</b>	0.150	0.238 ('03)	0.110	-3.4%	-26.7%
<b><u>Metal Furniture</u></b>	1.671	( '08)	4.216	10.8%	152.3%
<b>China</b>	0.767	( '08)	2.992	16.3%	290.1%
<b>Canada</b>	0.185	0.354 ('05)	0.271	4.3%	46.5%
<b>Taiwan</b>	0.257	0.282 ('00)	0.228	-1.3%	-11.3%
<b><u>Mattresses</u></b>	0.057	0.243 ('06)	0.219	16.2%	284.2%
<b>China</b>	0.001	0.107 ('06)	0.086	BIG	LARGE
<b>Mexico</b>	0.002	( '08)	0.079	54.0%	HUGE
<b>Canada</b>	0.018	0.049 ('05)	0.026	4.1%	44.4%

Source: AHFA, ISPA, ITA

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## The Domestic Furniture Industry Scenario

- Environmental and OSHA regulations were enacted in the 1970's and were met over time with precious capital expenditure funds
- Environmental and OSHA regulations were strengthened in the 1980's to create higher standards, and some states added regulations of their own. Most furniture plants spent even more of their precious capital expenditure funds to meet the higher standards, but some factories could not meet the requirements and had to be closed.
- Much more severe environmental and OSHA regulations were enacted in the 1990's, and the solutions utilized in the 1970's and the 1980's were often inadequate or in conflict with the new regulations (example: underground tanks\*), so many factories failed to meet the new standard, or had to spend all of their capital expenditure funds to meet the minimum standard. Some had adequate demand but could not produce above break-even levels because of emission standards or other regulations.

**Observation:** If universally acceptable standards had been enacted in the 1970's, capital funds could have been spent to both meet the required standards and to improve production efficiencies to remain competitive. New factories would have been built instead of unending upgrades to old plants.

\* For much of the 1980's and early 1990's, old underground tanks could be drained and filled with sawdust to avoid any residual fluids from leaking. In 1995, regulations were changed requiring the tanks to be removed which meant the sawdust, which had added both weight and additional materials that must be disposed of, added to the costs.

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## **The Import Scenario**

- The strengthening of the U.S. dollar from the mid-1990's to 2003, presented opportunities for both European and Canadian manufacturers to aggressively gain share of market in the U.S.
- By closely fixing the Chinese yuan to the U.S. dollar, China was able to utilize its less expensive labor, access to inexpensive raw materials, and incentives for exporters to penetrate the U.S. markets with long production runs of value priced furniture.
- More efficient global communications and transportation systems made trans-oceanic manufacturing efforts possible.
- With success in the U.S., Chinese manufacturers built more sophisticated factories and developed more state-of-the-art systems and logistics, allowing them to penetrate more product categories at a broader quality/price range.
- Growth in China created opportunities in neighboring countries including Malaysia, Thailand, Indonesia, and Vietnam, especially after the successful 2004 anti-dumping petition on Chinese bedroom furniture.

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**Bureau of the Census Data : U.S. Production**

	<b><u>2002</u></b>	<b><u>2007(P)</u></b>	<b><u>Total Change</u></b>
<b><u>Wood Furniture</u></b>			
Employees	111,984	63,066	-43.7%
Payroll	2.75b	1.84b	-33.1%
Cost of Materials	5.15b	4.40b	-14.6%
Capital Expenditures	217m	131m	-39.6%
<b><u>Upholstered Furniture</u></b>			
Employees	91,838	76,854	-16.3%
Payroll	2.44b	2.25b	-7.8%
Cost of Materials	5.45b	4.14b	-24.0%
Capital Expenditures	174m	107m	-38.5%
<b><u>Metal Furniture</u></b>			
Employees	25,715	11,933	-53.6%
Payroll	0.70b	0.39b	-44.3%
Cost of Materials	1.72b	1.14b	-33.7%
Capital Expenditures	71m	21m	-70.4%
<b><u>Mattresses</u></b>			
Employees	23,027	22,770	-1.1%
Payroll	0.76b	0.87b	14.5%
Cost of Materials	2.31b	3.60b	55.8%
Capital Expenditures	83m	132m	59.0%

Source: U.S. Census Bureau

(P) Preliminary Data

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**U.S. Residential Furniture Factory Closings**

<b><u>By State</u></b>				<b><u>By Year</u></b>	
NC	136	IL	4	2000	17
MS	39	IA	3	2001	73
VA	34	GA	3	2002	36
CA	25	TX	3	2003	44
TN	13	CO	2	2004	59
MI	14	AZ	2	2005	36
IN	13	WA	2	2006	27
PA	10	ME	2	2007	35
OH	9	UT	2	2008	29
AR	8	MA	2	March, 2009	11
WI	7	FL	1		
SC	7	OK	1		
VT	7	ID	1		
AL	6	KY	1		
NY	5	MD	1		
MO	4	OR	1		

*Source: Hardwood Review Weekly*

**Latest Results**  
(billions of dollars)

	<b>March Quarter</b>		<b><u>% Change</u></b>
	<b><u>2008</u></b>	<b><u>2009</u></b>	
<b><u>Wood Furniture</u></b>			
Domestic	\$1.899	\$1.356	-28.6%
Imports	2.323	1.774	-23.6%
China	1.021	0.747	-26.8%
Canada	0.250	0.141	-43.6%
Vietnam	0.285	0.263	-7.7%
<b><u>Upholstered Furniture</u></b>			
Domestic	\$2.271	\$1.755	-22.7%
Imports	0.697	0.527	-24.4%
China	0.467	0.386	-17.3%
Mexico	0.059	0.035	-40.7%
Italy	0.046	0.027	-41.3%
Canada	0.031	0.015	-51.6%
<b><u>Mattresses</u></b>			
Domestic	\$1.545	\$1.282	-17.0%
Imports	0.046	0.044	-4.3%
China	0.019	0.016	-15.8%
Mexico	0.014	0.016	14.3%
Canada	0.007	0.007	0.0%

Source: AHFA, ISPA, ITA

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## What in the World is Happening?

- The U.S. dollar continues to weaken, helping U.S. exports somewhat in the March 2009 quarter:  
wood furniture (17.1)%  
upholstered furniture (18.6)%  
while currency sensitive imports continue to weaken:  
wood furniture:  
Canada (43.5)%  
Italy (31.2)%  
upholstered furniture:  
Canada (50.4)%  
Italy (40.2)%
- U.S. furniture demand continues to decline which has seriously damaged Asian manufacturers that have not diversified to alternative markets like Europe, China and the Middle East. 300,000 Chinese factories (of all types) closed in 2008.
- A credit crunch in the U.S. has resulted in many U.S. furniture stores seeing their credit lines reduced, making these retailers:
  - reduce current inventories;
  - cut back on large orders (like containers);
  - rely on suppliers who offer extended credit terms; and
  - seek suppliers who offer accelerated deliveries to maximize GMROI\*

\*Gross Margin Return On Inventory

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### **What in the World is Happening? (continued)**

- China has enacted its own \$586 billion stimulus package, reinstated export and labor incentives, and forced their banks to lend.
- World shipping capacity is down 15%, and will drop further, lowering freight rates. Many new ships are being built that will force rates lower for the next year or so.
- As weak as the U.S. currently is, other developed nations like Japan, Russia, Germany and the U.K. are doing much worse.
- Global financing has been impacted as GE, American General and others have cut back on their lending to the furniture sector.

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### **What in the World is Happening? (continued)**

- As long as the U.S. dollar remains weak, it is unlikely that shipments from stronger-currency locations like Europe or Canada will recover, even if the U.S. economy picks up.
- Up and down oil prices will continue to impact all transportation and many raw materials used in the home furnishings sector.
- One clear trend is the development of U.S. sales forces (and domestic warehousing in some cases). We now count more than thirty Asian factories that are directly servicing U.S. retailers, some with U.S. warehouses. Some are in direct competition with importers that rely on them for OEM production and this may challenge some of the weaker importers.

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## **Bringing It Back Home?**

- Some speculate that some furniture production may return to the U.S.
- In the wood and metal furniture categories, we doubt that can occur, especially over the near term. It has been proven that it takes two to three years to get the governmental approvals, permits and environmental studies to re-open or start a furniture plant, assuming qualified labor remains available.
- Yes, some furniture production is opening but it is very specific to a need like IKEA's new Swedewood factory in Virginia or Stickley's new factory in North Carolina.
- In the upholstered furniture and mattress categories, imports have grown but so have complications. Upholstery imports declined more than domestic in the March, 2009 quarter.
- Companies that announced plans to close all U.S. upholstery production and sell only imports have had mixed success thus far.
- The use of fabric "cut and sewn" kits to use with domestic frames grew rapidly from 2000 to 2006, but have leveled since.

**Fabric "Cut & Sewn" Covers  
Imports by Significant Countries**  
*(dollars in millions)*

	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>CAGR</u>
<b>China</b>	\$34.3	\$112.3	\$202.1	\$321.7	\$340.8	\$334.6	\$327.2	45.7%
<b>Mexico</b>	8.3	20.4	22.9	19.6	19.9	15.7	9.4	2.0%
<b>Total Imports</b>	49.7	149.4	242.8	357.0	380.2	373.4	351.5	38.5%

*Source: ITA*

*\*Data has been collected only in the seven years listed in the table above.*

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### **Bringing It Back Home? (cont.)**

- Where China has dominated the upholstery sector is in leather where we estimate it makes almost 75% of the leather upholstery now sold in the U.S.
- Several U.S. companies have successful Asian production facilities or joint ventures in the upholstery category like Jackson/Catnapper, Caye, Ashley, Howard Miller and Stickley.
- Some U.S. wood manufacturers have invested heavily in flexible domestic production and inventories to optimally service retail demand quickly and this appears to be successful thus far.
- U.S. furniture retailers are very upset that often they are choosing imported furniture for their floors only to find months later it will not be manufactured. This has surpassed quality and broken delivery dates as the largest retailer complaint.

## The Future?

- In our recently released 5 year furniture and bedding forecast, we estimate both domestic and import shipments to year 2013. The following table gives our expected market share of imports.

**IMPORTS/TOTAL SHIPMENTS**  
**Mann, Armistead & Epperson, Ltd.**  
**Residential Furniture and Bedding Industry Forecast, April 2009**  
*(Market Share)*

	1	2	3	4
	Net Wood Furniture Shipments	Net Upholstered Furniture Shipments	Net Metal Furniture Shipments	Net Mattresses
<b>2013E</b>	74.0%	36.0%	77.0%	5.0%
<b>2012E</b>	74.0%	35.5%	76.1%	5.0%
<b>2011E</b>	72.0%	34.5%	76.0%	4.5%
<b>2010E</b>	71.5%	34.0%	74.0%	4.0%
<b>2009E</b>	70.0%	32.0%	72.0%	4.5%
<b>2008</b>	68.3%	30.8%	71.5%	4.3%
<b>2007</b>	65.0%	29.6%	68.3%	3.7%
<b>2006</b>	63.0%	28.5%	66.8%	4.2%
<b>2005</b>	61.1%	26.0%	64.4%	3.3%
<b>2004</b>	58.8%	24.0%	64.4%	2.3%

Notes:

<sup>1</sup> Updated series as of March 2009.

\*For detail and definitions please refer to the March, 2009 *Furnishings Digest* special report, "Furniture and Bedding Imports: A Statistical Study".

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