RAYMOND JAMES

Furnishings
Industry Report

Budd Bugatch, CFA
(727) 567-2527
Budd.Bugatch@RaymondJames.com

Chris Thornsberry
Research Associate

EQUITY RESEARCH

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Residential Furniture

An Industry in Transition and/or Trouble?

The Raymond James Financial Center, 880 Carillon Parkway, St. Petersburg, FL 33716
Institutional clients may call for additional information:
Research 800-237-5643 • Trading 800-237-8426

RAYMOND JAMES & ASSOCIATES, INC.

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Executive Summary

This report examines various critical investment and business issues facing the residential furniture industry with the goal of helping the investor/reader understand how these issues may develop in the future. Many observers know that the rapid growth of imports and the downsizing of the domestic manufacturing base continue to significantly impact the industry. Accordingly, it seems the subtitle of this report is quite appropriate: Is this an industry in transition or is it in trouble? The proper answer, we believe, is a little of both.

Investors in the stocks of the players in this industry also all too often find themselves in the frustrating position of being on the wrong side of an investment that is too illiquid to liquidate or accumulate rationally.

For professional investors, determining the meaningful investment opportunities within both the residential furniture universes requires care and discipline. Currently, the total market capitalization of the 20-member residential furniture manufacturer/retailer/supplier universe is $17.5 billion. These equities represent about 16 basis points of the $10.6 trillion dollar market capitalization of the companies within the S&P 500 index.

This means that commitments to these names as core investments are rarely appropriate and that a clear understanding of what drives both the fundamentals of company performance and stock action is needed. That said, the stocks often have strong moves – up and down – making occasional commitments interesting and offering opportunities for above-market "alphas."

In our experience, residential furniture manufacturing stocks, in particular, behave cyclically and performance varies in different interest rate environments. In summary, when the direction of interest rates moves in response to a change in policy by the Federal Reserve Board, the performances of the stocks can and do become unhinged from fundamental performance.

In a rising rate environment, the stocks tend to fall despite the fact that the fundamentals are strong and may even improve, at least for a while. This divergent situation means that valuation parameters compress to low levels. Typically, P/E ratios will fall to 5-9x forward earnings estimates.

The situation reverses when rates fall. As early cyclicals, the stocks surge while earnings fall or losses mount. P/Es, accordingly, rise, often to unsustainable levels, as investors anticipate that better times are around the corner. Typically, P/Es will rise to 14-20x projected earnings.

When interest rates are relatively stable, earnings expectations and earnings performance drive share price movements. Since residential furniture manufacturers tend to have high fixed costs and correspondingly high variable contribution margins, earnings surprises occur with relatively small movements in revenues. The key to success in these times comes from properly gauging earnings direction and potential upside and/or downside. Still, the stocks sell at varying discounts to broad market valuation parameters.

Investors, therefore, are well advised to enter and exit these stocks early at times when short-term rates start changing and to look for those indications of cusps of change when rates are stable. Additionally, being disciplined about entry prices and target prices will increase the likelihood of achieving acceptable risk-adjusted returns.

Regarding industry fundamentals, the residential furniture market is both mature and slow growing. According to North American Industrial Classification System (NAICS) data compiled by the Census Bureau, domestic sales of furniture stores now total about $53 billion annually. Over the last decade, sales growth for these stores has averaged 5.0%, nearly in-line with the 5.1% rate of GDP growth but below both the 5.7% annual growth rate average for personal consumption expenditures and 5.8% average annual growth for all retail sales.

Since about 40% of furniture is sold in channels other than those that are classified as furniture stores by the Census Bureau, the monthly NAICS data misses a certain portion of the retail furniture market. Similarly, most furniture stores sell more than furniture, including accessories, lamps, and other décor items. Despite these issues, NAICS data provides the only monthly data series to track near-term demand patterns.

The most important drivers to demand for home furnishings and furniture are: (1) personal income, (2) consumer confidence, and (3) sales of existing homes. Short-term interest rate movements, which used to be statistically significant when measuring changes in demand, do not now correlate significantly with retail furniture sales.

Translating retail sales to wholesale shipments is neither simple nor straightforward. Given the highly fragmented nature of the manufacturing roster, the data compiled and published by the industry's trade association, the American Furniture Manufacturers Association (AFMA), has been of uncertain accuracy historically.

That situation has become even more complex with the rapid growth of imports and the fact that many of the importers are AFMA members. The AFMA shipment data alone, however, misses import shipments outside of its membership. Additionally, simply by adding separately reported import data, unadjusted, to AFMA shipment data double-counts a portion of the wholesale data, thereby leading to an overstatement of wholesale shipments.

After making a series of analytical adjustments for these issues, we estimate the value of wholesale wood and upholstery furniture shipments in 2003 was about $30.6 billion, of which 33.5% were imports and 66.5% were domestically produced. Imports, particularly those from the Far East and China, remain the most important agent of change for residential furniture manufacturers and investors. Our analysis also indicates that wholesale shipments have grown at an average annual rate of 5.5% during the past seven years.

Incorporating estimates for bedding, metal, and other types of furniture, we estimate that the wholesale shipment market of residential furniture was about $42 billion in 2003.

Despite its relatively small size, the industry is, in reality, a composite of even smaller niche segments. Retailers often shop manufacturers for specific classifications of merchandise. A manufacturer's success in one segment does not translate automatically into the ability to succeed in another segment.

An analysis of segments begins with understanding that purchases differ by room use: living room/den room, dining room, bedroom, or other. Within the room classification, smaller sub-segments include: stationary fabric upholstered, leather upholstery, recliners, motion seating, living room occasional furniture, master bedroom, juvenile bedroom, major dining room, casual dining, home office, and home theater, among others.

In addition to use, style and price point provide additional dimensions of comparison between industry participants. Consumer style preferences move glacially, but they do move. Price point variations among manufacturers are more difficult to change. Retailers know and understand the quality capabilities of various suppliers and only rarely test the limits of their suppliers.

Distribution strategies are an additional point of comparison among manufacturers. The two extremes are open and closed systems. In open distribution, manufacturers sell many retailers in a market and place minimal requirements in terms of floor space and other commitments. In fact, it is often the larger and more dominant retailers that require exclusivity from manufacturers.

In closed system distribution arrangements, manufacturers and retailers partner to devote exclusive floor space – through in-store galleries and/or dedicated stores – to the product of that manufacturer. A recent trend is for some manufacturers to commit ownership and operating capital to stores that exclusively display and sell its brands.

The rapid growth of imports has changed, and continues to change, the face of the industry. Millions of square feet of domestic manufacturing space has been shuttered in the past several years, and according to the *Wall Street Journal* more than 30,000 wood furniture manufacturing jobs have disappeared since 2000. Additionally, unemployment in North Carolina, home to many furniture plants, has risen to a current level of 6.1% from 3.6% in 2000, according to the U.S. Bureau of Labor Statistics.

In response, a coalition of 31 bedroom manufacturers are signatories of an antidumping petition against the Republic of China that may add duties to the import cost of Chinese-produced wood bedroom. This is the largest antidumping case ever brought until now and is a contentious issue facing industry participants. The dumping issue will not be determined until April, at the earliest, and more likely, not until sometime in June.

The outcome of the petition is unknowable now. In our view, the rules seem stacked in favor of the petitioners, in that only favorable petitioner outcomes are included in the dumping margin calculation. Accordingly, a number of industry participants avow that they have begun to develop alternative sources to China if and when excessive dumping margins are assessed to Chinese imports.

Investors should remember that the petition only addresses wood bedroom furniture. It does not affect dining room or upholstery. We believe that it would be far more difficult for a coalition of manufacturers to bring a similar effort for dining room, occasional furniture, and/or upholstered product.

Deflationary price pressures have been the norm in the industry for the past five years. The primary beneficiary of these pressures has been the American consumer, who has received more value for his/her dollar than ever before. The fact of the matter, however, is that the industry participants have never had much pricing power at either the retail or wholesale levels.

Given the prospect of dumping duties and an eventual higher revaluation of the Chinese Yuan/Reminbi, inflationary pressures may be closer than many investors realize. The issue will arise, however, as to who bears the additional costs at a time when overseas production capacity has increased so rapidly.

We believe that companies that develop manufacturing capability around the world and have strong distribution links in the largest and most vibrant

markets will create nearly unassailable barriers to entry and ultimately "weed out" weaker, less profitable competitors.

Higher barriers to entry, in turn, will mean that these companies will be able to raise and defend margins, operate at higher levels of profitability, and boost returns on invested capital. Finally, higher returns on invested capital, in conjunction with higher barriers to entry, should translate into improving valuation multiples in the stock market for the shares of surviving companies.

Though higher valuations may be the ultimate endgame, investment results in the interim will remain captive to the issues we have described in this report, buffeted occasionally by specific news items like antidumping and currency revaluation.

Residential Furniture Stocks: The Public Arena

The size of the public equity arena for residential furniture industry participants is surprisingly small, particularly in proportion to other industries and to the overall stock market. Table 1 provides a list of 20 publicly traded equities that make up the bulk of the publicly owned residential furniture industry. In this list, 14 are identified as residential furniture manufacturers, three as suppliers, and three as retailers.

One of the manufacturers is headquartered in Italy and one in Canada. Another two that are labeled as manufacturers have significant owned retail operations and another three – maybe four – of the manufacturers are likely to increase the proportion of owned retail stores in the near term.

Interestingly, in the list, two of the companies — Culp and Quaker Fabrics — are textile companies and furniture "wannabes" since furniture companies have higher valuations. Two others — Select Comfort and Tempur-Pedic — are furniture "don't wannabes" since they want, again for valuation purposes, to be thought of as specialty growth companies. Finally, Leggett & Platt is really a furniture "used to be" since now only half of its business comes from residential furniture.

The market capitalization of the list totals $17.5 billion, and the daily trading volume of the entire group equates to less than $100 million, or 0.6% of the market capitalization.

As noted, the industry is tiny in relation to the overall market, measuring 16 basis points of the $10.6 trillion S&P 500 index or 13 basis points of the $13.4 trillion Russell 3000 index. Further, the low trading liquidity demands that investors approach the smaller issues with greater care. Six of the 20 issues account for nearly 90% of the trading volume.

Table 1

Name	Symbol	Price	52 Wk Low	52 Wk High	Stated Book Value	Tangible Book Value	Market Cap'n	Mkt Ent. Value	TTM Sales
Residential Furniture Manufacturers									
Bassett Furniture	BSET	$21.47	$9.86	$23.75	$220	$220	$249	$234	$302
Bush Industries	BSH	$2.54	$1.50	$5.65	118	118	35	162	313
Chromcraft Revington	CRC	$13.88	$10.76	$13.85	52	52	83	106	184
Dorel Industries	DIIB	$32.98	$23.05	$34.29	438	34	1,076	1,381	1,081
Ethan Allen Interiors	ETH	$43.00	$27.14	$46.65	576	497	1,602	1,463	925
Flexsteel Industries	FLXS	$21.34	$12.00	$23.53	98	98	138	156	334
Furniture Brands Int'l	FBN	$31.80	$17.23	$32.94	949	593	1,774	2,051	2,368
Hooker Furniture	HOFT	$24.32	$9.81	$25.99	101	101	352	386	309
La-Z-Boy	LZB	$22.38	$16.20	$24.75	610	460	1,195	1,364	1,995
Natuzzi S.p.A.	NTZ	$10.65	$7.13	$11.46	596	596	582	522	842
Rowe Furniture	ROW	$4.30	$1.55	$6.25	49	35	57	92	294
Select Comfort	SCSS	$25.03	$8.55	$32.32	76	76	895	826	458
Stanley Furniture	STLY	$36.90	$18.26	$38.80	95	93	229	249	261
Tempur-Pedic Int'l	TPX	$16.14	$14.00	$18.18	N/A	N/A	1,570	1,570	479
Resid. Furniture Mfrs Total					**$3,977**	**$2,973**	**$9,838**	**$10,560**	**$10,146**
Residential Furniture Retailers									
Haverty's	HVT	$20.44	$9.35	$24.60	$239	$239	$453	$501	$745
Bombay Company	BBA	$7.03	$4.34	$14.11	176	175	248	293	575
Pier 1 Imports	PIR	$22.66	$14.42	$26.44	663	663	2,015	1,861	1,834
Resid. Furniture Retailers Total					**$1,078**	**$1,078**	**$2,717**	**$2,655**	**$3,153**
Furnishings Suppliers									
Culp	CFI	$11.38	$3.75	$12.28	$99	$89	$131	$176	$323
Leggett & Platt	LEG	$24.43	$17.16	$25.74	2,036	1,068	4,689	5,238	4,388
Quaker Fabric	QFAB	$8.34	$5.16	$11.00	166	161	140	189	325
Resid. Furniture Suppliers Total					**$2,301**	**$1,319**	**$4,960**	**$5,603**	**$5,037**
All Residential Furniture Publicly Held Companies					**$7,357**	**$5,362**	**$17,514**	**$18,819**	**$18,336**

The small public market size and trading illiquidity cause two conclusions about investing in these issues. First, portfolio managers do not need to always have some percentage of their portfolios exposed to the residential furniture industry as insurance of performance against their respective benchmarks as they might in other, larger industries like healthcare, energy, and financial services. Accordingly, investors should not and do not view these issues as “core holdings.” Second, investor nimbleness is required, and this means that strong discipline is required to successfully navigate investment opportunities in the group.

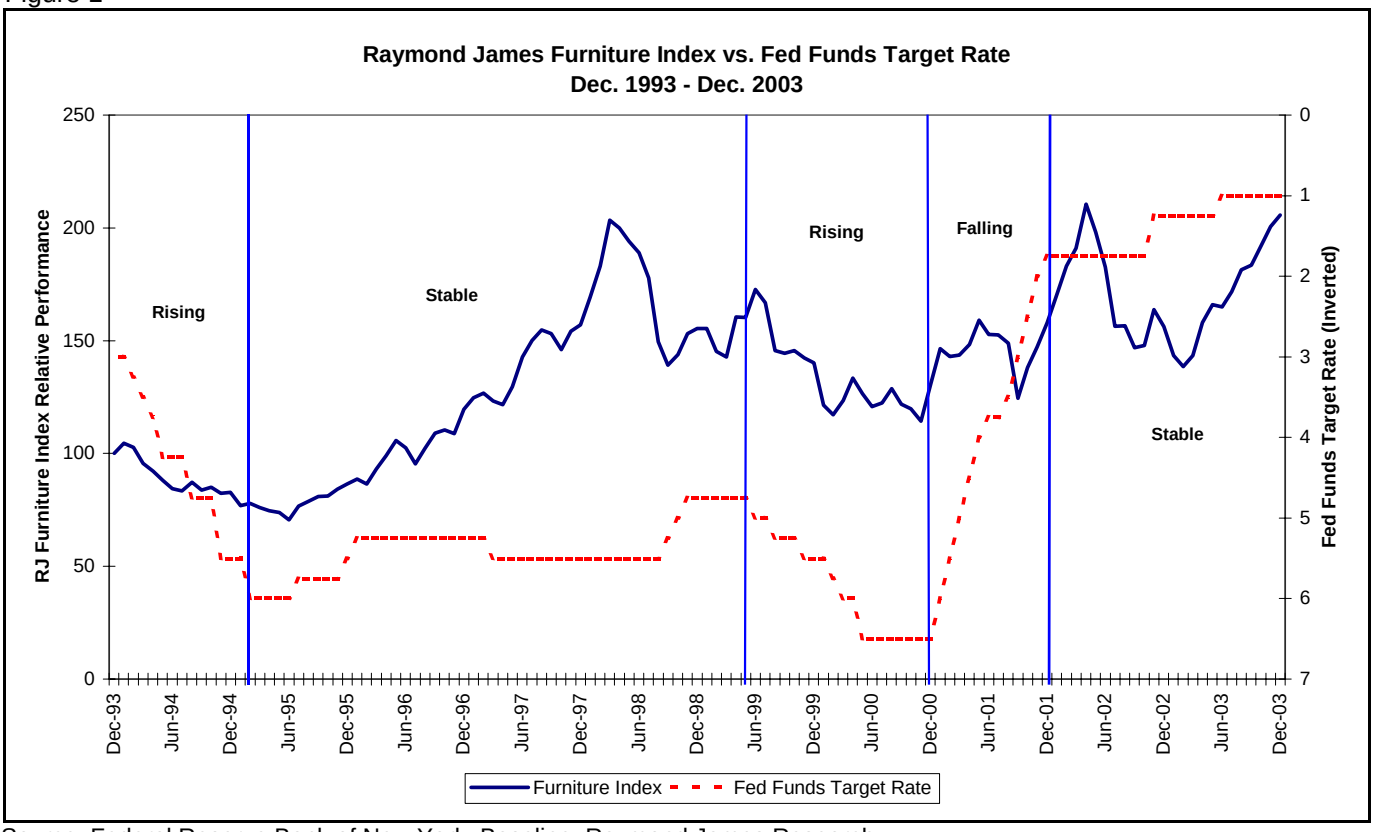
Nevertheless, when viewed as a part of the larger universe of consumer-related issues, these stocks have merit on occasion. In short, if professional investors can determine when and why these issues rise and fall, they have the occasional opportunity to gain a measure of outperformance to their benchmark and their competition. That, in a nutshell, is the attraction of investing in residential furniture industry stocks.

Furniture Stocks: How They Act and How They Are Valued

Figure 1 graphically depicts a 10-year history of the performance of our furniture stock index juxtaposed against the Fed Funds target rate over the same period. The axis for the Fed Funds target rate is inverted to emphasize the visual correlation between interest rate moves and stock price moves.

The message is clear: when interest rates move in one direction for a period of time, the stock prices move in the opposite direction. On the other hand, when the rates are "relatively" stable, the stock prices can and do move because of other factors. Our experience suggests that those key "other factors" are sales and earnings, more specifically, sales and earnings realities above or below expectations.

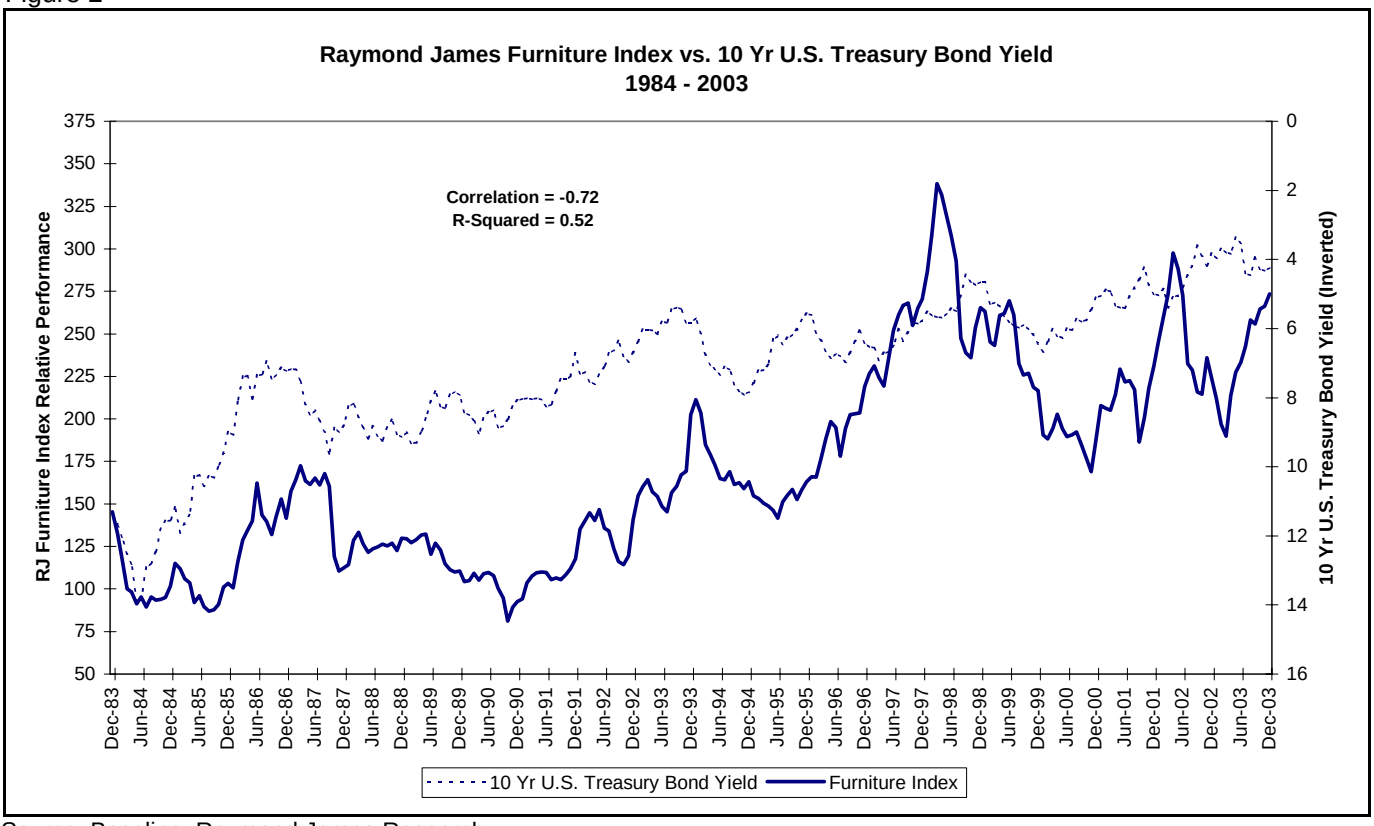
Figure 1



Source: Federal Reserve Bank of New York, Baseline, Raymond James Research.

Figure 2 provides a two-decade view of the index versus a longer-duration interest rate metric, the 10-year U.S. Treasury bond yield (again, axis inverted). For the major moves in rates, the index moves counter to the movement of rates. For our purposes, however, we will use the changes in Federal Reserve policy, as indicated by its words and deeds with respect to the Fed Funds target rate, as the barometer for change of recommendation regarding the attractiveness of the industry.

Figure 2



Source: Baseline, Raymond James Research.

Figure 3 examines median forward Price/Earnings ratios during changing interest rate environments. We note that we have used the median across 14 public equities to derive these data points, and this has had the effect of truncating some of the extremes that we occasionally see with individual issues (for a list of the stocks included in the Raymond James Furniture Manufacturers Index, please see the appendix at the end of this report). The conclusions, however, are unchanged:

1. The issues in this industry normally sell at a discount to the S&P 500 index as well as other broad averages.

2. That discount often widens and the absolute multiple declines when rates rise.

3. Valuation multiple troughs occur when and while rates are rising.

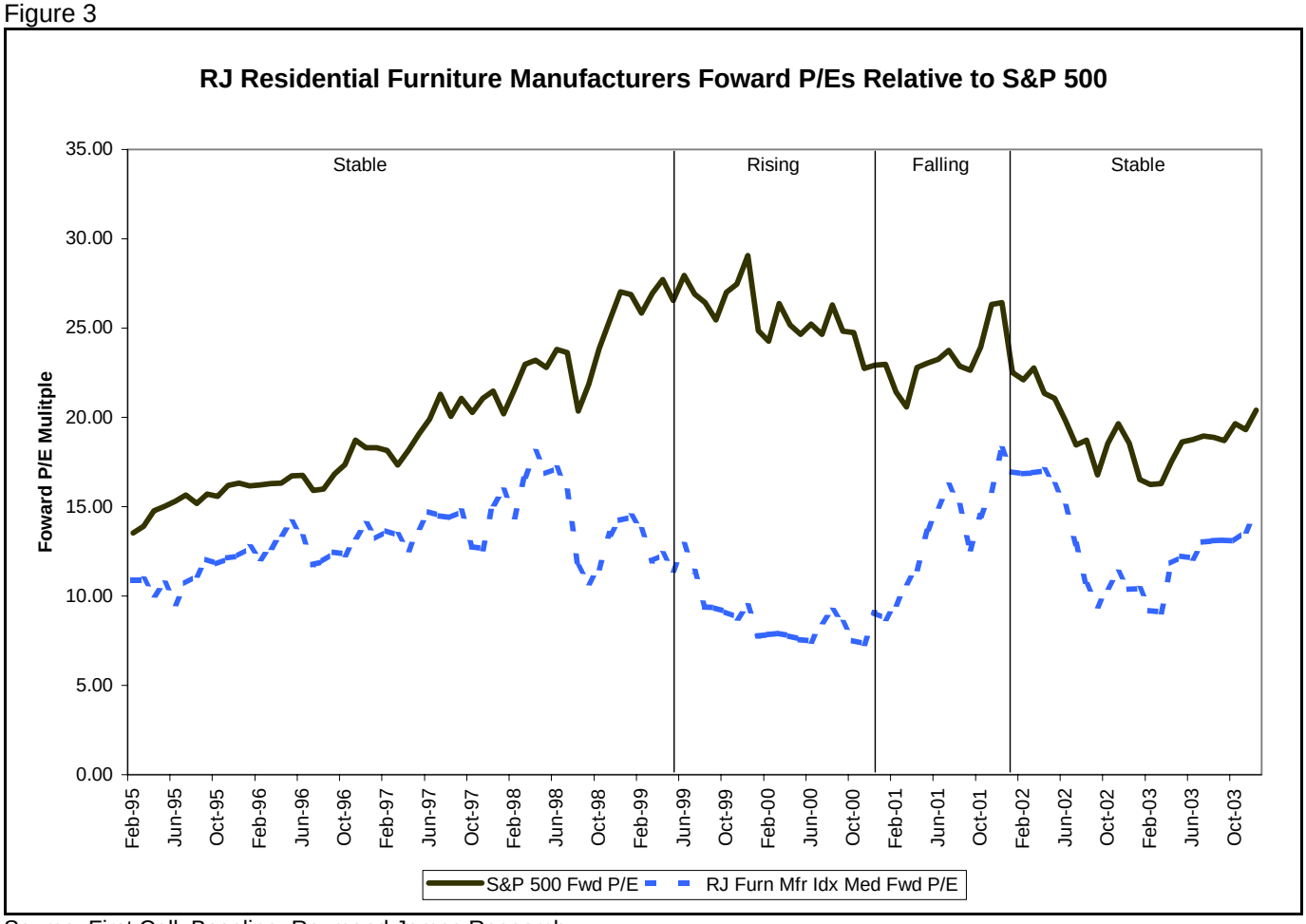
4. The discount tends to compress and the absolute multiple peaks when rates fall.

5. During relatively stable periods, the valuation multiple discount persists but the level rises and/or falls with periodic earnings events.

In the above chart covering almost nine years, the overall discount to the S&P 500 averaged 39%. In stable periods, the discount averaged 32%; in periods of rising rates, the discount averaged 66%; and in periods of falling rates, the discount averaged 43%.

In the attached appendices, we provide a similar valuation analysis for several individual manufacturers.

Figure 3

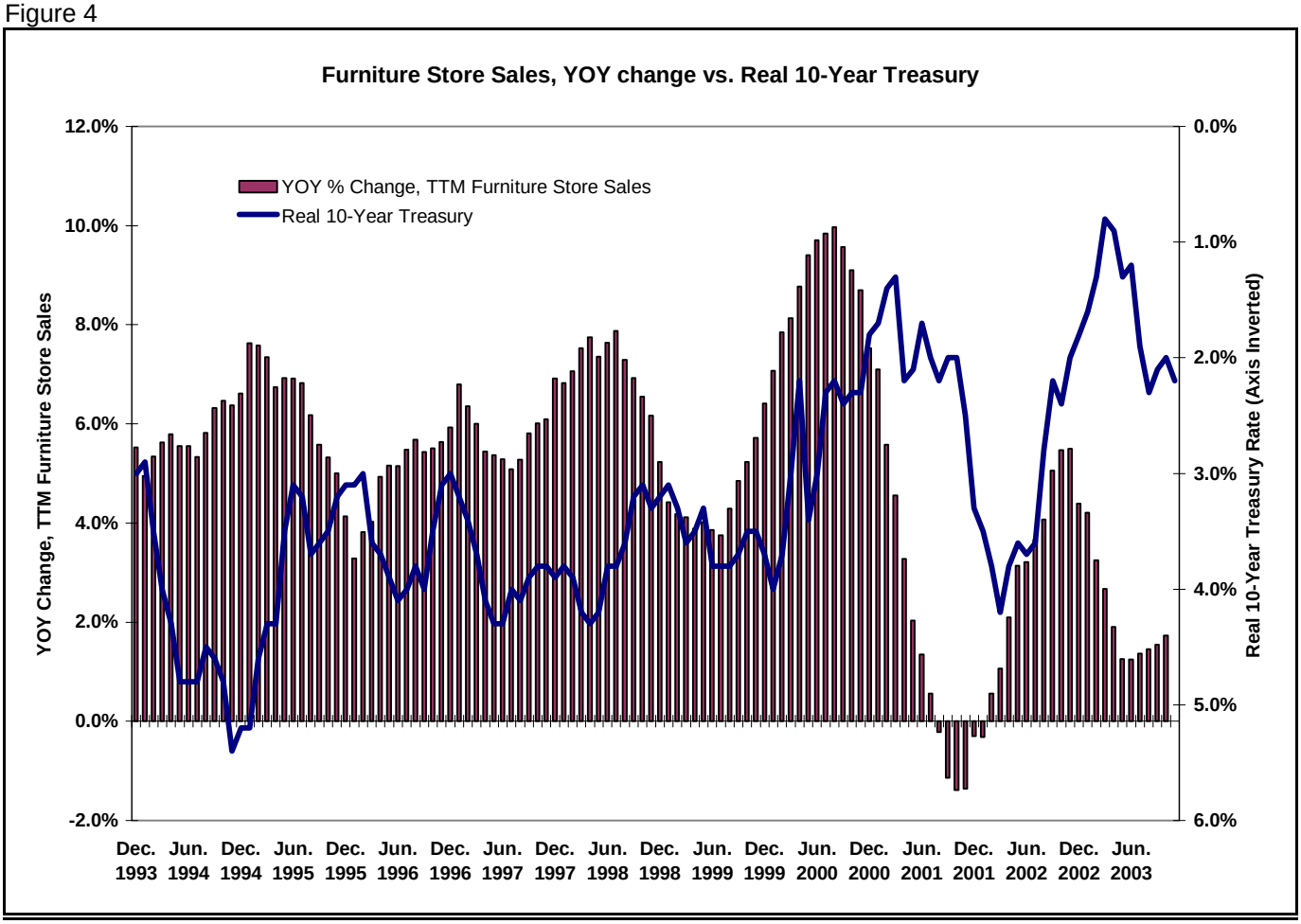


Source: First Call, Baseline, Raymond James Research.

Figure 4 switches attention to fundamentals and illustrates the movement of 10-year real treasury rates (adjusted for inflation premium) versus the smoothed year-over-year percentage change in furniture store sales. For this period, we were unable to demonstrate a statistically meaningful correlation between interest rates and furniture store sales.

Visually, we believe the reader should arrive at a similar conclusion. As before, the interest axis rate is inverted. The hypothesis is falling rates (rising in the chart) should naturally correspond with rising changes in retail demand for furniture, and vice versa. In fact, there are several periods including: (1) all of 1994, (2) February through June 1996, and (3) early 1998 when rising rates coincided with improving sales, exactly counter to the hypothesis. Then, in other intervals, most recently March 2002 to November 2002, falling rates coincided with rising sales. But then after November 2002, rates continued falling but sales comparisons reversed and fell as well. In any case, the lag seems wrong as sales began falling before rates advanced.

Figure 4



Source: Baseline, U.S. Census Bureau, Raymond James Research.

In short, there are significant periods when the fundamental performance and outlook of the companies become unhinged from the performance, market perception, and valuation of the shares.

Rules for Investing in Residential Furniture Manufacturer Stocks

This analysis leads, therefore, to the following rules for investing in residential furniture manufacturer stocks:

1. In periods of rising interest rates, avoid the stocks.

2. In periods of falling rates, buy and own the stocks.

3. In periods of stable rates, selectively buy the stocks when you believe the sales and earnings performance is likely to exceed consensus expectations, and sell and avoid the stocks when the reverse is true.

We note that selectivity is less important when rates are moving in one direction or the other. Another issue that investors have is to determine when interest rates will begin to shift direction. Although our preference is to use actual changes in policy by the Federal Reserve, a variety of investors attempt to "jump the gun" by watching Fed futures and other forward indicators. History shows that movements happen most often coincident with policy shifts, but as this behavior becomes better understood, the likelihood increases for earlier changes.

The Public Arena: Current Valuation Metrics

Table 2

Residential Furniture

As of: 02/24/04

			P/E						P/B		Other			
Name	**Symbol**	**Price**	**Cal 2003 A**	**Cal 2004 E**	**Cal 2005 E**	**Last 12 Mos**	**Next 12 Mos**	**NTM PE/EPS Grth**	**LT Grth Rate**	**Price to Book**	**Price to Tgbl Book**	**MEV / EBITDA**	**Price / Gross Cash Flow**	**Price / Net Cash Flow**	**Price / Trailing Sales**
Residential Furniture Manufacturers															
Bassett Furniture	BSET	$21.47	36.4	27.5	18.5	36.4	27.5	184%	15.0%	1.1	1.1	11.9	14.3	35.2	82%
Bush Industries	BSH	$2.54	NMF	50.8	NMF	NMF	NMF	NMF	11.0%	0.3	0.3	9.4	2.6	1.3	11%
Chromcraft Revington	CRC	$13.88	8.4	6.6	NMF	8.4	6.6	51%	13.0%	1.6	1.6	4.6	5.7	3.5	45%
Dorel Industries	DIIB	$32.98	14.3	10.1	9.1	15.4	11.1	74%	15.0%	2.5	31.5	10.3	11.4	9.7	99%
Ethan Allen Interiors	**ETH**	**$43.00**	**19.5**	**16.6**	**NMF**	**19.5**	**16.6**	**128%**	**13.0%**	**2.8**	**3.2**	**9.5**	**15.5**	**25.0**	**173%**
Flexsteel Industries	FLXS	$21.34	15.5	NMF	NMF	15.5	NMF	NMF	15.0%	1.4	1.4	7.6	10.1	2134.0	41%
Furniture Brands Int'l	**FBN**	**$31.80**	**18.9**	**12.5**	**10.6**	**18.9**	**12.5**	**83%**	**15.0%**	**1.9**	**3.0**	**9.5**	**12.4**	**28.4**	**75%**
Hooker Furniture	HOFT	$24.32	17.9	14.3	12.6	17.9	14.3	95%	15.0%	3.5	3.5	9.1	12.7	NMF	114%
La-Z-Boy	LZB	$22.38	18.2	15.1	NMF	18.2	15.1	126%	12.0%	2.0	2.6	9.1	12.4	17.2	60%
Natuzzi S.p.A.	NTZ	$10.65	NMF	NMF	NMF	10.2	NMF	NMF	NMF	1.0	1.0	5.8	7.8	42.6	69%
Rowe Furniture	ROW	$4.30	35.8	11.3	7.2	35.8	11.3	NMF	NMF	1.2	1.6	5.2	5.4	3.4	19%
Select Comfort	SCSS	$25.03	36.3	26.9	20.5	36.3	26.9	90%	30.0%	11.8	11.8	17.8	25.5	31.7	195%
Stanley Furniture	**STLY**	**$36.90**	**15.8**	**14.2**	**13.3**	**15.8**	**14.2**	**101%**	**14.0%**	**2.4**	**2.7**	**8.0**	**11.3**	**19.3**	**88%**
Resid. Furniture Mfrs Median			***18.2***	***14.3***	***12.6***	***18.0***	***14.2***	***95%***	***15.0%***	***1.9***	***2.6***	***9.1***	***11.4***	***22.2***	***75%***
Residential Furniture Retailers															
Haverty's	**HVT**	**$20.44**	**19.1**	**16.9**	**14.7**	**18.9**	**16.8**	**120%**	**14.0%**	**1.9**	**1.9**	**8.4**	**NMF**	**8.3**	**61%**
Bombay Company	**BBA**	**$7.03**	**26.0**	**20.7**	**NMF**	**20.1**	**23.4**	**69%**	**34.0%**	**1.4**	**1.4**	**8.0**	**8.9**	**16.0**	**43%**
Pier 1 Imports	**PIR**	**$22.66**	**17.0**	**16.3**	**NMF**	**17.0**	**16.2**	**108%**	**15.0%**	**3.0**	**3.0**	**7.9**	**12.2**	**34.9**	**110%**
Resid. Furniture Retailers Median			***19.1***	***16.9***	***14.7***	***18.9***	***16.8***	***108%***	***15.0%***	***1.9***	***1.9***	***8.0***	***10.6***	***16.0***	***61%***
Furnishings Suppliers															
Culp	**CFI**	**$11.38**	**15.8**	**12.1**	**NMF**	**15.8**	**12.1**	**151%**	**8.0%**	**1.3**	**1.5**	**5.3**	**5.8**	**5.4**	**41%**
Leggett & Platt	**LEG**	**$24.43**	**23.3**	**18.1**	**14.0**	**23.3**	**18.1**	**129%**	**14.0%**	**2.3**	**4.4**	**10.0**	**12.8**	**19.9**	**107%**
Quaker Fabric	QFAB	$8.34	19.4	14.9	11.3	19.4	14.9	99%	15.0%	0.8	0.9	5.7	5.6	NMF	43%
Resid. Furniture Suppliers Median			***19.4***	***14.9***	***12.6***	***19.4***	***14.9***	***129%***	***14.0%***	***1.3***	***1.5***	***5.7***	***5.8***	***12.6***	***43%***

Source: Baseline.

Table 2 reviews a variety of valuation metrics for 19 of the 20 public equities in the residential furniture arena. Tempur-Pedic was a December 2003 IPO, and we have excluded it from the comparison for now. As in Table 1, we separated this list into manufacturers, retailers, and suppliers. Those names in bold face type are issues under Raymond James research coverage.

Industry Size and Growth Rate

The End Market: The Retail Furniture Landscape

We begin the discussion of industry fundamentals by examining the end consumer market. The U.S. Census Bureau provides the most readily available and consistent data on a monthly basis in its North American Industrial Classification System (NAICS). Class 4421 pertains to furniture stores. First appearing in 1997, this classification system replaced the prior SIC series (code 5712). To provide continuity, the Bureau – as best as it could – translated five years of SIC data into the NAICS classification. Prior to that, however, the series are not compatible.

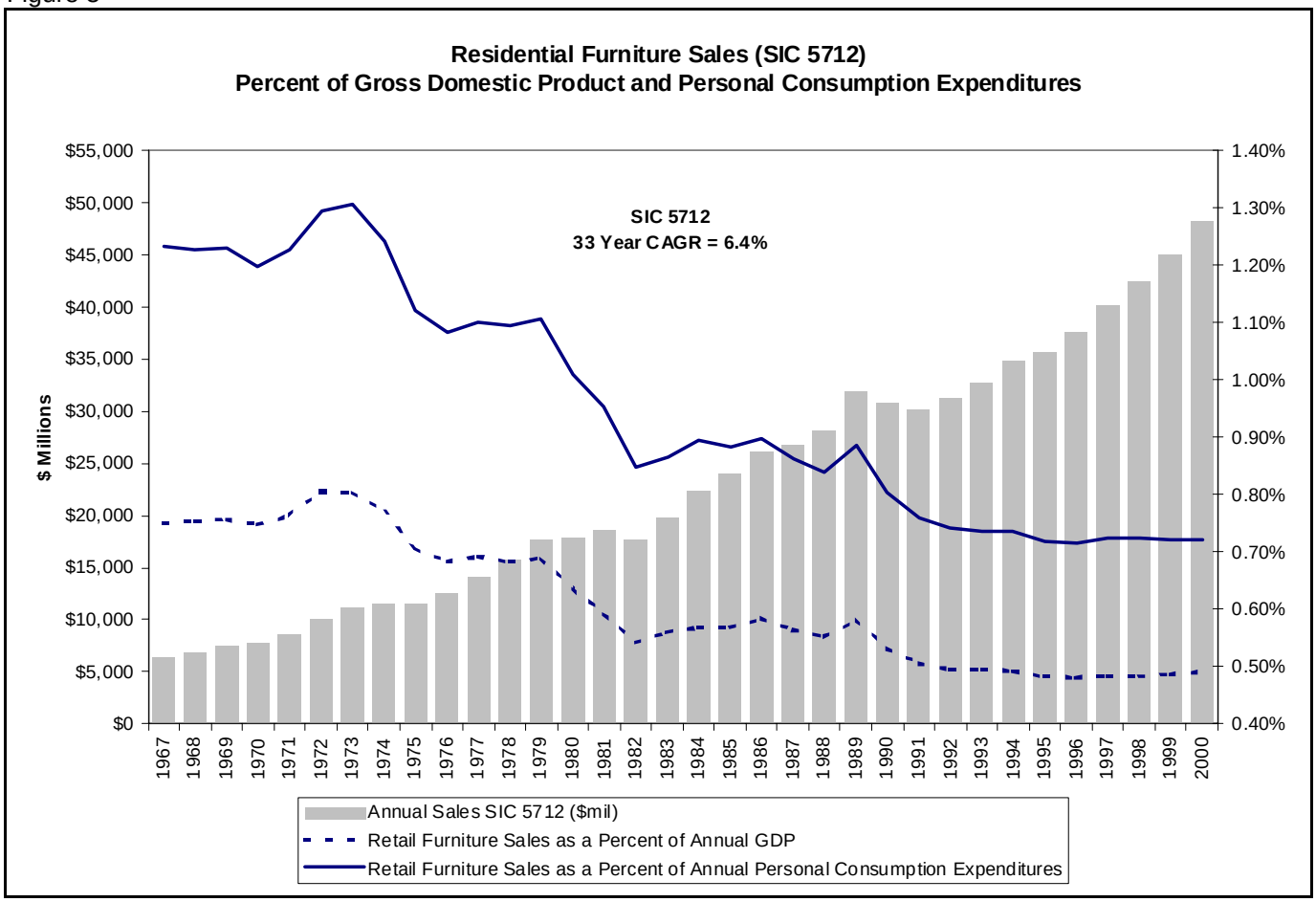
We rely on NAICS 4421 and SIC 5712 for most of our discussion, though we will also refer to additional trade press data to add some clarity about the channels that sell residential furniture. The Bureau ceased reporting SIC data at the end of 2000.

The U.S. residential furniture market is mature and grows at a sub-GDP growth rate.

The U.S. residential furniture market is mature and grows at a sub-GDP growth rate. According to SIC data, retail furniture store sales increased from $6.2 billion in 1967 to $48.2 billion in 2000, equating to an average annual growth rate of approximately 6.4%. Over the same period, U.S. gross domestic product increased nominally from $834 billion to $9.8 trillion, representing a 7.8% average annual growth rate.

As a result, retail furniture consumption, defined relative to annual GDP or aggregate annual personal consumption expenditures declined significantly since 1967, as illustrated in Figure 5. Importantly, however, retail furniture store sales relative to these measures stabilized from 1995 through 2000.

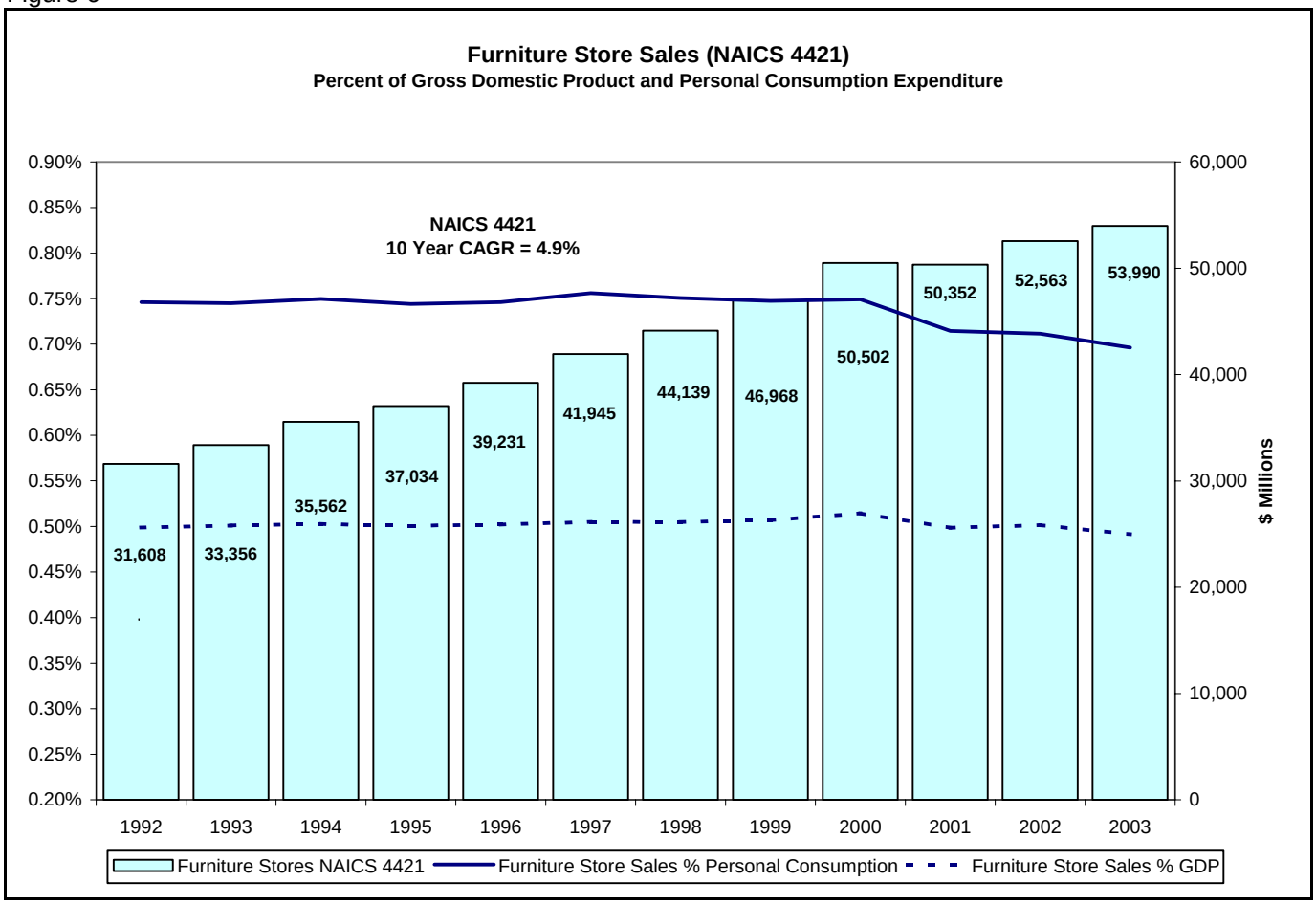
Figure 5



Source: U.S. Census Bureau, Bureau of Economic Analysis, Raymond James Research

Figure 6 portrays a similar graphic for the NAICS data. The trends, though shorter in duration, are roughly equivalent between the two series. Specifically, as seen in Figure 6, retail furniture store sales as a percent of total GDP and as a percent of Personal Consumption Expenditures remained flat from 1992 through 2000 before declining modestly since. We suspect that the decline is, in part, due to the deflationary impact of surging furniture imports.

Figure 6



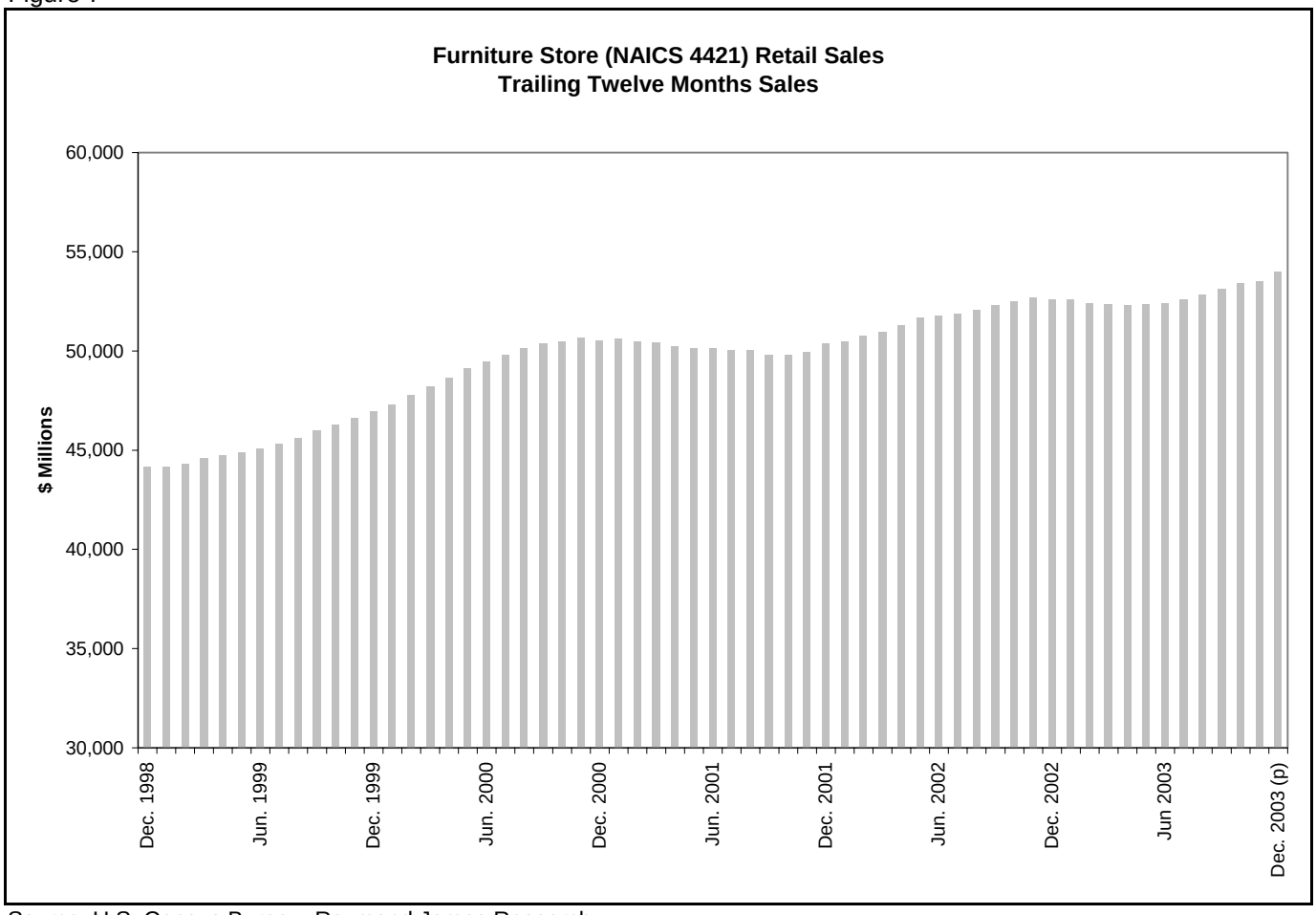
Source: U.S. Census Bureau, Bureau of Economic Analysis, Raymond James Research

One note given the discrepancy between the compound annual growth rate calculations for the SIC data and the NAICS data might be appropriate. In the 33-year period between 1967 and 2000 covered by the SIC 5712 data, retail furniture store sales grew approximately 6.4% a year on average. In the 10-year period between 1993 and 2003 covered by the NAICS data, retail furniture store sales grew about 4.9% a year, which is about 25% lower than the growth rate calculated using the SIC data. We do not have unit data, but suspect that the recent decline in growth rate again reflects, at least in part, the deflationary impact of rising imports.

History shows that the industry grows at about 5% per year, with a range of flat on the downside and 10% on the upside.

Figure 7 illustrates the retail sales data for furniture stores on a trailing 12-month basis. As shown, there has been fairly steady growth over the past several years, with two downturns during 2001 and during the first half of 2003. Examining our NAICS series data for furniture stores, which goes back roughly 10 years, we have found that the year-over-year growth rate in trailing 12-month sales has averaged 5.0%, with a standard deviation of 2.5%. Using a range of two standard deviations to frame the most likely minimum and maximum, we suggest that trailing 12-month retail furniture store sales would at worst, be flat, and at best, grow at 10% year-over-year. Obviously, greater volatility can occur for individual monthly sales comparisons. We address that monthly volatility later in this report.

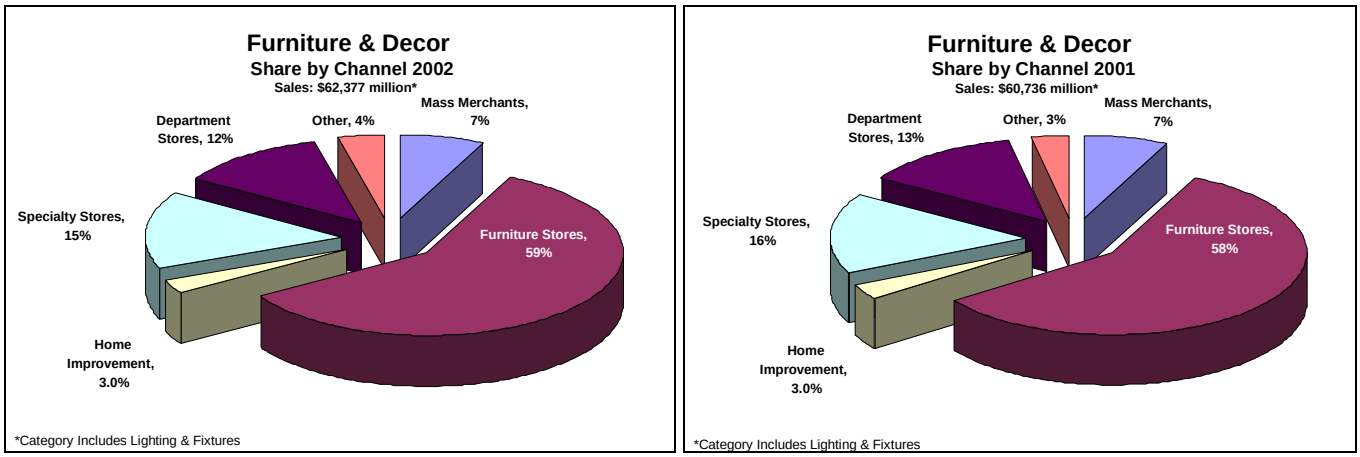
Figure 7



Source: U.S. Census Bureau, Raymond James Research.

Finally, in looking at the size of the end market for furniture, we note the following data points from two trade press sources. Figure 8 estimates sales by type of store and sizes the end market for furniture at the end of 2002 at $62.4 billion, with furniture stores accounting for $36.8 billion of furniture sales. Subtracting this total from that reported in the NAICS series implies that furniture stores sell nearly $16 billion, or 30% of total sales, of non-furniture merchandise, which seems too high.

Figure 8



Source: Home Furnishings News, Raymond James Research.

Table 3 comes from the other major weekly industry trade publication and estimates the retail market by major merchandise classification. It sizes the market, as of 2002, at about $67 billion, including the sales of bedding (primarily mattresses and box springs).

Ideally, to reconcile the NAICS data with these additional data points, we would like to know what percentage of the NAICS reported furniture store sales were non-furniture items like accessories, pictures, lamps, etc. Then, we could apply the channel percentage to arrive at a retail estimate for residential furniture.

Unfortunately, that ideal is not available; but more to the point, is not critical for our purposes. What we can take away from the available data is a general size of the end market — $63-67 billion — and, even more importantly, a reasonably accurate picture of current demand trends by monitoring the monthly NAICS data.

Table 3

Furniture Market at Retail, 2002
(Amounts in Billions)

	Market Size at Retail				
	2001	% of Total	2002	% of Total	01/02 % Chg
Total Upholstery	$21.4	33.5%	$21.8	32.7%	1.7%
Stationary Upholstery	14.3	*22.3%*	14.3	*21.4%*	0.0%
Motion Upholstery	2.3	*3.6%*	2.4	*3.6%*	4.3%
Motion Chairs	4.8	*7.5%*	5.1	*7.6%*	6.3%
Bedding	8.5	13.3%	8.8	13.2%	3.5%
Adult Bedroom	7.2	11.2%	7.8	11.7%	8.3%
Infant Bedroom	1.0	1.6%	1.1	1.6%	10.0%
Youth Bedroom	2.9	4.5%	3.3	4.9%	13.8%
Formal Dining	4.1	6.4%	4.5	6.7%	9.8%
Casual Dining	3.9	6.1%	4.1	6.1%	5.1%
Occasional	6.1	9.5%	6.0	9.0%	-1.6%
Home Office	3.1	4.8%	2.9	4.3%	-6.5%
Entertainment	2.8	4.4%	3.1	4.6%	10.7%
Outdoor/Other*	3.0	4.7%	3.3	4.9%	10.0%
Totals	$64.0		$66.7		4.2%

*Estimated

Source: Furniture Today, Raymond James Research

Two final observations seem warranted from these data points. First is the fact that about 40% of residential furniture is purchased in stores and/or venues outside of furniture stores, including mass merchants, department stores and other specialty stores. Wal-Mart, by virtue of its size and reach, has been anointed as the largest furniture retailer despite the fact that the classification is not a key focus. It sells ready-to-assemble (RTA) merchandise in its discount stores and Supercenters, some selected upholstered product and other items in its Supercenters, and other selected items in its Sam's Club operation.

That said, Wal-Mart seems unlikely to enter the segment of the market that requires significant consumer touch and/or in-home delivery and service. Irrespective, manufacturers need to craft marketing strategies that can maximize reach to all channels while minimizing or eliminating channel conflict and/or market erosion from sales through channels that these manufacturers may not wish to serve.

Secondly, Table 3 separates the industry by function and use of the product. The major functions in American homes include sleeping, eating, entertaining, relaxing and, more recently, working from home. Table 3 demonstrates that the industry is really a composite of smaller niche segments. In the table, we list 13 distinct types of furniture; in reality, retailers and manufacturers will parse consumer needs and wants into even more categories.

Living Room and Den Room sales normally account for about one-half of revenues

For most retailers, living room and den room sales normally account for about one-half of their revenues. Upholstery sales typically represent about one-third of purchases, with other categories that often go into living rooms and den rooms (occasional, home entertainment, and home office) representing the balance.

The bedroom represents the next largest classification (bedding, adult bedroom, youth bedroom, and infant bedroom), with more than 30% of the market spent to furnish these rooms. The youth bedroom market, though the fastest growing sub-segment in the list, represents slightly more than a $3 billion retail market now.

Finally, dining rooms (formal dining and casual dining) account for between 12-13% of furniture spending. Interestingly, formal dining, a sub-segment that had been widely agreed to be in decline in the latter part of the 1990s, grew markedly in 2002, perhaps due to the fact that the capabilities of Asian manufacturers are well suited to the carvings and fancy faces that make that product more attractive to consumers.

An interesting and sometimes difficult concept for investors and observers to grasp, however, is that manufacturers cannot simply travel from one niche to another. Experienced retailers know and understand the capabilities of their potential suppliers and only infrequently do they experiment outside of those capabilities. Beyond classification type, manufacturers are further limited first by price-point capability and, sometimes, by styling capabilities.

The importance of this fact to professional investors is the reality that the industry is a combination of smaller niche industries that do not offer benefits of increased scale. For example, the distribution platform and manufacturing skill set that makes one manufacturer the largest and/or lowest cost maker of youth bedroom do not translate necessarily into the entrée and skills needed to become an efficient maker of adult bedroom, formal dining room, casual dining room, or any type of upholstery product.

To wit, retailers that are loyal to that youth bedroom producer, however, will not automatically proffer the same feeling when and if that maker decides to begin manufacturing upholstery. This has significant strategic implications for publicly owned furniture manufacturers that aim to continually grow and increase shareholder value. At the same time, scale is necessary for public players to attract and retain shareholders. Strategies must be well crafted to those niches where they can add value, develop and maintain competitive advantages, and develop scale. We address some of these issues later in this report.

Drivers of Demand

Conceptually, residential furniture demand is driven by several macro-economic factors: (1) consumer incomes, (2) housing activity, (3) consumer feelings about their situation and/or prospects, and (4) by the consumer's willingness to borrow to make a big-ticket purchase.

Consumer incomes underpin the ability of buyers to purchase furniture. Housing activity provides another key indicator of future furniture demand. In our past experience, existing home sales provided the best indicator as with these sales, households have typically sold an appreciating asset against a depreciating mortgage liability, applying some of proceeds to a new mortgage but using another portion to improve and/or furnish their new homes. Recently, total housing transaction growth has slowed somewhat from its vibrant levels, but the overall level of housing turnover is still high relative to history, and there exists some measure of pent-up demand as furniture sales have typically lagged housing turnover by between 12-18 months.

Consumer confidence and expectations measure how consumers feel about their present circumstances and future expectations. Changes in confidence and expectations correlate well with changes in furniture demand. As such, the purchases are often postponable when the circumstances and/or expectations change.

Major furniture purchases are big-ticket purchases and consumers often shop for extended times before committing to the purchase. Since the size of the commitment often exceeds immediately available resources, many purchasers assume debt to execute the purchase.

Beginning in the mid-1960s when researching several college papers and then at various times since, we have examined various data series through linear regression analyses to better understand what drives residential furniture demand. In those intervening decades, several new data series have become available and, as we described earlier, the metric for furniture sales changed with the creation of the NAICS series. For this report, we refreshed this analysis using the most recent data available.

In Table 4, we present the structure and results of our analysis, when we last conducted the study several years ago.

Table 4

Least Squares Regression, #1
Monthly Furniture Store Sales

Dependent Variable: LOG(N4421)
Method: Least Squares
Date: 02/08/04 Time: 09:12
Sample(adjusted): 1992:08 2003:10
Included observations: 135 after adjusting endpoints
Convergence achieved after 6 iterations

Variable	Coefficient	Std. Error	t-Statistic	Prob.
LOG(CC)	0.124670	0.038789	3.214011	0.0017
LOG(EHS(-4))	0.090047	0.026054	3.456177	0.0007
LOG(PISA(-6))	0.788066	0.030671	25.69387	0.0000
LOG(FF)	-0.027091	0.018590	-1.457324	0.1474
AR(1)	0.084193	0.088201	0.954555	0.3416

R-squared	0.910300	Mean dependent var	8.180415
Adjusted R-squared	0.907540	S.D. dependent var	0.175623
S.E. of regression	0.053402	Akaike info criterion	-2.985594
Sum squared resid	0.370734	Schwarz criterion	-2.877992
Log likelihood	206.5276	Durbin-Watson stat	1.965461

Inverted AR Roots .08

Source: Raymond James Research.

This result demonstrates that more than 90% of the change in sales of furniture stores is explained by the equation depicted in this analysis. In the past, however, each of the four independent variables proved to be statistically significant. In this analysis, we note that the Federal Funds rate "t-statistic" dropped below 2.0, which suggests it is not statistically significant in improving this equation. Our hypothesis is that the widespread success and use of no interest/no down payment/no payment finance promotions is, in fact, visible with this result and diminishes the impact of this variable.

In Table 5, we updated the regression analysis, using some series that have become more widely available since we started these studies. This structure eliminates the Fed Funds variable, incorporates total housing transactions and consumer expectations. It improves the explanatory characteristics modestly and each of the variables tested are statistically significant.

Table 5

Least Squares Regression, #2
Monthly Furniture Store Sales

Dependent Variable: LOG(N4421)
Method: Least Squares
Date: 02/08/04 Time: 09:22
Sample(adjusted): 1992:08 2003:10
Included observations: 135 after adjusting endpoints
Convergence achieved after 8 iterations

Variable	Coefficient	Std. Error	t-Statistic	Prob.
LOG(CCE)	0.137127	0.032914	4.166268	0.0001
LOG(THT(-3))	0.120605	0.029151	4.137296	0.0001
LOG(PISA(-6))	0.770010	0.027798	27.69998	0.0000
AR(1)	0.113530	0.087061	1.304027	0.1945

R-squared	0.912712	Mean dependent var	8.180415
Adjusted R-squared	0.910714	S.D. dependent var	0.175623
S.E. of regression	0.052478	Akaike info criterion	-3.027674
Sum squared resid	0.360763	Schwarz criterion	-2.941592
Log likelihood	208.3680	Durbin-Watson stat	1.943983

Inverted AR Roots .11

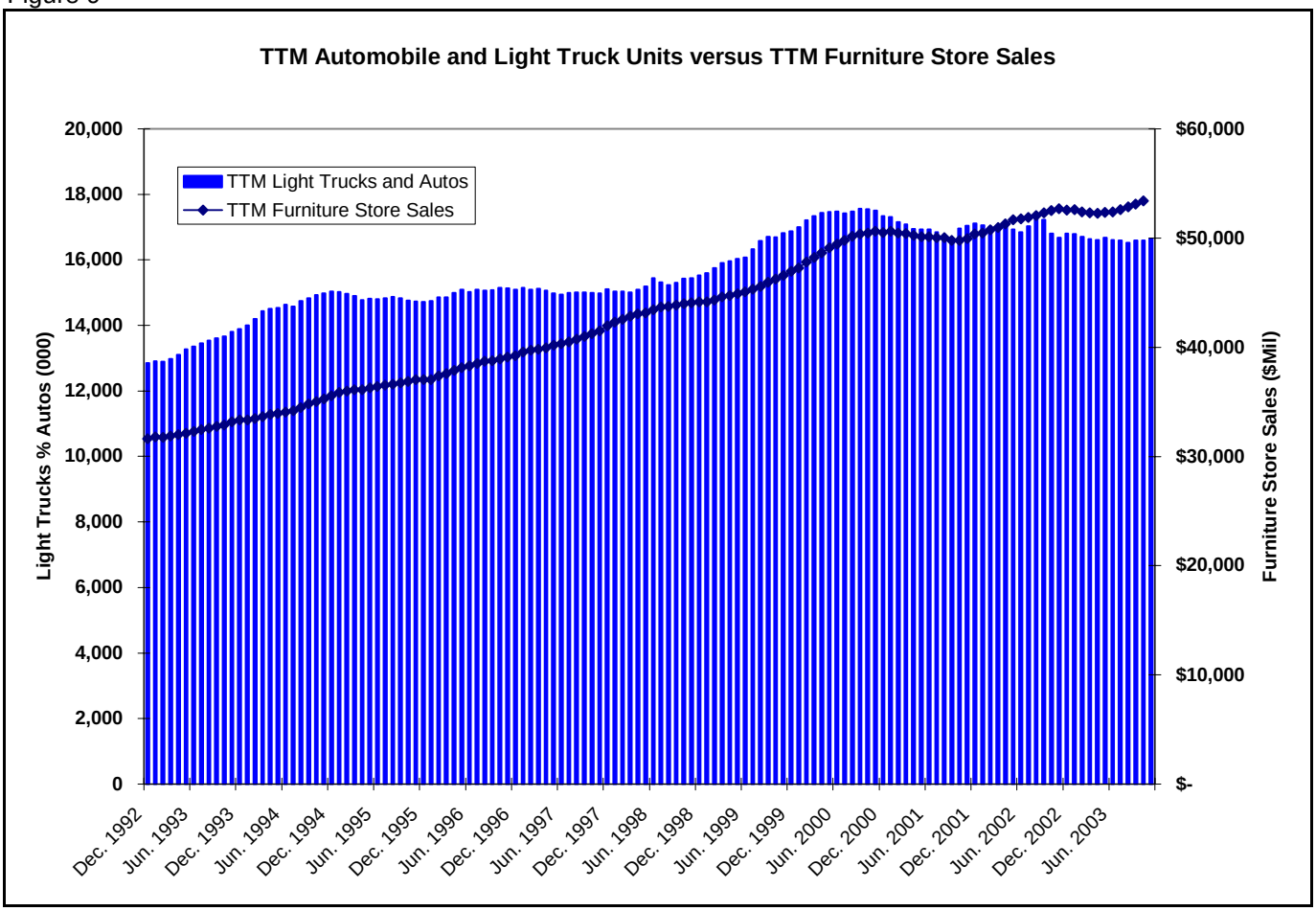
Source: Raymond James Research.

As elegant as these equations appear to be in explaining the drivers of demand, they are not practically useful because of our inability to accurately predict the independent variables.

One last observation about the drivers of demand may be useful. Earlier, we noted that the furniture purchases are often postponable when circumstances change. Figures 9 and 10, which juxtapose light truck and auto unit sales versus furniture store sales, help to make that point.

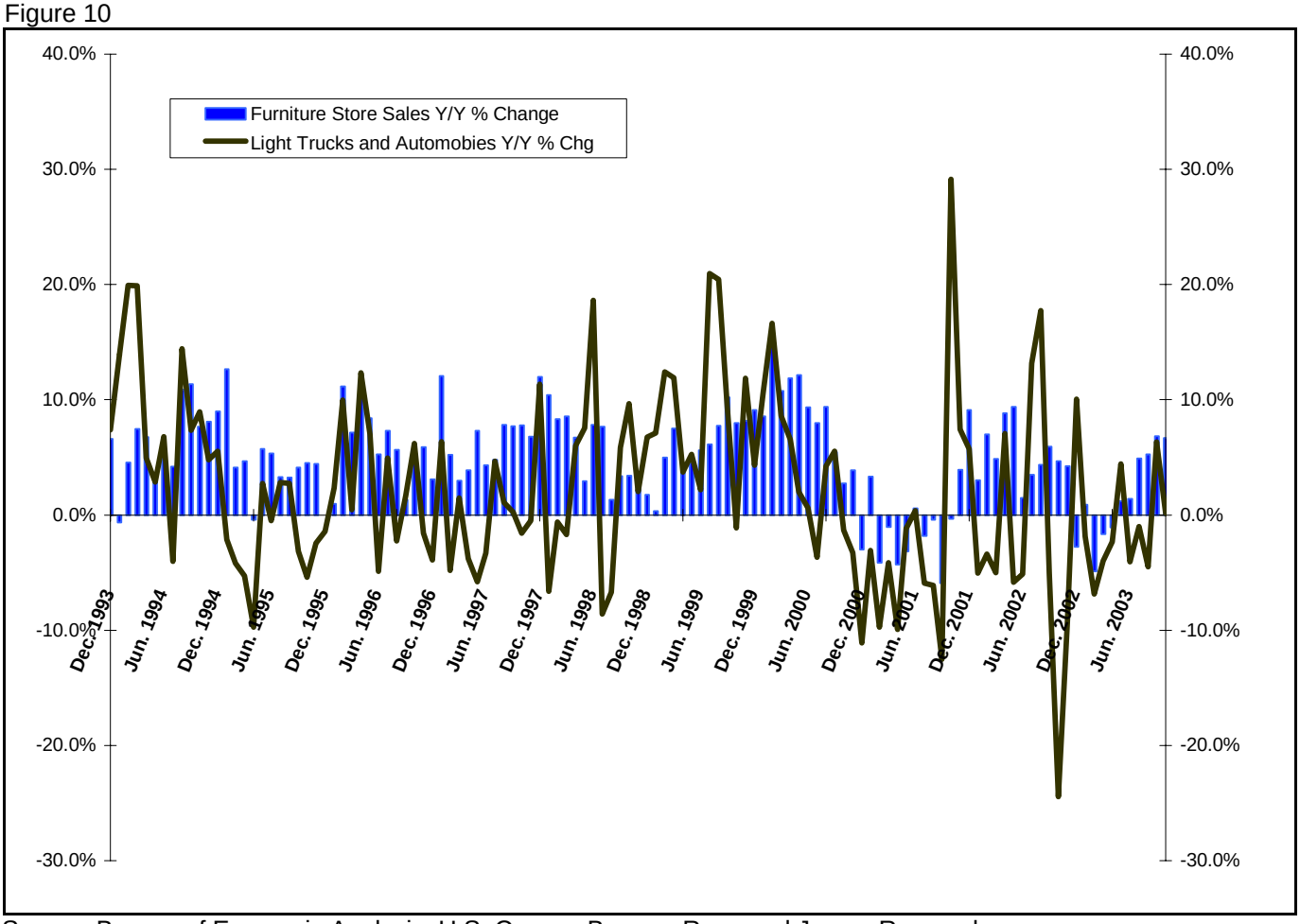
A rational hypothesis would be that both types of purchases would naturally respond to similar economic drivers and in general, they seem to be in sync. On occasion, however, when the slope of the auto line either accelerates or moderates, it seems evident that furniture store sales moderate or accelerate simultaneously. Long-time observers and participants in the furniture industry often comment that heavy automotive promotional activity seems to impact near-term sales of furniture.

Figure 9



Source: Bureau of Economic Analysis, U.S. Census Bureau, Raymond James Research.

Figure 10

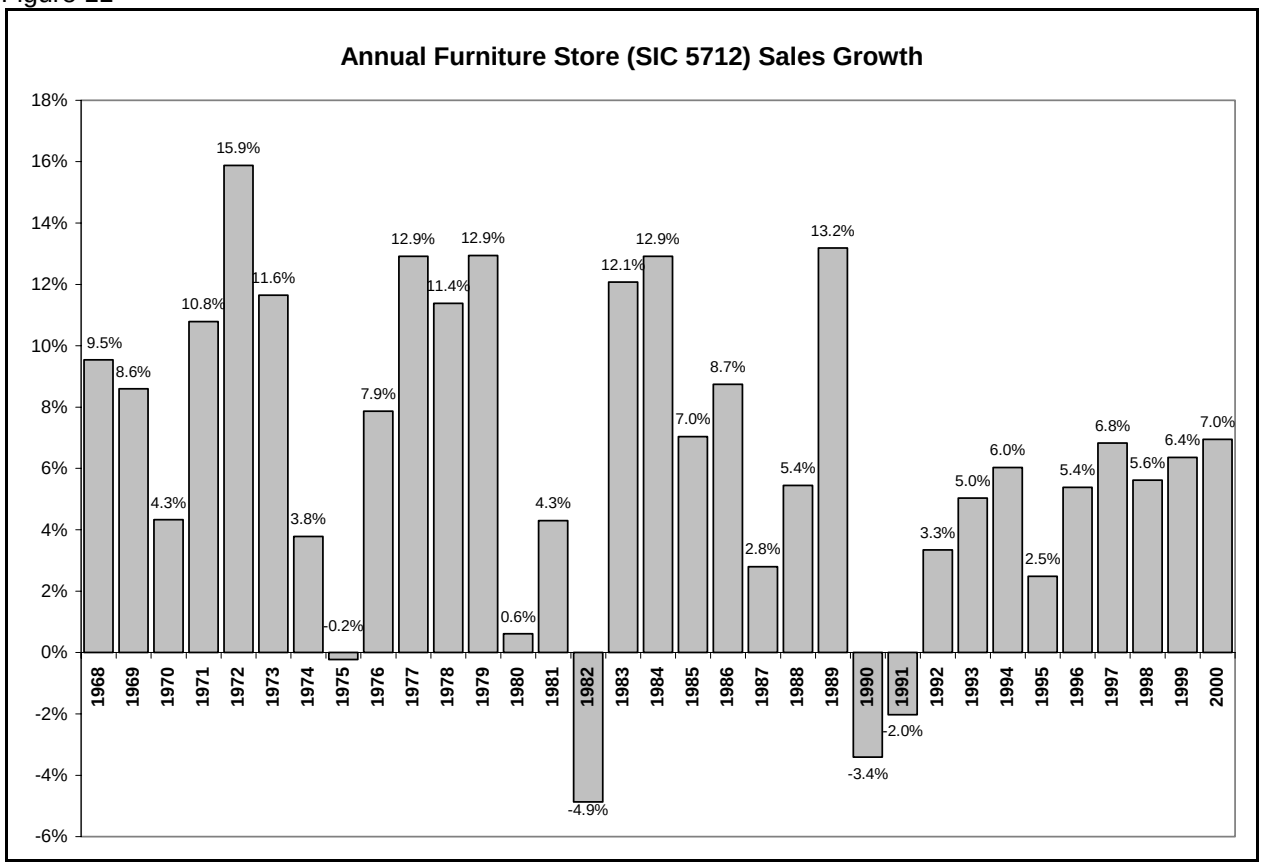


Source: Bureau of Economic Analysis, U.S. Census Bureau, Raymond James Research

Variability of Demand

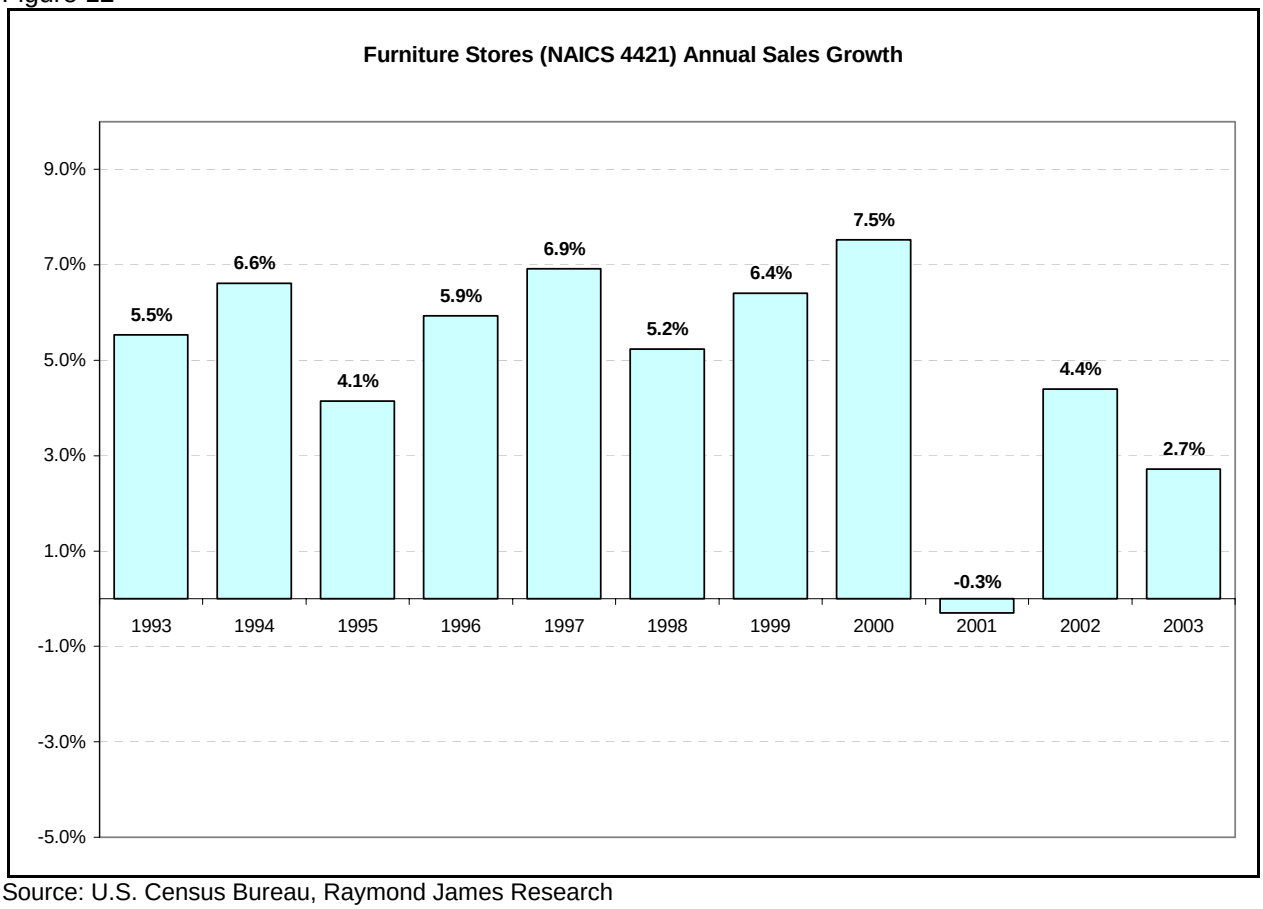
Figures 11 and 12 illustrate the variability in year-over-year sales growth for retail furniture store sales based on the SIC 5712 and NAICS 4421 data respectively.

Figure 11



Source: U.S. Census Bureau, Raymond James Research.

Figure 12



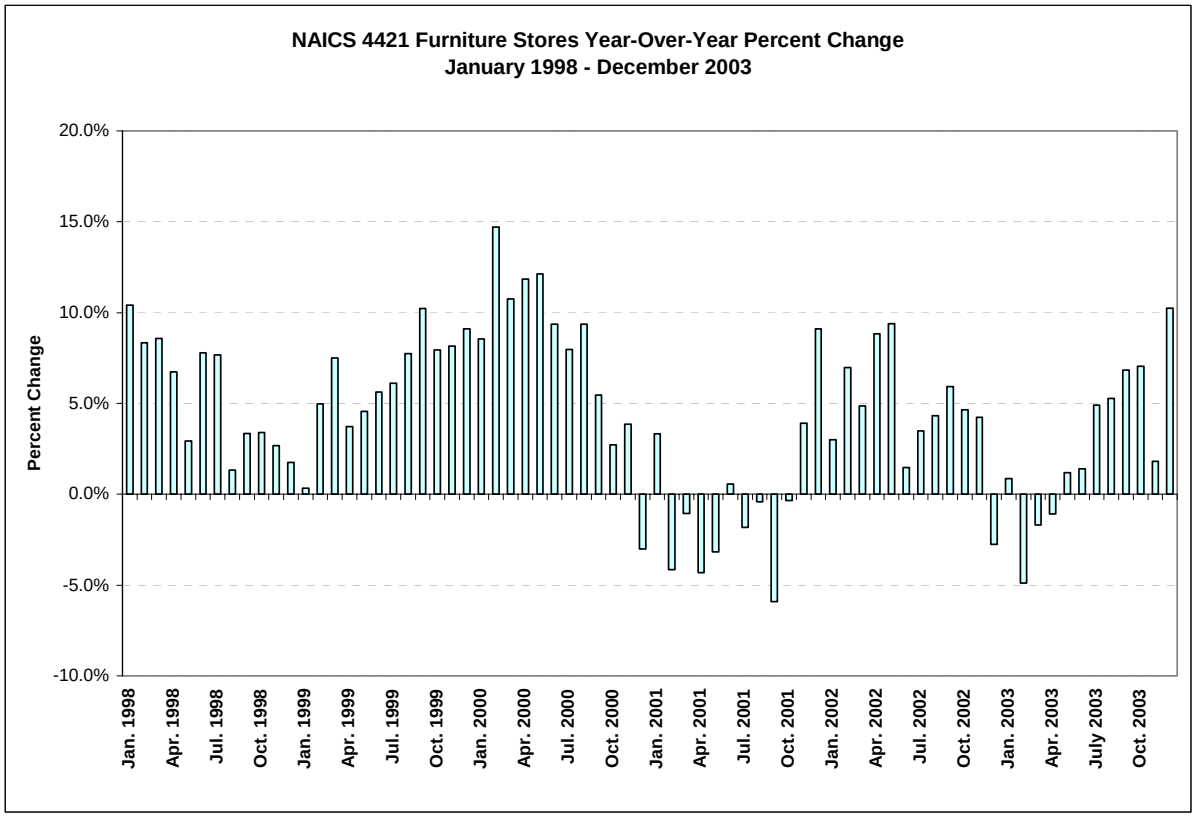
Source: U.S. Census Bureau, Raymond James Research

Figure 13 illustrates the variability of monthly sales on a year-over-year basis between March 2000 and March 2003. Beginning in mid-2000, the rate of growth in retail furniture store sales rapidly decelerated, eventually turning negative for the entire industry for the first time in December 2000 when the high-end of the industry began to see the same sort of slowdown first reported in the mid-priced segments of the industry in mid-2000. By November 2001, total retail sales began posting positive year-over-year comparisons again due to renewed strength in the mid-priced segment of the industry.

While total retail sales remained quite strong through the end of 2002, this apparent strength actually masked a deep disparity in results between mid-priced furniture sales, which remained very strong, and high-end furniture sales, which remained soft. As seen in Figure 13, aggregate industry sales again turned negative by the end of 2002 as sales of mid-priced furniture slowed while higher-end furniture sales remained weak.

Earlier we addressed the year-over-year volatility, making the point that the average annual growth rate was about 5% and that the range of extremes – using two standard deviations – was from flat to about 10%. Of course, this assumes a normal distribution Figure 13 shows the volatility for monthly sales, with the extremes of 15% on the upside and about 6% on the downside.

Figure 13



Source: U.S. Census Bureau, Raymond James Research.

Figure 14 highlights the periods of extended downturn in retail furniture sales discussed above. As seen, there have been six distinct episodes of prolonged sales decline (defined by at least six consecutive months of declines) between 1968 and 2002, ranging between six months in duration to as many as 18 months in length. The mean duration of these downturns was almost 10 months, while the median was eight months.

Figure 14

Historical Year-Over-Year Change in Monthly Retail Sales (SIC 5712) Extended Slumps Highlighted

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Annual Change
1968	7%	11%	10%	9%	11%	8%	12%	11%	6%	13%	12%	6%	9.5%
1969	11%	10%	13%	11%	10%	12%	9%	3%	9%	6%	2%	10%	8.6%
1970	12%	5%	2%	6%	3%	3%	4%	6%	0%	4%	6%	2%	4.3%
1971	4%	6%	13%	6%	4%	8%	12%	12%	13%	13%	18%	18%	10.8%
1972	19%	24%	21%	20%	22%	20%	12%	17%	14%	12%	12%	5%	15.9%
1973	14%	13%	12%	15%	15%	9%	14%	11%	10%	10%	8%	9%	11.6%
1974	4%	1%	4%	5%	5%	2%	7%	7%	6%	5%	2%	-1%	3.8%
1975	1%	1%	-4%	-1%	-2%	0%	-2%	-5%	-3%	2%	2%	9%	-0.2%
1976	8%	11%	13%	11%	2%	4%	5%	6%	9%	3%	10%	12%	7.9%
1977	5%	8%	15%	12%	17%	18%	16%	19%	14%	13%	13%	6%	12.9%
1978	5%	7%	4%	11%	15%	13%	10%	14%	14%	15%	16%	12%	11.4%
1979	23%	18%	19%	6%	8%	14%	17%	16%	10%	14%	9%	6%	12.9%
1980	11%	10%	-1%	1%	0%	-10%	-3%	-6%	1%	1%	4%	5%	0.6%
1981	6%	2%	9%	14%	11%	20%	6%	3%	3%	-4%	-9%	-3%	4.3%
1982	-14%	-10%	-7%	-7%	-8%	-9%	-5%	-7%	-4%	0%	6%	6%	-4.9%
1983	10%	6%	11%	9%	9%	8%	8%	21%	16%	15%	15%	14%	12.1%
1984	16%	20%	13%	12%	15%	16%	12%	9%	11%	13%	11%	9%	12.9%
1985	7%	6%	6%	6%	9%	4%	8%	9%	6%	6%	8%	9%	7.0%
1986	12%	6%	6%	8%	8%	9%	12%	9%	14%	10%	4%	8%	8.7%
1987	5%	10%	12%	10%	4%	5%	3%	-2%	-1%	-1%	-3%	-4%	2.8%
1988	-1%	4%	4%	4%	1%	4%	2%	2%	4%	6%	15%	18%	5.4%
1989	21%	12%	10%	14%	17%	15%	15%	20%	15%	10%	11%	2%	13.2%
1990	7%	6%	7%	-1%	-2%	-4%	-8%	-8%	-7%	-5%	-10%	-11%	-3.4%
1991	-16%	-7%	-8%	-1%	-1%	-4%	5%	-1%	0%	3%	4%	4%	-2.0%
1992	7%	7%	1%	-1%	-1%	3%	3%	3%	5%	2%	2%	10%	3.3%
1993	7%	-1%	4%	3%	5%	5%	6%	4%	5%	5%	10%	7%	5.0%
1994	-2%	4%	8%	7%	3%	5%	4%	11%	10%	7%	7%	8%	6.0%
1995	11%	3%	2%	-2%	4%	3%	2%	2%	3%	3%	3%	-1%	2.5%
1996	1%	10%	8%	11%	8%	4%	6%	6%	0%	5%	6%	2%	5.4%
1997	11%	4%	3%	3%	8%	5%	5%	8%	7%	8%	7%	12%	6.8%
1998	10%	10%	8%	7%	3%	8%	8%	1%	4%	4%	3%	2%	5.6%
1999	1%	5%	8%	4%	4%	6%	6%	7%	10%	8%	8%	9%	6.4%
2000	8%	14%	10%	12%	11%	8%	7%	9%	5%	2%	4%	-4%	7.0%
average	7.0%	7.2%	7.1%	6.7%	6.6%	6.5%	6.6%	6.5%	6.4%	6.3%	6.5%	5.9%	6.5%

Historical Year-Over-Year Change in Monthly Retail Sales (NAICS 4421) Extended Slumps Highlighted

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Annual Change
1993	7%	-1%	4%	5%	6%	5%	7%	5%	5%	6%	9%	7%	5.5%
1994	-1%	5%	7%	7%	3%	5%	4%	11%	11%	8%	8%	9%	6.6%
1995	13%	4%	5%	0%	6%	5%	3%	3%	4%	5%	4%	0%	4.1%
1996	1%	11%	7%	11%	8%	5%	7%	6%	1%	5%	6%	3%	5.9%
1997	12%	5%	3%	4%	7%	4%	5%	8%	8%	8%	7%	12%	6.9%
1998	10%	8%	9%	7%	3%	8%	8%	1%	3%	3%	3%	2%	5.2%
1999	0%	5%	8%	4%	5%	6%	6%	8%	10%	8%	8%	9%	6.4%
2000	9%	15%	11%	12%	12%	9%	8%	9%	5%	3%	4%	-3%	7.5%
2001	3%	-4%	-1%	-4%	-3%	1%	-2%	0%	-6%	0%	4%	9%	-0.3%
2002	3%	7%	5%	9%	9%	1%	3%	4%	6%	5%	4%	-3%	4.4%
2003	1%	-5%	-2%	-1%	1%	1%	5%	5%	7%	7%	2%	10%	2.7%
average	5.3%	4.6%	5.0%	4.7%	5.3%	4.7%	5.0%	5.5%	5.1%	5.1%	5.4%	5.0%	5.0%

Source: U.S. Census Bureau, Raymond James Research.

Wholesale Shipments

Translating from an estimate of the retail end market for residential furniture to a definable wholesale market estimate is not as straightforward as we would hope. As noted in our retail market discussion, some available data addresses channel sales and no series actually captures the product data sold through all channels.

The residential furniture market consists of wood furniture, upholstered furniture, furniture made of metal or other materials, and bedding, which includes mattresses and box springs. Figure 15 provides an estimate of the size of the wholesale residential furniture market in 2003.

Figure 15

Estimated Total Wholesale Market, 2003
(in billions of $)

Wood Furniture	$17.8
Upholstered Furniture	12.8
Metal & Other Materials Furniture	6.4
Bedding Products	5.0
Total	**$42.0**

Source: AFMA; Dept. of Commerce, International Trade Admin., Furniture Today, International Sleep Products Association.

This data was compiled from the American Furniture Manufacturers Association (AFMA), the Department of Commerce, International Trade Administration, *Furniture Today* (a trade publication), and the International Sleep Products Association (ISPA), from which we derived a total wholesale furniture market estimate of $42.0 billion in 2003.

A simplistic approach to check the reasonableness off this estimate would be to apply the complement of a mark-up percentage to the previously shown retail furniture market of $67 billion in 2002. For instance, assuming that the gross margin percentage for most furniture retailers lands between 40-45% would yield a 2002 wholesale market of $37-40 billion dollars, including mattresses and box springs.

For each of the types of residential furniture, the wholesale market for residential furniture logically consists of: (1) the dollar value of domestically manufactured shipments (net of imported components) to domestic dealers and (2) the total value of imported components and finished products.

There are flaws in the data. AFMA stopped reporting domestic metal & other furniture in 2002. In 2002, metal and other furniture accounted for about $6 billion in wholesale shipments, 70% of which was imported. We address the last available data for these classifications in the appendices.

The ISPA data is questionable as well. We have used a variety of sources to triangulate to a bedding wholesale estimate. Most of that product continues to be made domestically and accounts for about $5.0 billion in annual shipments.

From this point forward, we will concentrate on wood and upholstered furniture.

Table 6 is a tabular snapshot of the total wood & upholstered furniture industry that we have distilled from a compilation of data from AFMA and the Department of Commerce, International Trade Administration (ITA).

Table 6

Summary of U.S. Wholesale Wood & Upholstery Shipments: Imports and Domestic Production

$ Billions	1996	1997	1998	1999	2000	2001	2002	2003	7 Yr CAGR
Imports of Wood & Upholstered Furniture	3.7	4.3	5.1	6.3	7.5	7.6	9.1	10.2	15.6%
Domestic Production of Wood & Upholstered Furniture	17.3	18.3	20.1	21.9	22.3	20.0	20.9	20.3	2.4%
Total U.S. Wholesale Wood & Upholstered Furniture Market	21.0	22.6	25.2	28.1	29.9	27.7	30.0	30.6	5.5%
Year-Over-Year % Change:									
Imports of Wood & Upholstered Furniture		16.2%	18.3%	23.4%	20.2%	1.1%	19.9%	11.8%	
Domestic Production of Wood & Upholstered Furniture		6.3%	9.5%	8.8%	2.3%	-10.4%	4.1%	-2.5%	
Total U.S. Wholesale Wood & Upholstered Furniture Market		8.0%	11.2%	11.7%	6.3%	-7.5%	8.5%	1.9%	
Share of Wholesale Production:									
Imports of Wood & Upholstered Furniture	17.6%	19.0%	20.2%	22.3%	25.2%	27.6%	30.5%	33.5%	
Domestic Production of Wood & Upholstered Furniture	82.4%	81.0%	79.8%	77.7%	74.8%	72.4%	69.5%	66.5%	
Total U.S. Wholesale Wood & Upholstered Furniture Market	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	

Source: American Furniture Manufacturers Association (AFMA); Department of Commerce, International Trade Administration, and Raymond James Research.

As seen in Table 6, imports of residential wood and upholstered furniture have increased more than 15% per year on average between 1996 and 2002, about six times the rate of growth for domestically produced residential furniture and more than two times the 5.5% U.S. wholesale wood and upholstered furniture market growth rate over the same time. Given the disparities in growth rates, it is axiomatic that imported furniture has and continues to take significant market share from domestic manufacturers.

The AFMA data on domestic wholesale shipments includes imports of its members that report and there is no publicly available effort to distinguish between produced and imported components. Given that many domestic manufacturers are importers as well — of components and finished product — precisely determining which is which is difficult, if not impossible.

In our analysis, we attempted to develop what we believe to be a reasonably defensible picture of the total U.S. wholesale shipment market. In order to make our numbers as “transparent” as possible, we feel that it is important to discuss the methodology we used to assemble our statistical aggregates.

We compiled our import and export figures for each category of finished good and component from data supplied by the U.S. International Trade Commission (USITC) Interactive Tariff and Trade DataWeb using 10-digit Harmonized Tariff Schedule (HTS) codes as the basic classification scheme.

The finished goods and components classification scheme used to aggregate the 10 digit HTS codes in this report borrows heavily from the system used by The Office of Consumer Goods (OCG) of the Trade Development Unit of the International Trade Administration. A list of the 10 digit HTS codes that comprise each category, and the compiled data used in this report, is available by request.

All values are as appraised by the U.S. Customs Service based on actual price paid, or payable, and exclude import duties (if applicable), freight, insurance, or other charges. While the customs value of finished goods imports would include the manufacturer’s mark-up, the reported value of imported components is at manufacturer’s cost. Given the difficulties of

estimating the proper mark-up for components, our analysis uses the unadjusted customs value.

Domestic manufacturers' wood and upholstery shipments are reported by AFMA. Domestic production, net of imported components is the Raymond James estimate of wholesale shipments arising from U.S. furniture factories and is calculated by subtracting imported components from AFMA shipments for wood, upholstery, and metal & other furniture. Total U.S. residential furniture shipments at wholesale is the sum of domestic production, net of imported components, and total imported finished goods and components.

Analyzing the import data is complicated by the fact that several different types of purchasers import finished furniture product: (1) Retailers directly without the aid of an intervening party, (2) Manufacturers for resale to retailers, (3) Importers and/or agents on behalf of retailers, and (4) Consumers for their own use. We believe that the amount of product going to end consumers is relatively minor and immaterial to the analysis. Product imported directly by retailers, without the use of an agent or other middleman, is presumably included in the data reported by the ITA and described in the report. The major limitations with the International Trade Administration (ITA) data arise in the lack of quantification about the amount of finished furniture sourced by manufacturers and by importers.

For furniture manufacturers, the data limitation pertains to the indeterminate amount of finished product that is sourced by AFMA member manufacturers and then reshipped to retailers without any additional value-added work. To the extent that this product has been classified as components, we were able to account for it in the component portion of imports and reduce AFMA reported shipments by that amount in our analysis.

To the extent that these products are reported by the ITA as finished furniture imports and then also included as part of reported AFMA member shipments, however, the amount would be double-counted in calculating the overall size of the wholesale market. Neither AFMA nor the ITA provides data to distinguish this potential duplication. Interestingly, the amount of manufacturer mark-up on this imported product is included in the AFMA shipment data.

Knowing the portion of AFMA shipments that is comprised of imported finished goods re-shipped by domestic manufacturers with no additional value added work would result in a lower total wholesale market and a higher proportion of the market being represented by imports.

The agent/importer data limitation relates to the markup on this product. Our analysis does include the "raw" cost of imported finished product. Since this product is resold to retailers by these importers/agents, however, we were unable to determine and accordingly include any amount of additional profit that may have been added after the imported goods entered the country. If the profit were first added to the importer acquisition cost but reported to the ITA, the data would not be impaired. Inclusion of this additional importer profit would increase both the total wholesale market and the level of import percentage of the overall market.

The net impact of these issues makes the data "messy" and hampers precision in determining the total wholesale market and the level of import penetration. In fact, we believe that the major impact of these issues is on the wood furniture category and perhaps on the "other" category. Irrespective of the data shortcomings, we believe that the report's conclusions are appropriate. We are confident that our estimates of the rates of change in, and penetration of, imports are most likely understated rather than overstated.

Residential Furniture Manufacturing – An Industry in Transition

Fragmentation at Wholesale and Retail

Despite a recent trend toward some consolidation, the residential furniture industry – at both the manufacturer and retailer levels – remains fragmented. Tables 7 and 8 provide detail about the top 25 retailers and manufacturers and the penetration trend of both groups during the last three years. The top 25 manufacturers still account for less than 40% of estimated wholesale shipments and the top 25 retailers account for less than 30% of retail sales.

The industry remains fragmented – top 25 manufacturers account for less than 40% of shipments and top 25 retailers less than 30% of retail sales.

The persistence of the industry's fragmentation is further reinforced by the implications of our earlier discussion about the industry being a collection of even smaller niche segments. As we noted, success in one segment does not translate into the ability to succeed in another. Additionally, in the manufacture of furniture, there are few, if any, real economies of scale. In fact, many manufacturers have often noted that when furniture plants become too large, diseconomies of scale can develop.

Fragmentation extends beyond the manufacturers to retailers as well. Unlike other specialty products like consumer electronics, office supplies, and home improvement DIY, there is no dominant single chain of residential furniture stores. Levitz and Heilig-Meyers have retrenched under the umbrella of bankruptcy protection. Ethan Allen and Thomasville have a wide geographic presence but are a collection of some company-owned stores and independent dealer-owned stores. Currently, Pier 1 Imports, Pottery Barn, and Restoration Hardware are as close to national retailers as there are.

The reasons for this lack of national presence are due to history and economic reality. In the late 1960s, Levitz, as the first big box retailer in the country, began expanding rapidly and had a coast-to-coast presence by the mid-1970s. Its original strategy included below market pricing in warehouse-type stores. After a stumble in the mid-1970s, new management changed the strategy by increasing mark-ups to the high 40s. This changed the competitive posture, allowing regional retailers to compete very effectively with Levitz and to develop strong and hard to assail market positions.

As the market shifted away from warehouse retailing, logistics of handling and delivery began to play a more significant role. Furniture is bulky and costly to receive, handle, and deliver. Additionally, the small size of furniture manufacturers means that the quantity break points for discounts are at relatively low levels, with little opportunity for more discounts for additional volumes. These factors mean that there are few, if any, real natural economies of scale for furniture retailers to develop on a national scale.

Interestingly, national opportunities have developed for single brand operations. Ethan Allen is a national brand as is La-Z-Boy and, to a lesser extent, Thomasville. Ethan Allen has increased its percentage of company-owned stores by acquiring underperforming operations and dealers that have not had identifiable successor owner-operators. Thomasville now owns several stores in the San Francisco area and more company-owned stores are likely. Bassett Furniture has developed some company owned Bassett Furniture Direct stores as well. Also, some other privately owned companies, including Ashley Furniture, have purportedly invested capital in its single branded stores.

That said, it is important for investors to understand two issues about these investments. First, the economic rationale of incremental investment in retail stores by manufacturer/wholesaler entities is not compelling on the surface.

In a vacuum, the economics of furniture retailing are often unattractive, providing single-digit to low double-digit returns on employed capital. To wit, Ethan Allen, which delivers the highest overall returns on capital of publicly held companies, likely posts sub par results when only its retail division economics are considered. In this case, the whole is greater than the sum of its parts.

Second, the management skill set needed to successfully retail furniture and that needed to successfully manufacture and wholesale furniture are different. Accordingly, the opportunity may be present, but the management to successfully capitalize on this opportunity is scarce.

Table 7

Top 25 Residential Furniture Manufacturers
Based on 2002, 2001, and 2002 Wholesale Shipments

All Figures in $ millions		% Whlsl		% Whlsl		% Whlsl
Manufacturer	**2002**	**Shpmnts**	**2001**	**Shpmnts**	**2000**	**Shpmnts**
Furniture Brands International	$2,302	6.8%	$1,816	5.8%	$2,032	6.1%
La-Z-Boy	2,060	6.1%	2,065	6.6%	2,223	6.6%
Ashley	1,267	3.7%	1,259	4.0%	NA	NA
Klaussner	860	2.5%	826	2.7%	912	2.7%
Ethan Allen	757	2.2%	734	2.4%	741	2.2%
Sauder	621	1.8%	563	1.8%	508	1.5%
Berkline BenchCraft	456	1.3%	NA	NA	NA	NA
Dorel	455	1.3%	408	1.3%	376	1.1%
Lacquer Craft	400	1.2%	NA	NA	NA	NA
Natuzzi	365	1.1%	337	1.1%	303	0.9%
Bassett	312	0.9%	302	1.0%	337	1.0%
Brown Jordan International	337	1.0%	341	1.1%	NA	NA
Bernhardt	307	0.9%	305	1.0%	328	1.0%
O'Sullivan	300	0.9%	314	1.0%	358	1.1%
L&P Consumer Products Unit	277	0.8%	271	0.9%	313	0.9%
Bush Furniture	268	0.8%	267	0.9%	364	1.1%
Lexington Home Brands	261	0.8%	257	0.8%	NA	NA
Standard Furniture	250	0.7%	207	0.7%	197	0.6%
Hooker	243	0.7%	216	0.7%	245	0.7%
Rowe	243	0.7%	229	0.7%	259	0.8%
Stanley Furniture	230	0.7%	223	0.7%	266	0.8%
Chromcraft Revington	212	0.6%	226	0.7%	257	0.8%
Palliser	207	0.6%	192	0.6%	175	0.5%
Pulaski	205	0.6%	205	0.7%	226	0.7%
Flexsteel	201	0.6%	190	0.6%	203	0.6%
Total	**$13,396**	**39.6%**	**$11,751**	**37.8%**	**$10,622**	**31.7%**

Source: Furniture Today, Raymond James Research.

Table 8

Top 25 Residential Furniture Store Sales
Percent of Total U.S. Retail Furniture Sales in 2002, 2001, and 2000

All Figures in $ millions Retailer	2002 Sales	% Retail Sales (NAICS 4421)	2001 Sales	% Retail Sales (NAICS 4421)	2000 Sales	% Retail Sales (NAICS 4421)
Rooms To Go	$1,300	2.5%	$1,260	2.5%	$1,193	2.4%
Pier 1 Imports	1,238	2.4%	1,091	2.2%	777	1.5%
Ethan Allen	1,156	2.2%	1,171	2.3%	1,193	2.4%
Levitz	965	1.8%	920	1.8%	893	1.8%
La-Z-Boy	920	1.8%	836	1.7%	744	1.5%
Berkshire Hathaway Furniture Division	879	1.7%	833	1.7%	831	1.6%
Ikea	873	1.7%	826	1.6%	670	1.3%
Havertys	704	1.3%	678	1.3%	681	1.3%
Value City	700	1.3%	675	1.3%	625	1.2%
Art Van	560	1.1%	575	1.1%	575	1.1%
Rhodes	544	1.0%	514	1.0%	469	0.9%
Thomasville Home Furnishings	485	0.9%	475	0.9%	468	0.9%
The Bombay Co.	438	0.8%	384	0.8%	373	0.7%
W.S. Badcock	427	0.8%	395	0.8%	387	0.8%
Pottery Barn	405	0.8%	345	0.7%	305	0.6%
Raymour & Flanigan	395	0.8%	316	0.6%	281	0.6%
Crate & Barrel	371	0.7%	326	0.6%	300	0.6%
Wickes Furniture	365	0.7%	345	0.7%	335	0.7%
Breuners Home Furnishing	362	0.7%	368	0.7%	406	0.8%
Ashely Home Stores	350	0.7%	140	0.3%	NA	NA
The RoomStore/Heilig-Meyers	325	0.6%	373	0.7%	NA	NA
Select Comfort	319	0.6%	251	0.5%	270	0.5%
Bassett Furniture Direct	315	0.6%	241	0.5%	206	0.4%
American Furniture Warehouse	299	0.6%	286	0.6%	275	0.5%
Slumberland	276	0.5%	272	0.5%	270	0.5%
Restoration Hardware	273	0.5%	276	0.5%	139	0.3%
The Mattress Firm	265	0.5%	249	0.5%	226	0.4%
Sleepy's	252	0.5%	221	0.4%	206	0.4%
Total Top 25	**$14,970**	**28.5%**	**$13,895**	**27.6%**	**$12,527**	**24.8%**

Source: Furniture Today, Raymond James Research.

The Lack of Industry Pricing Power

Figure 16 compares the consumer price index to a more restrictive price index for household furnishings. During the last three decades plus, the cost of living has risen nearly twice as rapidly as that of residential furniture.

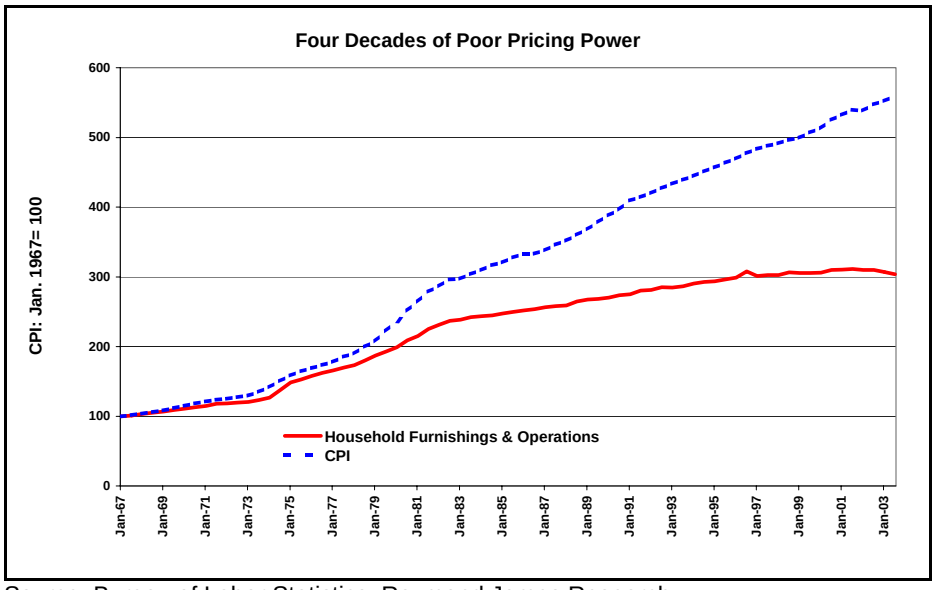
Some industry participants note that furniture is a far better value to consumers today, in relation to other goods and services, than it has ever been. This chart would seem to corroborate that view.

It demonstrates also, however, the lack of pricing power for industry participants. Interestingly, the comparison of the producer price index for all of manufacturing and for the more restrictive producer price index for furniture does not yield this level of disparity. The disparity pertains to consumers' relative cost of furniture and other goods and services.

This is a fact that becomes even more worrisome in the face of the bedroom antidumping petition that threatens to raise prices to consumers. Though we have no data to verify or quantify the "elasticity" of the furniture demand curve, the vociferous reaction by some very thoughtful retailers to the bedroom antidumping petition is instructive.

We point out that the index has "rolled over" to the same level as it was in 1997. That, we suspect, demonstrates the impact of the globalization of manufacturing, the topic we next examine.

Figure 16



Source: Bureau of Labor Statistics, Raymond James Research

Globalization of Manufacturing

The rapid growth of imports remains the most significant story in the residential furniture industry. As noted earlier, imported furniture has grown far more rapidly than domestic shipments during the past several years. As a result, imported furniture has gained a significant amount of market share in recent years.

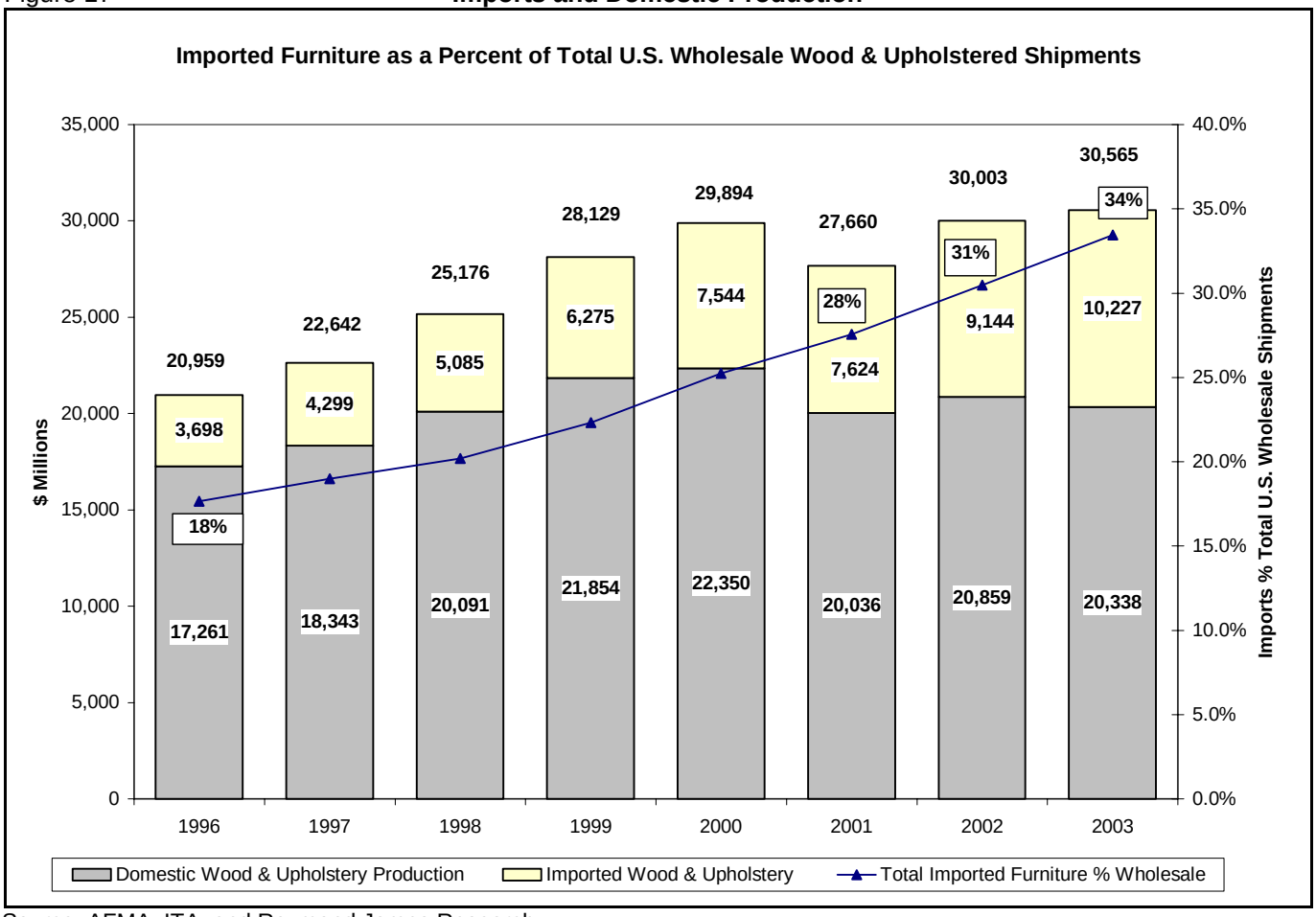
The size of the import threat is hard to overestimate. One manufacturer/ importer noted that there were approximately 5,000 furniture factories in China alone in 2002 and that enterprising importers had brought in approximately 16,000 furniture samples from China to the April 2002 International Home Furnishings Market in High Point, North Carolina.

The past several years were a period of hyper-expansion for the China-based furniture manufacturing industry. New capacity appeared at nearly warp speed. Every factory group that we visited on a trip to China in September 2002 — 14 in total — was then in the process of expanding, and millions of square feet were being added into the pipeline. The unit of measure amongst furniture manufacturers is not, however, square footage, or even Reminbi. The unit of measure of capacity is “containers shipped” per month.

Without seeing it firsthand, it is almost impossible to conceive of the amount of new manufacturing space that has developed in the Far East. In our brief visits, we saw at least two manufacturing facilities that were adding 1.5 million new manufacturing square feet at each facility with another several that are planning, or have recently finished, new capacity.

While imports represented just over 18% of total U.S. wholesale shipments in 1996, by 2002, imports had increased to almost 34% of wholesale wood and upholstered volume. Figure 17 displays the same information graphically.

Figure 17 **Composition of U.S. Wholesale Wood & Upholstered Furniture Shipments: Imports and Domestic Production**



Source: AFMA, ITA, and Raymond James Research.

Table 9 presents a detailed breakdown of imported and domestically produced residential wood and upholstered furniture. For this report, we examine only wood furniture and upholstered furniture shipments for two major reasons: 1.) Wood and upholstered furniture tend to make up the majority of indoor residential furniture. 2.) Data used to produce the charts and table to follow draws from Department of Commerce and AFMA statistics. However, AFMA stopped releasing information relating to metal and other types of furniture at the end of 2002. We have therefore eliminated these furniture classifications for the purposes of making apples-to-apples comparisons with the most recent data. As noted earlier, information regarding metal and other furniture domestic production and imports is included in the appendices of this report.

During this period, total wholesale wood and upholstered furniture shipments, which included both domestically produced and imported finished goods and components, increased by about 5.5% per year in nominal terms. Total upholstery wholesale shipments grew modestly faster than the overall market at roughly 6.2% per year on average, while total shipments of case goods increased by about 5.1% per year on average. While we do not have access to average unit price data, we suspect that one of the primary reasons why case goods grew slightly slower than the overall industry during this period is price deflation brought about by the rapid growth of low cost imported case goods from China and the Far East. Additionally, the increase in popularity of leather upholstery likely added to its growth rates.

Composition of U.S. Wholesale Residential Wood & Upholstered Furniture Market

Table 9

All Figures in $ Millions

Imported Finished Goods & Components	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**7 Yr CAGR**
Imported Household Wood Furniture	3,147	3,616	4,301	5,303	6,293	6,355	7,605	8,349	15.0%
Imported Upholstered Furniture	551	683	784	972	1,251	1,269	1,539	1,878	19.1%
Total Imported Finished Goods & Components	**3,698**	**4,299**	**5,085**	**6,275**	**7,544**	**7,624**	**9,144**	**10,227**	**15.6%**
Domestic Manufacturers Shipments (AFMA), Net of Imported Components	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**7 Yr CAGR**
Wood Furniture	9,400	9,856	10,576	11,277	11,497	10,188	10,099	9,410	0.0%
Upholstered Furniture	7,861	8,487	9,515	10,577	10,853	9,848	10,760	10,928	4.8%
Total Domestic Wood & Upholstered Production	**17,261**	**18,343**	**20,091**	**21,854**	**22,350**	**20,036**	**20,859**	**20,338**	**2.4%**
Total U.S. Residential Furniture Shipments at Wholesale	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**7 Yr CAGR**
Total U.S. Wood Furniture at Wholesale	12,547	13,472	14,877	16,580	17,789	16,543	17,704	17,759	5.1%
Total U.S. Upholstered Furniture at Wholesale	8,412	9,170	10,299	11,549	12,104	11,117	12,299	12,806	6.2%
Total U.S. Wholesale Wood & Upholstered Furniture Market	**20,959**	**22,642**	**25,176**	**28,129**	**29,893**	**27,660**	**30,003**	**30,565**	**5.5%**

Source: AFMA, ITA, Raymond James Research

As mentioned earlier, however, the rate of growth for imports, which increased by approximately 15.6% per year on average between 1996 and 2002, significantly outstripped that of domestically manufactured product, which increased by 2.4% per year on average during the same period. Upholstery imports, which increased by about 19% per year, grew faster than total imports and outpaced the growth of case goods, which grew by 15% per year between 1996 and 2003.

While 2002 and 2003 were difficult years for many in the residential furniture industry, the pain was not felt equally, as seen in Table 9. In 2002, domestic wholesale shipments fell about 0.9% to $10.1 billion, while imported case goods grew by 19.7% to $7.6 billion.

In 2003, again, wholesale domestic wood furniture shipments declined another 6.8% to $9.4 billion while wood imports advanced 8.9% to $8.3 billion.

In 2002, domestically produced upholstery increased by 9.3% while imported upholstery increased by 21.3%. In 2003, domestically produced upholstery grew 1.5% while upholstery imports grew by more than 18%.

Table 10 decomposes the import data for each major product category into finished goods and components. Interestingly, while aggregate finished goods imports continued to rocket ahead in 2002 after a pause the prior year, total imported components fell for the second consecutive year in nominal terms.

Residential Wood & Upholstered Furniture Imports:
Finished Goods and Components

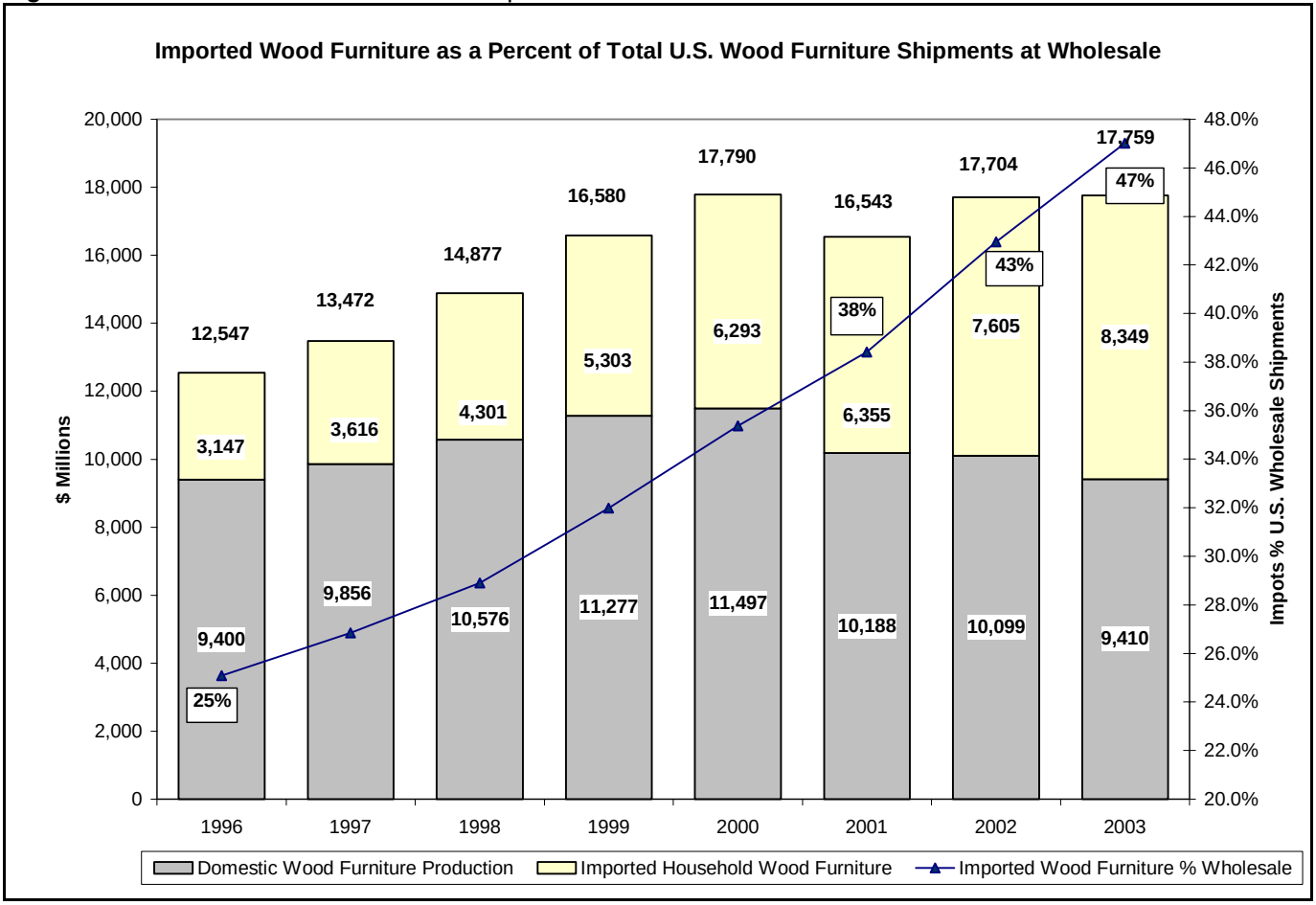
Table 10

All Figures in $ Millions									7-Year
Imported Finished Goods, net components	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**CAGR**
Wood	2,831	3,228	3,872	4,720	5,590	5,682	6,834	7,557	15.1%
Upholstered	551	683	784	972	1,251	1,269	1,539	1,878	19.1%
Total Wood & Upholstered Finished Goods, net components	**3,382**	**3,911**	**4,656**	**5,692**	**6,841**	**6,951**	**8,373**	**9,435**	**15.8%**
Imported Components	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**CAGR**
Imported Wood Components	316	388	429	583	702	673	771	792	14.0%
Total Imports	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**CAGR**
Wood	3,147	3,616	4,301	5,303	6,293	6,355	7,605	8,349	15.0%
Upholstered	551	683	784	972	1,251	1,269	1,539	1,878	19.1%
Total Imports of Wood & Upholstered Furniture	**3,698**	**4,299**	**5,085**	**6,275**	**7,544**	**7,624**	**9,144**	**10,227**	**15.6%**

Source: AFMA, ITA, Raymond James Research

Clearly, domestic wood furniture manufacturers have been most affected by the rapid rise in imports. Figure 18 illustrates the continued market share gains for imported case goods. In 1996, imports represented approximately 25% of the nearly $12.6 billion wholesale wood furniture market. By 2002, imports increased to 43% of the market advancing again in 2003 to 47% of the $17.8 billion wood furniture market.

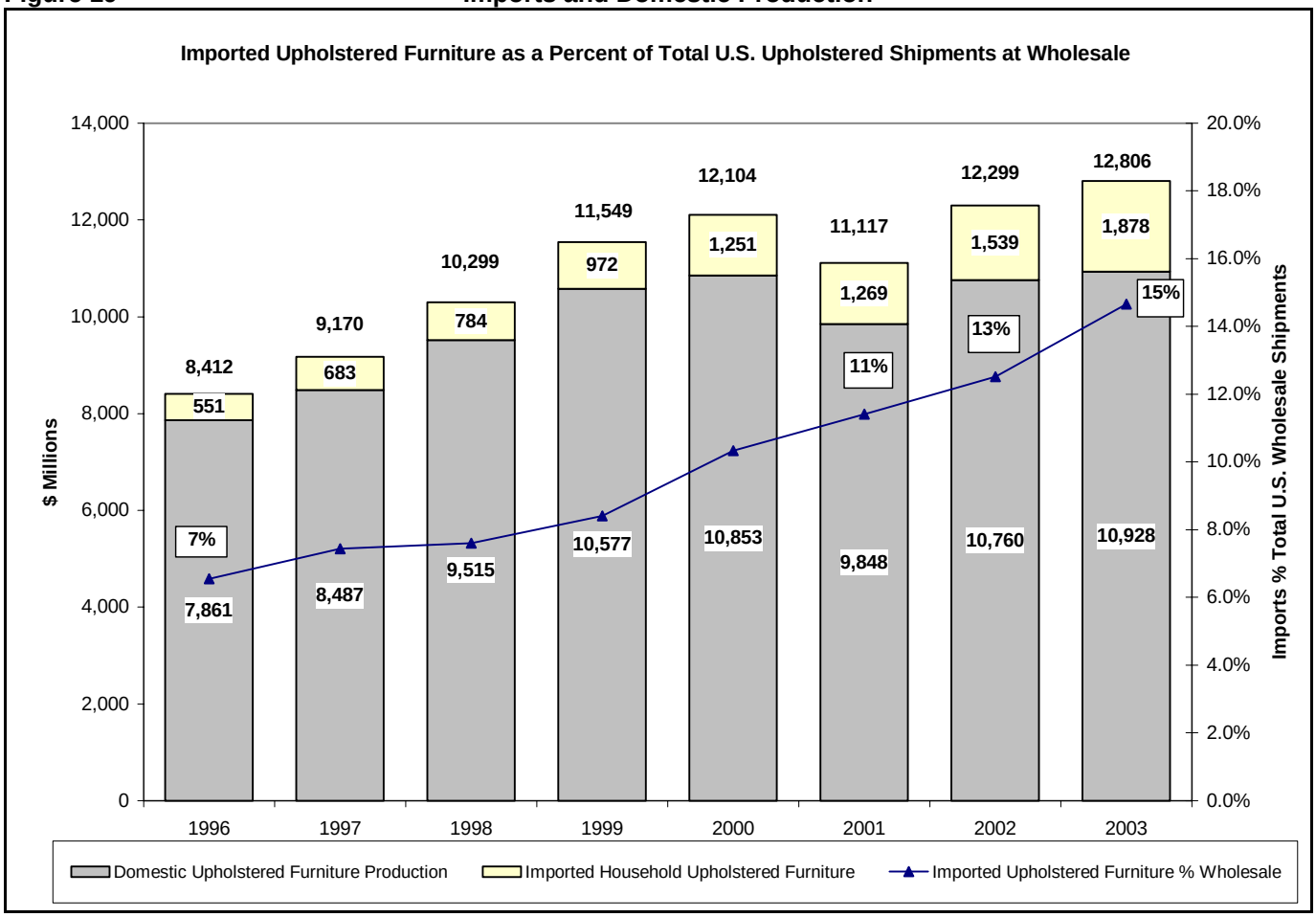
Composition of U.S. Wood Furniture Wholesale Shipments:
Figure 18 Imports and Domestic Production



Source: AFMA, ITA, and Raymond James Research.

While imports have not penetrated residential upholstery to the same degree as case goods, foreign products continue to gain market share at a rapid pace, as seen in Figure 19. In 1996, upholstery imports represented just 7% of the nearly $8.4 billion wholesale wood furniture market. By 2002, however, upholstery imports increased to about 13% of the wholesale market, advancing to 15% of the $12.8 billion market in 2003.

Figure 19 **Composition of U.S. Upholstered Furniture Wholesale Shipments: Imports and Domestic Production**



Source: AFMA, ITA, and Raymond James Research.

Imports from China grew considerably faster than total imports between 1996 and 2003, leading to significant market share gains for product manufactured in China. Table 11 decomposes Chinese total imports into finished goods and components by major category. During this period, Chinese imports grew on average by 34% per year. This rate of growth is more than twice the 15.6% average growth rate for total imports over the same period.

The two fastest growing major categories of Chinese furniture imports are wood furniture components and upholstery. Between 1996 and 2003, wood component imports from China have increased by 44% per year on average, while Chinese upholstery import growth averaged 57% annually. The rate of growth for Chinese wood components and upholstery imports is approximately three times the rate of growth for total imports in these categories. Perhaps even more sobering, the rate of growth of Chinese upholstery imports during this period is about nine times that of the entire U.S. upholstery furniture wholesale market.

Table 11 **Chinese Residential Furniture Imports: Finished Goods and Components**

All Figures in $ Millions

Imported Finished Goods & Components from China	1996	1997	1998	1999	2000	2001	2002	2003	7 YR CAGR
Total Imported Household Wood Furniture from China	423	572	794	1,141	1,651	1,898	2,894	3,592	35.7%
Total Imported Upholstered Furniture from China	24	38	57	97	141	201	378	573	57.2%
Total Imported Metal Household Furniture from China	182	355	541	767	939	1,034	1,236	1,627	36.8%
Total Imported Other Materials Household Furniture from China	111	138	157	229	269	286	317	338	17.2%
Total Imported Furniture and Fixtures NEC	120	155	234	340	515	560	683	804	31.2%
Total Imported Finished Goods & Components from China	**860**	**1,258**	**1,784**	**2,575**	**3,515**	**3,978**	**5,508**	**6,934**	**34.7%**

Imported Components from China	1996	1997	1998	1999	2000	2001	2002	2003	7 YR CAGR
Imported Wood Components from China	19	36	43	78	123	140	219	250	44.3%
Imported Metal Components from China	13	25	37	52	69	83	96	125	38.1%
Imported Other Materials Components from China	12	13	12	19	22	26	29	35	16.3%
Imported Components NEC from China	22	38	42	72	104	182	271	375	49.7%
Total Imported Components from China	**67**	**112**	**133**	**220**	**318**	**431**	**615**	**785**	**45.2%**

Imported Finished Goods from China	1996	1997	1998	1999	2000	2001	2002	2003	7 YR CAGR
Imported Household Wood Furniture from China	404	536	751	1,063	1,528	1,758	2,675	3,343	35.3%
Imported Upholstered Furniture from China	24	38	57	97	141	201	378	573	57.2%
Imported Metal Household Furniture from China	169	330	505	715	869	950	1,140	1,502	36.6%
Imported Other Materials Household Furniture from China	99	125	146	211	247	260	288	303	17.3%
Imported Furniture & Fixtures NEC from China	98	116	193	269	411	379	412	428	23.5%
Total Finished Goods, net components from China	**793**	**1,146**	**1,651**	**2,355**	**3,196**	**3,547**	**4,893**	**6,149**	**34.0%**

* YTD Data is through Sept.

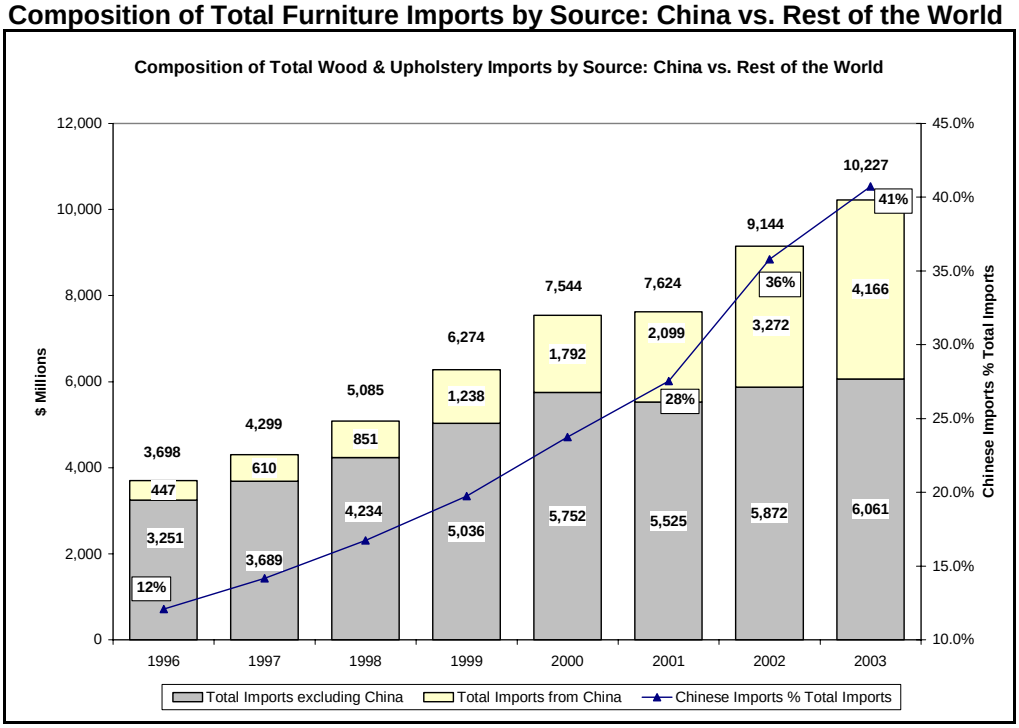
Source: ITA, Raymond James Research.

Chinese imports are not only taking market share from U.S. based manufacturers, but from other exporting countries as well. As seen in Figure 20, China's share of total residential furniture imports increased from approximately 12% in 1996 to 41% in 2003. A comparison of the year-over-year gains for Chinese imports versus aggregate imports seems to indicate that this trend actually accelerated in 2002, maintaining nearly that rate in 2003.

The accelerating difference between the growth rate of Chinese imports and imports from the rest of the world is even more striking when we examine imported furniture components by themselves. Between 1996 and 2003, imported components from China grew at 44% per year on average, or about 3.2 times the 14% average growth rate for total imported components. In 2002, however, total imported furniture components actually increased 8.9% to $1.8 billion, while imported components from China increased by 42.6% to $615 million, which equates to just over 32% of all imported components.

Figure 20

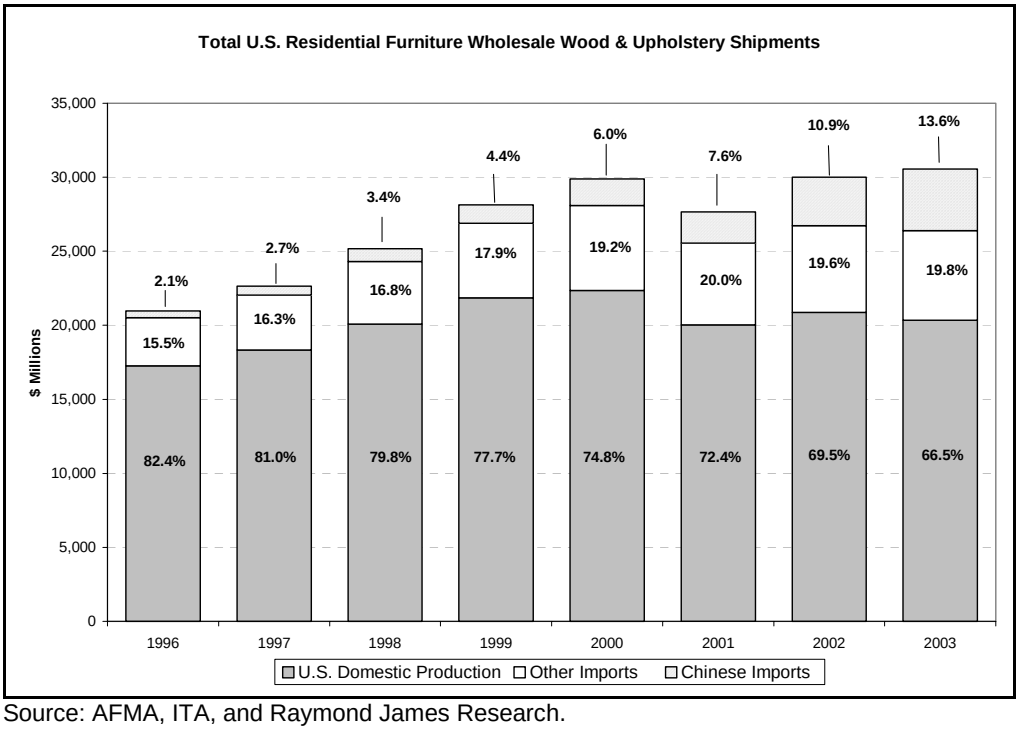
Composition of Total Furniture Imports by Source: China vs. Rest of the World



Source: AFMA, ITA, and Raymond James Research.

The fact that Chinese imports have gained market share from other importers as well as domestic producers is underscored by Figure 21, which illustrates the share of the total wholesale market held by domestic manufacturers, Chinese imports, and imports from the rest of the world between 1996 and 2002.

Figure 21

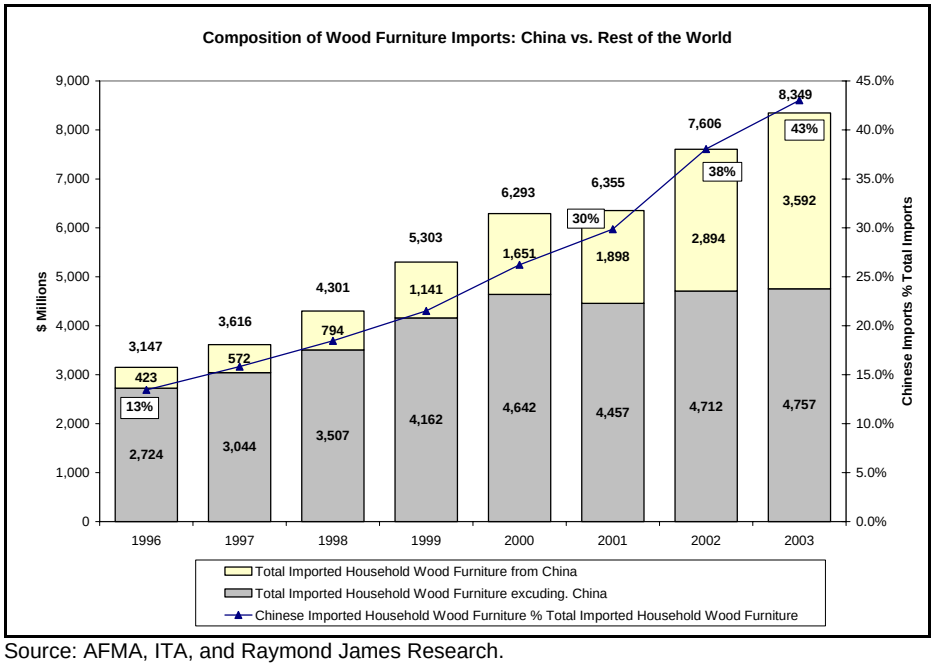


Source: AFMA, ITA, and Raymond James Research.

In 1996, wood furniture imports from China represented about 13% of the $3.1 billion in total imports. By 2003, Chinese imports had grown to represent approximately 43% of the nearly $8.36 billion of total wood furniture imports. As seen in Figure 22, almost all of the growth in imported wood furniture since 2000 has come from Chinese imports, as imported wood furniture from the rest of the world has remained relatively flat in total dollar terms at $4.6-$4.7 billion. Over that same period, wood furniture imports from China have increased approximately 75% from almost $1.7 billion in 2000 to close to $3.6 billion in 2003.

Figure 22

Composition of Wood Furniture Imports: China vs. Rest of the World

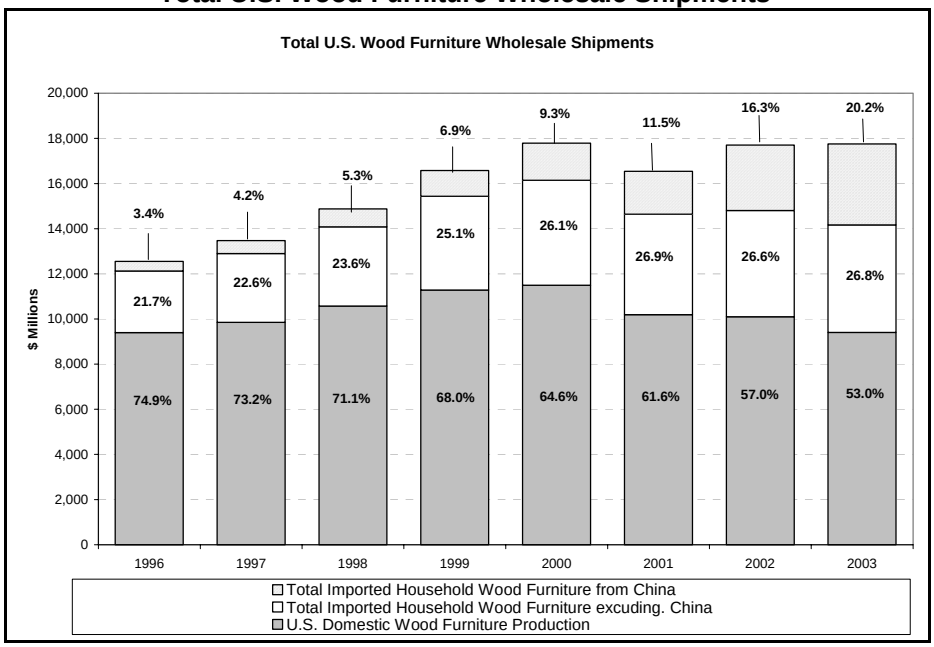


Source: AFMA, ITA, and Raymond James Research.

Figure 23 illustrates the relative share gains and losses of domestic case good manufacturers, Chinese case good imports, and imported case goods from other countries between 1996 and 2003.

Figure 23

Total U.S. Wood Furniture Wholesale Shipments

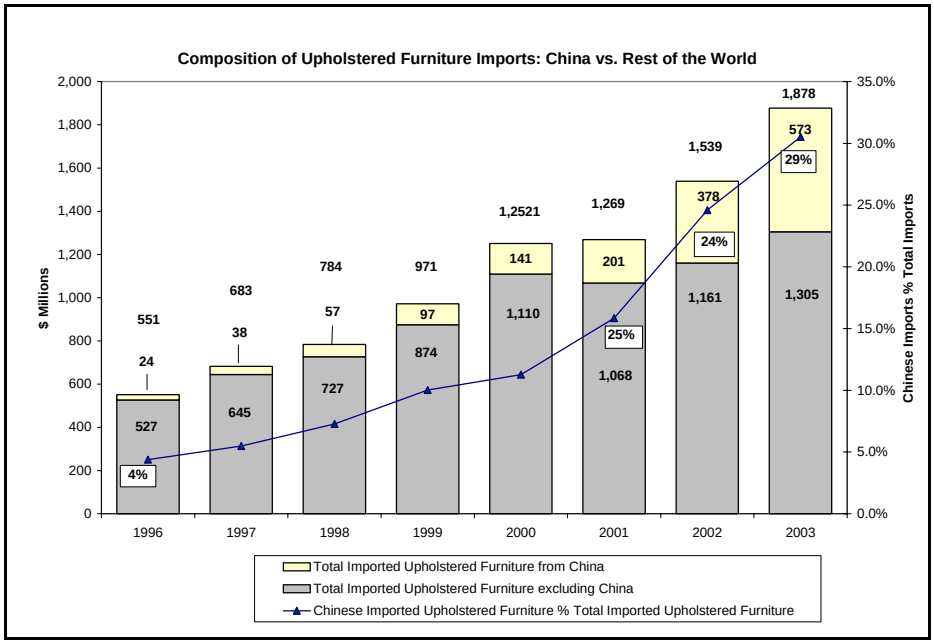


Source: AFMA, ITA, and Raymond James Research.

Upholstery imports from China are also expanding rapidly although the magnitude of total upholstery imports is significantly lower than for wood furniture. In 1996, upholstery imports from China represented about 4% of the nearly $0.6 billion in total imports, but by 2002, Chinese imports had grown to represent approximately 29% of the nearly $1.9 billion of total upholstery imports. As illustrated in Figure 24, imported upholstery excluding China has remained relatively flat since 2000 at approximately $1.1 to $1.2 billion. Upholstery imports from China, however, have increased a staggering 300% over this same period to $573 million.

Figure 24

Composition of Upholstered Furniture Imports: China vs. Rest of the World

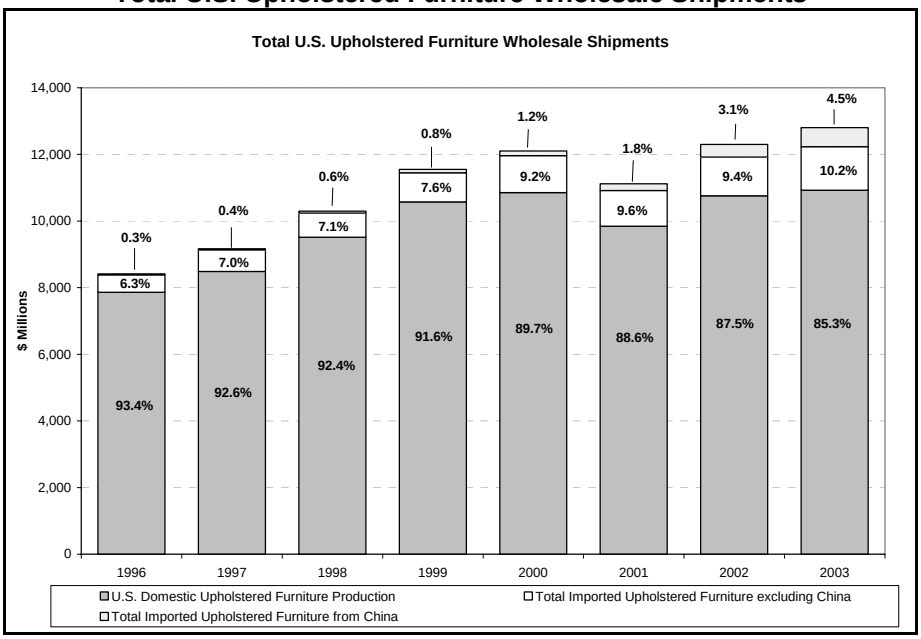


Source: AFMA, ITA, and Raymond James Research.

Given the rapid growth of imported upholstery, especially from China, relative to the growth of the domestic wholesale upholstery market, it comes as no surprise to see that imports have gained a sizeable share of the total market over the past seven years. That said, upholstery imports today represent just 15% of the total wholesale market, significantly less than its 47% percent penetration of the wholesale case good market. Figure 25 illustrates the market share gains and losses for domestic upholstery producers, Chinese upholstery imports, and upholstery imports from the rest of the world between 1996 and 2003.

Figure 25

Total U.S. Upholstered Furniture Wholesale Shipments



Source: AFMA, ITA, and Raymond James Research.

Other Issues

From this point forward, we address a series of issues that continue to affect the industry. These include price deflation, deflation economics, the antidumping petition, the prospects for further deflation or rekindling of inflation, the inexhaustible supply of labor in China, the so-called value gap, the potential for supply disruptions, and several other issues.

Price Deflation

The spectacular growth in imported residential furniture from the Far East, and China in particular, has precipitated rapid declines in the average selling price of wood furniture, especially in the mid-priced segment of the market, and leather upholstery, the two segments of the industry that have seen the most competition from offshore producers.

Furniture makers in Asia, and China especially, benefit from enormous reserves of low cost labor. The labor content in furniture, especially for wood furniture (case goods), varies as a function of design. In today's market, the U.S. consumer has shown a preference for intricately carved wood furniture. The high cost of labor in the U.S. makes domestic production of this type of product widely price uncompetitive vis-à-vis Chinese and Asian manufacturers, whose cost of labor is currently somewhere on the order of 1-5% of that of the U.S.

Not surprisingly, many companies have sought to exploit the discrepancy in labor cost between the U.S. and the developing markets of Asia by importing furniture manufactured in China, the Philippines, Vietnam, Indonesia, and others into the domestic market.

The result has been the unprecedented decline in wholesale prices for residential furniture over the past several years; a classic case of what economists define as deflation.

Deflation has been a fact of life despite the increased popularity of leather upholstery, which is more costly per seat than most fabric upholstery. Movement of production of leather upholstery to low cost countries, however, has also reduced its cost per seat. Imports have caused the entire pricing structure of the residential furniture industry to shift downward and, at every price point in the industry, consumers get "more" furniture for their dollar. This has been especially problematic for domestic manufacturers in the lower and mid-priced segments of the industry where the bulk of the imported product has been positioned so far.

Deflation Economics

While deflation has been good for furniture consumers, the impact on domestic manufacturers and retailers has been mixed and, in some ways, counterintuitive.

This section attempts to demonstrate and quantify for the investor the impact of deflation economics on both manufacturers and retailers. Table 12 was developed from a "real-life" example of a case good collection that was manufactured in Taiwan for the past several years before being reengineered and moved to the PRC (People's Republic of China) last year. The base case in the table shows our estimate of the economics of the Taiwan cost and manufacturing profit.

The invoice price to retailers of this collection, at that time, was $2,000; FOB the domestic shipping point, which meant that the retailer paid the freight to ship the merchandise to his warehouse. We also estimate the cost of ocean freight from Taiwan to the U.S. per collection was about $200, which implies that the merchandise value was about $1,800. The next section of the base case illustration estimates the cost of the various factors of production, as a percentage of manufacturer merchandise revenues: materials (25%-40%), direct labor (12%-15%), indirect labor, (13%-10%) and other manufacturing burden (20%-15%). This brought the range of manufacturing costs to a range of 70%-80%, implying a manufacturing margin of 20%-30%.

Since the base case product was manufactured in Taiwan (not in the U.S. in this example), we use an estimated "all-in" labor rate of between $9-$10 per hour to estimate the hours of production (direct and indirect) in the manufacturing process. This leads to an imputed labor content of between 45-50 hours.

After the reengineering, the price of the product was dropped to $1,500, which included the freight needed to "land" the product at the retailer's warehouse. In looking at the "China Import Case," we made the following simplifying assumptions: (1) same dollar cost of materials; (2) same amount of direct and indirect labor hours; (3) same dollar cost of other manufacturing burden; and (4) a labor rate of $150 per month, which equates to about $0.69 per hour. This implies that the landed price deflation to the dealer was about 30% and that the manufacturer revenues per collection dropped by 28%.

Using the above assumptions, we determine that the manufacturing margin in this case actually rose by between 145 to nearly 500 basis points. It is instructive to point out that labor rates in Taiwan more than tripled in the period from the early 1980s to the late 1990s, dramatically changing the economics of furniture manufacture.

Table 12

Deflation Economics - Manufacturers					
	Base Case		China Import Case		
Range of Estimates	From	To	From	To	% Chg
Landed Price to Retailer	2,130	2,130	1,500	1,500	-30%
Inbound Freight to Retailer	130	130	0	0	
Dealer Invoice Price	2,000	2,000	1,500	1,500	-25%
Ocean Freight	200	200	200	200	
Manufacturer Merchandise Revenues	1,800	1,800	1,300	1,300	-28%
% of Merchandise Value	100%	100%	100%	100%	
Materials	25.0%	40.0%	34.6%	55.4%	
Direct Labor	12.0%	15.0%	1.3%	1.4%	
Indirect Labor	13.0%	10.0%	1.4%	1.0%	
Other Manufacturing Burden	20.0%	15.0%	27.7%	20.8%	
Total Manufacturing Expense Ratio	70.0%	80.0%	65.0%	78.6%	
Manufacturing Profit Margin	30.0%	20.0%	35.0%	21.4%	
Materials	450	720	450	720	
Direct Labor	216	270	17	19	-92%
Indirect Labor	234	180	18	12	-93%
Other Manufacturing Burden	360	270	360	270	
Manufacturing Expenses	1,260	1,440	845	1,021	
Manufacturing Profit	540	360	455	279	
Margin Pick Up (Basis Points)			**503**	**145**	
Assumptions:					
Cost Per Month			150.0	150.0	
Days worked per month			21.7	21.7	
Hours worked per day			10.0	10.0	
Labor/Hour, all-in average (Taiwan)	$9.00	$10.00	$0.69	$0.69	
Implied Hours-Direct	24.00	27.00			
Implied Hours- Indirect	26.00	18.00			

Source: Raymond James Research.

While this example was extracted from an actual case where the invoice price fell by 25% and where the comparison was between a mainland product and a Taiwan product, we note that if we had assumed the same factors of production and U.S. labor rates of $14-$15 per hour (including benefits), the labor differential is a whopping 95% and the improvement in manufacturing margin ranges from 200-600 basis points.

In our view, this is convincing evidence of the power of the move to low cost country case goods manufacturing.

At this point, because of my background as a furniture retailer, I am going to change the discussion from the editorial “we” to the more personal “I.” Extending the analysis to retailers, however, leads me to a somewhat different though, admittedly, more controversial, conclusion. Table 13 takes the reader through my analysis of this situation.

Retailers are naturally attracted to proprietary merchandising opportunities, particularly when that unique product is priced attractively versus comparable items. My father drummed the concept, “An item well bought is half sold” into my consciousness from a very early age. I am not unique in that view, and most merchants are always looking for excess margin opportunities.

In looking at this example, the "Old Way" takes the merchandise as originally manufactured from Taiwan and "keystones" it to get a retail price of $4,000. This implies a 46.8% landed gross margin. Into the analysis, we incorporate three additional elements of expense: (1) selling commission, (2) advertising, and (3) warehousing, handling, and delivery. Commission normally varies with selling price; advertising varies with total sales, though is typically fixed in the near-term; and the cost of receiving, warehousing, and delivering to customers is a function of units processed. In the first case, we conclude that the contribution of the next sale exceeds $1,000 and approaches a 28% margin.

The second example, which I labeled "Early," depicts the advantage of excess margin. Here the customer gets the advantage of a lower price and the retailer gets the best of all worlds: improved gross profit dollars, modestly lower expenses (due to lower commissions), and higher gross and contribution margins. This clearly indicates why retailers salivate over these prospects.

Table 13

Deflation Economics-Retail

	Old Way	Early	Ultimate	
Retail Selling Price	$4,000	$3,500	$3,000	
Cost of Merchandise, Landed	2,130	1,500	1,500	
Gross Profit	1,870	2,000	1,500	
Sellling Commision	240	210	180	6% on sales
Advertising	240	240	240	Variable to total sales, fixed short-term
Warehousing, Handling, & Delivery	280	280	280	Varies with units handled
Direct Expenses	760	730	700	
Contribution Profit	$1,110	$1,270	$800	
Gross Margin	46.8%	57.1%	50.0%	
Contribution Margin	27.8%	36.3%	26.7%	
Sales Elasticity Requirement		1.14	1.33	
Profit Elasticity Requirement		0.87	1.39	

Source: Raymond James Research.

Not surprisingly, furniture retailing is highly competitive. As manufacturers move more of the domestic production offshore, two outcomes are inevitable: (1) the abundance of offshore product extends the opportunity for all retailers to merchandise and sell low priced product, and (2) the opportunity for exclusive product becomes somewhat more limited. The competitive nature of the business and these two factors make me conclude that ultimately, retailers will be pressured and margins will compress to or near keystone levels. When and if that occurs, the impact on contribution profit and margins is severe. In this example, the retailer would need to sell 33% more units to maintain its sales and 39% more units to maintain its contribution profit.

Increased competition and lower prices undoubtedly benefit residential furniture consumers. The logic of competition leads us to believe that the flood of supply from China and the Far East, and the associated competitive response by domestic manufacturers utilizing imported components, will translate into lower average selling prices and better quality and style at almost all price points.

The Wood Bedroom Antidumping Petition

In late October 2003, a consortium of 27 domestic wood bedroom manufacturers and several trade unions filed a petition with the U.S. International Trade Commission and Department of Commerce to impose duties on wood bedroom manufactured and exported from China.

This is the most divisive issue that has ever faced the industry. It has created strange bedfellows.

We refer readers to an in-depth report, dated November 13, 2003, to understand the arcane nature of the Department of Commerce and International Trade Administration investigation of this issue.

The petition has already passed two hurdles and the investigation will progress over the next weeks and months. Seven Chinese manufacturers have been named as mandatory respondents, and there will be no additional voluntary respondents because of the lack of manpower to conduct the investigation. The next major issue to be resolved will be which country will be chosen as the surrogate market economy to develop "costs" of production. The petitioners have requested India, which does not appear to be very representative, but has precedent in past investigations. The other side has suggested Indonesia, but the amount of publicly available data – critical to the choice – is questionable.

Additionally, in a surprising development, one of the petitioning companies, Hooker Furniture, just announced that it had withdrawn from the petitioning group of 27 and was now taking a neutral position. Hooker management claims that it did not realize how divisive this issue would become and now says that it has heard serious negative comment from its retailer partners. In fact, Hooker's participation in the petition initially seemed incongruous. Its management was among the most aggressive importers and has been a leader in sourcing product from China, though its level of bedroom imports historically was small. Its "buyer's remorse" at this time will likely have no bearing on the outcome other than to reinforce the divisiveness of the petition – something that seemed evident in early November.

It is still too early to know how this issue will play out, but the likelihood of some dumping margin is reasonably high.

What's Ahead? More Deflation or Some Inflation

In an earlier section, we demonstrated that the industry has historically lacked pricing power. In fact, since the mid-1990s, prices again rolled over, most likely reflecting the impact of surging imports. The easy conclusion among many investors is that deflation will continue. The problem with that conclusion is that it flies in the face of reality. Several developments, in fact, suggest that there will be some inflationary pressures building.

First, the prospect of some amount of dumping margin will raise the cost of imported bedroom product. Importers and manufacturers will need to pass those increased costs on to retailers and ultimately to consumers.

Second, given China's rapid economic growth along with increasing political pressures, the prospect for some sort of Yuan revaluation or unpegging to the U.S. dollar is increasing quickly.

The primary argument for additional deflation comes from the implications of excess capacity and import penetration. Even assuming that there is now excess manufacturing capacity that will lead to inventory liquidation, these

effects will be relatively short-lived. Additional deflation may result from increasing levels of imports but the marginal increase will not be at the same rate as that which has already been felt. Our view is that the prospect for prices to level or increase modestly is higher than it is for additional deflation.

The Value Gap

Another issue, subtler and potentially more troubling, is that of the value gap at the upper end of the price spectrum. There is no question that the Chinese producers have developed the capability to produce medium priced product of comparable quality to U.S. producers. There remains, however, considerable question about the ability of many new manufacturers to deliver upper-end quality product. Finishes are not yet where they need to be, veneering capabilities are not yet sophisticated, and construction details are not consistently up to par. The achievements of the past several years and the opportunity notwithstanding, there is only limited opportunity for imports today that qualifies for high-end U.S. producers.

This reality aside, however, both retailers and consumers face a daunting challenge because the price gap has widened between imported product that has a good look and the high-end U.S.-made product. We have no way to judge the degree to which this factor has delayed or prevented the recovery of consumer demand at the high end, but it certainly does not help.

To date, the impact of low priced Asian imports has been focused mostly at the mid-priced wood furniture segment of the U.S. market where the heavily carved Asian imports provide significantly more perceived value in the client's eye than similarly priced domestically manufactured case goods. Additionally, much of the new capacity that has come on line in China in recent months has been focused predominantly at the mid-level price points, particularly in the manufacture of wood bedroom, dining room, and occasional furniture.

Imports have, to date, had less of an impact at the higher-end and premium segments of the market. At the higher end, the perception has been that the quality of the imports, as measured primarily by fit and finish, is lower than the quality of the domestically manufactured goods. While the country's labor rate advantage means that excess labor is available for a variety of manufacturing issues, there is currently a perceived lack of institutional knowledge needed for the production of high-end wood furniture at the present time. Additionally, many Asian furniture manufacturers, especially those based in Mainland China, have been focused on long production runs of a limited number of SKUs in order to minimize per unit costs. Accordingly, such manufacturers have had only tepid interest in the low unit volume production runs required to compete in the upper-price point segment of the residential furniture market.

That said, nobody in the industry believes that the quality gap between the Asian imports and domestically manufactured furniture will be last permanently. The quality of Asian furniture imports continues to noticeably improve as each High Point Market passes. Moreover, it is not just a matter of improved construction. The look and style of the furniture is definitely improving as well. As the Asian furniture manufacturing industry matures, it is also likely that some manufacturers will ultimately begin to concentrate on the high-end niche market as well, adjusting their business models in such a way that they can make a reasonable rate of return on low volume production runs.

U.S. manufacturers of high-end and premium furniture that once may have believed that they would remain unaffected by imports must now realize and deal with the threat that the Asian manufacturers will increasingly pose. The Chinese manufacturers will get better over time and close that gap, but they are not there presently.

Even with the quality of the imports not yet being all that it should be or will be, the gulf in price differential well exceeds the perceived difference in "look," even to the best trained merchants.

For the average furniture consumer, even at the high end, it is often difficult to understand why one piece of furniture can cost so much more than another. As the quality of imported case goods has improved, the perceived value of imported case goods, which are often much more elaborately carved and decorated than comparably priced domestically made products, has grown rapidly. When looking at two pieces of furniture on a retailer's floor, it has become increasingly difficult for consumers to understand why the imported product costs so much less than the domestically made product – a phenomenon that we and some others call the "value gap."

In this situation, the likelihood rises that consumer becomes confused. Left to their own devices, most consumers tend to conclude that one piece of furniture must be highly overvalued, or else, that one piece of furniture must be of inferior quality. Rather than take the time to figure out the answer, in most cases the confused consumer simply does not make a purchase. While it is difficult to quantify what impact that this value gap phenomenon may be having on industry sales, we believe that it may be contributing somewhat to the malaise that gripped the high-end segment of the market since the end of 2000 and is just now beginning to turn.

Finally, this value gap should increase the sense of urgency among U.S.-based producers of high-end furniture to capitalize on the enormous labor differential. Since it will likely take additional time for the Chinese manufacturers to achieve high-end competency on their own, we think it likely that one or more domestic managements will act to create high-end capabilities. In the early going, it will require a combination of Chinese labor and U.S. know-how, which will limit somewhat the cost advantage. Irrespective, the difference should be sizable and worth the attempt.

China Has a Virtually Inexhaustible Labor Supply

Practically speaking, there is an inexhaustible amount of labor for these new factories. Current statistics suggest that there are 1.3 billion people in the country and we understand that about 500 million are in the coastal regions with 800 million in the interior of the country. China's policy is to disband many of its State-Owned Enterprises (SOEs), and these workers need to find employment. None of the management teams we visited indicated any difficulty in finding new workers; just the opposite.

Chinese factory workers are predominantly young. More than one factory executive said that the policy is to hire workers between the ages of 18 and 25, though those hired before the age of 25 can work past that age. Factory worker turnover consistently appears to run between 2-3% per month, which means that the full workforce turns over every three to four years.

"From 80 to 120 million surplus rural workers are adrift between the villages and the cities, many subsisting through part-time low-paying jobs."

New workers often come from the interior of China, where living conditions are often wretched. The CIA World Factbook estimates that "from 80 to 120 million surplus rural workers are adrift between the villages and the cities, many subsisting through part-time low-paying jobs." When employed, many live in company-provided dormitory housing, work for several years, save enough either to return home or to bring their loved ones East to a better life. Irrespective, it seems that the factory management teams will have to provide some continuing opportunity in order to continually upgrade the capabilities of their workforces.

Likewise, many of the factories are massive. A prevailing joke among Chinese manufacturers is that "less than 3,000 workers this year, small factory; less than 4,000 next year, small factory." To wit, workers are plentiful in all factories and we suspect that management teams are not too focused on improving productivity now, given the low labor costs and government goal of increasing employment. Accordingly, Western-style labor streamlining would probably not resonate well in this environment.

Though not always, working conditions in some of the factories would make Westerners shudder. In some cases, dust collection systems appeared inadequate, certainly by Western standards and perhaps with the tacit acquiescence of local officials, and safety guards on woodworking equipment were not evident. That said, it is important that we realize that these are according to our standards, and that the conditions may be far superior to those that the workers can find in other jobs or other endeavors.

Additionally, many of the factories — irrespective of size — appear to be laid out in a manner that many U.S. factory executives would find sub-optimal. Only one factory we visited (and a small part of another) used cells. Available numbers would seem to reinforce the conclusion about inefficiency. According to one Internet-available report, the annual productivity of the average laborer in the Chinese furniture industry in 2000 was RMB 24,000, or about $2,900. By contrast, the median revenue per employee for public U.S. residential manufacturers is $113,000, close to a 40:1 ratio.

We think this analysis is misleading, however, because it suffers from the shortcoming that it includes very small enterprises and some state-owned enterprises. In the factories that we visited, even those inefficiently configured, labor productivity was much higher than the computed average, ranging from about $25,000-$30,000 per worker. Accordingly, the equivalency ratio between the public U.S. factories and those visited is about 4:1.

Imputing further, labor rates in the visited factories were about RMB 1,000 per month, with the workers working about 280 hours per month. At today's currency exchange rate, this equates to about $0.43 per hour whereas the normal U.S. all-in labor rate is about $15 per hour. Factoring in the equivalency ratio, it appears the equivalent labor in China is now about 11%-12% of that in the U.S.

Not All Players May Be Using the Same Playbook

Chinese business rules differ from than those in the U.S. These differences are important to potential foreign investors because it could be easy to run afoul of regulations and get mired in costly delays.

In Chinese society, capitalism meets and meshes with communism and non-democratic ideals. Party and government officials are an integral part of the business fabric, and entrepreneurs pay attention to the wants and needs of those officials. During our trips, we noted that CEOs of several companies actually excused themselves to meet with government officials who requested their presence. In other cases, public officials actually accompanied us on the tour of some facilities. And in yet another instance, we were told that an investor in a start-up project had "strong" government connections, which was necessary to keep the project on a fast track.

As visitors enter various manufacturing compounds, it is common to pass through a guarded and gated checkpoint. It was intimated that the purpose of the security was to protect from within as much as from without, though the particular issue(s) were left unsaid.

Factories have been built in a matter of months, if not weeks, at a fraction of the capital costs that U.S. executives have come to expect for new facilities. To wit, in one example, the owner of newly created space asserted that his cost of construction was RMB 215 per square meter, which equates to less than $3.00 per square foot. As a contrast, excluding real estate costs, U.S. executives might expect to spend $15.00 per square foot or higher on new space.

Some of the reasons that the costs are lower include the lack of regulation; the lower quality of construction; and, of course, the lower costs of construction labor. Other differences include the speed to build. China remains a controlled society and, though in the midst of exploding growth in the coastal areas, local party and governmental officials are critical to "getting things done." This is important for foreign investors who have to know the rules and obstacles that may provide unpleasant surprises.

We have no data to judge returns on capital earned by Chinese manufacturers though the antidumping petition investigation may provide some clues. The companies are mostly privately funded and, in the rare instance where there might be a public entity, determining what is included is not easily apparent. Clearly, however, the level of continuing investment leads us to conclude that the entrepreneurs believe that the prospective returns are sufficient to warrant committing new capital.

U.S.-based manufacturers may be developing enough experience with China to get tempted to invest capital in either companies and/or facilities. As we noted above, there will likely be enough capacity at mid-level price points to accommodate the needs of the U.S. market for years to come. In our view, the best opportunity for investment is at the upper-end. Nevertheless, given that the rules in China are different than those we follow, U.S. corporate investors would be best advised to cultivate and develop trusted Chinese partners that are also well-connected politically. There remains, of course, a real sovereignty risk in this type of investment.

Given the number of new entrants to the U.S. market, it would be a safe bet that not all of the competitors are likely to behave rationally in the marketplace. Domestic manufacturers are consequently faced with a twofold threat. First, Asian manufacturers have a lower cost of production. Second, not all of the manufacturers compete with an eye toward maximizing return on invested capital.

An irrational competitor eventually will cease to become a competitor – a business cannot operate at a loss forever. That said, weak competitors can limp along for quite a long time, doing considerable damage to other companies' income statements in the interim. The fact that corporate governance and the financial/banking systems in the developing parts of Asia are not as developed as in the U.S. only exacerbates the situation.

The Potential for Supply Chain Disruptions

Given that it normally takes three to four weeks for a container of furniture to arrive in the U.S. from China and other Far East ports; imports lengthen the tail of distribution and logically necessitate higher inventories. For domestic manufacturers, lower levels of other components of inventory would likely modestly offset the increase in finished goods and/or raw materials. Additionally, as new players enter the competitive landscape, the potential for other inventory accumulation rises. In sum, the longer the supply tail, the harder it becomes for manufacturers and other importers to adjust supply to meet demand.

If consumer demand abruptly shifts downward, finished goods inventory can quickly build up in warehouses and showrooms across the country. When this happens, gross margins get slashed as retailers and wholesalers cut prices to reduce inventory and generate cash. The growth of imports as a percent of total industry sales will likely exacerbate this problem going forward.

The fall 2002 West Coast port work stoppage posed a distinctly different threat to the supply chain and a reminder about its fragility. The prospect of a Longshoremen strike focused attention on the ramifications of Chinese imports failing to materialize. More specifically, industry observers worried about the impact of the West Coast port work stoppage on industry revenues and earnings if and when the 80-day "cooling off" period expired and the Longshoremen went on strike and/or were locked out by management again.

Similarly, manufacturers and retailers are planning for alternative supply arrangements should the level of dumping margin be inordinately high and threaten the import advantage. The key for investors is to question managements about their flexibility when the supply chain is strained or broken.

Conflict Between Manufacturers and Retailers

Unmistakably, the development of Chinese furniture manufacturing continues to reshape the U.S. furniture manufacturing landscape. Though discussed less, the landscape of relations between domestic-based furniture producers/marketers and its retail customers has also changed. The most interesting ramification, however, seems to be a divergence of opinion among retailers about future relationships.

Some major retailers accuse the domestic producers of hogging the cost advantages by overpricing product, thereby limiting what would be the natural elasticity of demand. Other retailers have suggested that domestic manufacturers will become irrelevant, replaced by a combination of Chinese manufacturers and agents.

We find both arguments unconvincing, though important because they represent the beliefs and perceptions of major customers. Investors and producers should never forget the three proverbial keys to success in this industry: product, product, and product, a fact that never changes.

A key part of product is not only its design, which must be fresh and desirable, but it must also be attractively priced, properly constructed, and available in a timely fashion to meet retailers' needs. The residential furniture industry has long been criticized because it forces consumers to wait inordinate and often unpredictable lengths of time for delivery. The Chinese factor adds another complication to that situation.

Certainly, there will be different capabilities and competencies required to ensure that domestic producers remain vital and important. In addition to removing excess plant capacity, non-essential operating costs will also need to be pared. Chinese producers have lower overheads as do importer agents, and asking retailers to pay for bloated administrative overheads seems likely to be a failed strategy. These are issues that are not trivial, and we are confident that the most thoughtful management teams are already addressing them.

Trend: Where Will It Ultimately End?

Some investors believe that all furniture manufacturing will move offshore. We do not share that belief. What is likely to be the upper bounds?

Will imports reach some asymptotic percent of the total market and then level off, or are domestic residential furniture manufacturers an endangered species, relegated only to certain "protected" market niches?

While it would be difficult to project what percent of the total U.S. market imports will represent five years from now, we are confident that domestic manufacturing capacity will remain a visible and viable part the U.S. residential furniture industry over the next decade.

We find little evidence to support the assertion that all manufacturing will move offshore. There is no question that imports have made and will continue to make significant inroads in certain segments of the market. By 2003, imports accounted for 47% of total wood shipments and 15% of upholstery shipments.

It seems reasonable, ceterus paribus, to expect wood penetration to reach between 60-70% of industry shipments and upholstered to be 25%-35% of total shipments.

No one can know with certainty where these percentages will land in five years. Our suspicion is that wood penetration continues to exceed upholstered. It seems reasonable, *ceterus paribus*, to expect wood penetration to reach between 60-70% of industry shipments and upholstered to be 25%-35% of total shipments. The experience of two other industries, autos and textiles, may provide some clues.

Beginning in the 1970s, the U.S. auto industry faced rising imports from a reindustrializing Japan where labor costs were significantly lower than in the U.S. Initially, Japanese imports were focused on the low end of the market, with price a much more important factor in the purchase decision than quality.

In time, however, Japanese car quality improved and those companies penetrated higher end segments of the market and gained market share. Nevertheless, Japanese imports did not spell the end of domestic auto production. Similarly, we believe that the logistics of the furniture industry make it highly unlikely that imports will replace the entire domestic residential furniture industry; despite the large discrepancy in labor costs and the continuous improvement in import quality and styling.

The apparel industry experience provides the counter argument. Unlike autos, the U.S. apparel manufacturing industry buckled under the weight of low cost imports. As a result, domestic apparel manufacturers now represent only a small fraction of total industry shipments.

While both furniture and apparel are fashion businesses with high labor content, there are significant differences in the economics. Most important, apparel can be air freighted, which reduces the tail of distribution, or shipped by sea with very low per unit freight costs. Furniture, on the other hand, is bulky. As a result, ocean freight normally becomes a significant part of the unit cost for furniture.

Additionally, while apparel is mass-produced, upholstered furniture is often made to order, a fact that significantly complicates production scheduling and logistics. The logistics and lead-time tradeoffs lead us to conclude that all U.S. furniture manufacturing will not disappear.

That said, the percentage of the industry that will move offshore will continue to grow, at least for the foreseeable future.

The Ghost of Things to Come

In this section, following a short Porter Analysis, we discuss our views about how the industry will develop and what factors will drive success. In the following section, we then hypothesize about the structure of some of the entities that may appear in the next several years.

Porter Analysis

These analyses flow from a classic Porter analysis regarding: (1) barriers to entry, (2) supplier power, (3) buyer power, (4) threat of substitution, and (5) degrees of rivalry.

As discussed earlier, the absolute barriers to entering the manufacturing industry are low. Capital requirements are relatively modest though they are higher for wood furniture than for upholstery. Relative barriers, however, are more significant due to historical competencies in various niche segments and distribution legacies. Nonetheless, by acquisition, barriers have historically been lowered. Overall, we conclude that barriers to entry are moderate.

Neither suppliers nor buyers typically have much power. In the case of suppliers, there are usually enough options, and in the case of buyers, there has never been a shortage of customers. Additionally, a number of the inputs are commodities and these vary with supply and demand and are not readily hedged. In the case of labor, with the reduction in the domestic manufacturing footprint, labor is now plentiful.

While we note that there is never a shortage of customers, we need to recognize that not all customers are of equal strength or importance. The industry depends greatly on “relationships” that often have decades of history. Accordingly, while the buyers do not much power, they do have some and both manufacturers and retailers are strengthened when they work in concert.

In terms of substitution, the product is not readily substituted. A dining room does cannot easily perform the function of a bedroom. Nevertheless, as discussed earlier, the purchase is extremely deferrable, and within classifications, unlimited style and price point substitution is possible. Additionally, as consumer preferences change – and have over the past several decades – computers, cars, stereos, and other big-ticket items have occasionally crowded out purchases of furniture.

Rivalry in this industry equals China – not much more need be said.

Critical Factors of Success and Failure

As noted, price, while an important consideration, is not the only criterion successful furniture retailers use to choose their resources. Retailers need vendors that can quickly and reliably “flow product” from the factory to their stores, and this is a function of expertise in logistics.

While gross margin is important to the retailer, the amount of working capital that the retailer needs to operate its business is also a vital concern. Getting furniture from Asia to the U.S. extends the supply chain, requiring that someone bear the cost and risk of inventory. Purchases are most often paid for at the time of shipment. Many furniture retailers simply do not have the financial resources required to float their inventory across the ocean, even if the imports offer a few hundred basis points of incremental margin.

Uneven quality of imports is another serious issue. Sometimes quality issues are not evident until months after the furniture has already been delivered into a customer’s home, when the retailer gets a call from a customer who is upset

about the warping or splitting in their new dining room table or armoire. Quality assurance takes resources, both money and people, on the ground in Asia. Recently, a major manufacturer was forced to recall an entire first shipment of product that failed on retailers' display floors.

Quality issues are always present in wood furniture manufacturing. In China, the relative "newness" of the industry and lack of institutional knowledge exacerbates these issues, not normally an unwillingness and/or lack of care by the management teams to create better quality product. From the experienced China watchers in the group, however, we learned that the improvement continues to come in relatively large chunks. Three general areas of quality concerns are moisture content, purchased parts, and packaging materials.

Moisture content is typically the most critical variable in manufacturing wood furniture, and improperly dried wood can be a looming disaster for the retailer and/or manufacturer. Our experience, confirmed by other experienced industry veterans, suggests that when the moisture content of the product – before finishing and packaging – exceeds 10%, the risk of future checking, splitting, veneer separation, and/or cracking rises markedly.

Southern China, in particular, is quite humid and this means that manufacturers need to reduce and measure moisture contents at the beginning and during production. We saw a number of instances where special rooms were built in factories to reduce moisture during the flow of production.

The quality of unseen purchased parts is another area of focus. In one case, we saw where a manufacturer had used poorly constructed MDF (medium density fiberboard), which is a substrate for veneers. This type of problem could pass all the way through the distribution chain into customers' homes before problems might arise. Ultimately, however, some separation might occur, for which replacement would be the only remedy.

Packaging materials present potential issues as well. Interestingly, in one case, a manufacturer specified cartoning according to industry standard specifications and sourced the items from a local supplier. On testing, it was discovered, however, that the supplier had shipped cartons that were not as ordered. Few, if any, of the manufacturers we saw had the capability to test the cartoning.

Often, there are agent and other OEM customer-related quality assurance personnel in these factories on a continuing basis to monitor product quality and to catch potential problems before they get packaged and shipped. In fact, agents or OEM customers that operate without on-premises quality assurance people increase the risk of poor quality to levels that we believe are unwise.

Foreign manufacturers – particularly in the PRC and other emerging countries – have the advantage of low cost labor, but the quality of imports from the Far East remains an issue currently, especially at the higher-end of the price continuum. Fit, finish, and style become more important to consumers the higher the price point, and while the quality of imported furniture has improved substantially over the past several years, it still lags the best of the domestic manufacturers.

This is changing, however, and will continue to change. For this reason, U.S.-based furniture companies that are considering investing in China need not invest in the mid-level production facilities. Given the hyper-expansion now underway, there should be enough capacity to meet almost any conceivable need of these producers. High-end producers, however, face a more serious challenge. Few, if any, Chinese producers have the capability at this time to meet the quality of high-end producers.

Additionally, retailers need vendors that can reliably "flow product" from the factory to the showroom floor, a capability that requires expertise in logistics and a significant investment in working capital that many foreign manufacturers will find difficult to develop and support. Bottom line, imports will likely grow as a percent of the total U.S. market over the next five years, but as in electronics, computer chips, automobiles, and many other categories, domestic manufacturing capacity will remain an important part of the total U.S. industry.

Domestic furniture manufacturers have not been idle in responding to the growing reality of imports. In response to the growing reality of imports, we are increasingly seeing domestic manufacturers import both components and fully assembled and finished furniture into the U.S. This strategy of blending domestic manufacturing capacity with offshore sourced components and products allows U.S. manufacturers to gain the benefits of low cost Asian labor, while simultaneously assuring the fit, finish, and service that domestic retailers demand.

It appears that a growing number of domestic manufacturers, in fact, are attempting to incorporate product complexity and options as a source of competitive advantage in the competition with imports. By bringing out large collections with a wide variety of SKUs and multiple finish options, these domestic manufacturers hope to make it much harder for importers to match their range of product offerings, thereby reducing direct competition.

The implicit wager that the domestic manufacturers are making is that foreign manufacturers will be loath to give up extended runs of a few SKUs in order to match the breadth of product offerings that the domestic manufacturers are presenting to retailers. More SKUs obviously mean an increase in the number of component parts and smaller production runs, which typically adds inefficiencies and costs to production and additional inventory burden.

Until now, many of the foreign manufacturers have sought long production runs to increase efficiencies and reduce unit costs. If product line complexity can help forestall the competitive threat posed from imports, then domestic manufacturers will benefit even if more complexity increases domestic manufacturing costs. On the other hand, even if foreign manufactures rise to the challenge presented by increased SKUs and finishing options, unit costs are likely to rise; dampening some of the relative advantage conferred to foreign manufacturers by way of lower labor costs.

The unstated assumption in this strategy, of course, is that the consumer will value additional choices at least as much if not more than she values price alone when making furniture purchase decisions. It is an interesting question for furniture retailers who must decide what product to put on their sales floors.

There are times when consumers are more open to purchasing entire collections, and times when they seem more prone to purchasing individual items. In recessions, consumers are more focused on price and value and are more likely to purchase individual items rather than collections as a result. In better times, wider collections and choices have become more popular.

Upholstery manufacturers have felt less threatened by import competition for a number of reasons. First, upholstered furniture is a fashion business. Customers have literally hundreds of fabric coverings to choose from for any frame, making it difficult to forecast future demand with certainty. Any company that tried to import a broad line of fully upholstered furniture from Asia to the U.S. would have to be willing to shoulder an unreasonable amount of inventory.

Fully upholstered product is also bulky and, with one important exception, cannot be compressed. About 120 seats fit in a 40-foot container that costs

about $4,000 in ocean freight. This $30+ per seat freight cost means that a normally scaled three-seat sofa carries $100 in freight to reach this country. This limits the choice of set-up upholstery that can reasonably be made and shipped assembled to either leather upholstery or relatively more expensive fabric upholstery.

The exception to the physical compression of upholstered products pertains to "cut and sewn" covers. Manufacturers can import cut and sewn covers and upholster these to frames built domestically. Accordingly, there is an increase in the import cut-and-sewn covers (primarily leather), which represent the most labor-intensive and least bulky component of upholstered furniture. One manufacturer told us that as much as $450,000 worth of cut and sewn leather covers could be packed into one container.

As noted, an exception to the generalization about importing fully upholstered items has been with leather upholstery. The number of frame/color combinations available for leather seating is less than for cloth fabrics, thus reducing both forecasting complexity and the amount of inventory an importer needs to hold. Additionally, the value per piece is typically greater than for equivalent fabric covered upholstery (except at the very promotional side of the industry). Accordingly, though not immune, domestic upholstery makers will remain more insulated from the impact of imports.

The fully upholstered issue aside, domestic fabric makers (upholstery textile mills) are in for some rude competition. We visited one Chinese textile mill where the entrepreneur/owner/designer had created a broad offering of chenille and textured jacquard designs that were significantly less expensive than comparable U.S.-produced goods. Ironically, these patterns were being produced with low technology (old fashioned card-driven jacquard looms) that cost about $3,800 each. This compares to the cost of a new, modern, high-speed loom of about $200,000.

Chinese textile mill producers are not as motivated as their U.S. counterparts to buy the fastest, most labor-efficient looms. The lower labor advantage factors into both its cost of fiber production and its labor cost to weave and repair fabric coming off the looms. Additionally, given the cheaper cost of building, the Chinese overhead burden is probably lower as well. By one account, even after factoring in tariff and quota costs and freight for "roll" goods (where there are restrictions), the per yard costs were 30-35% lower than comparable domestic fabric. On a typical three-seat sofa, this could amount to a difference of $50 at wholesale or $100 at retail, enough to be meaningful.

Ultimately, we expect to see a number of domestic manufacturers, in both the case good and upholstery components of the industry, begin to invest capital in Asia, whether by establishing their own factories or by taking an equity stake in an existing furniture manufacturer.

The end result will be the creation of a new generation of hybrid manufacturer/marketers, combining domestic and offshore manufacturing assets, the logistical expertise necessary to coordinate production and delivery of furniture across multiple continents, and a strong balance sheet in order to fund increased levels of working capital. Further, we believe that the investment flows will likely flow in both directions, with more Asian manufacturers/entrepreneurs investing in U.S. companies in order to obtain U.S.-based manufacturing assets and to assure distribution of product coming out of factories in Asia.

The changes brought about by the rapid growth of imports are changing the required competencies for success in the residential furniture industry. Over time, we believe that success will require not only balancing manufacturing

capacity in Asia and the U.S., but also the logistical expertise needed to ensure consistent and reliable delivery of product to customers from a network of factories spanning multiple countries. Accomplishing this is not trivial, and therein lays the silver lining in this story.

We expect that successful residential furniture producers in the future will require a manufacturing presence in both Asia ***and*** North America, a strong balance sheet in order to fund increased levels of working capital, and the expertise in logistics necessary to coordinate production and delivery of furniture across two continents.

A Proliferation of Business Models

Pure Domestic Manufacturers

The era of a purely domestic manufacturer, if it ever existed, has ended. The realities of competition and consumer preferences mean that manufacturers have to pay attention to style, cost, quality, logistics, and service. Any manufacturer that claims to be wholly domestic in production will either serve a very small niche or be vulnerable to continual market share erosion.

Asian/Chinese OEM Manufacturers

This has been the model that has spurred the rapid growth of imports in the last decade. At first, Taiwanese entrepreneurs, capitalizing on vast cheap labor and new political/economic realities, established facilities on the mainland to produce furniture. Most often, though not always, their first customers were either domestic manufacturers or agent middlemen who sold product to domestic manufacturers and, in some cases, large retailers. In this case, the domestic makers and their agents essentially effected a technology transfer to these new producers — trading their know-how of design, production technique, and quality requirements for cheap product. The education remains long after the product has been shipped and sold.

Hybrids

Given the success of the early entrepreneurs, additional entrants, including some Chinese nationals, entered the landscape. In one case, one of the early entrepreneurs and, according to *Furniture Today*, the largest, Lacquer Craft, has several simultaneous strategies. It remains an OEM manufacturer with strong relationships with a number of the largest domestic manufacturers. It also now owns the U.S. distribution arm of Universal Furniture and has several dedicated manufacturing facilities to that business. Additionally, Lacquer Craft, or its principal, was the primary equity backing of a domestically based importer, Legacy, and that relationship continues today. Finally, though unconfirmed, we believe that Lacquer Craft's principal also has a significant equity ownership in the publicly held portion of another Chinese manufacturer, Marcor Holdings.

Direct Imports by U.S. Retailers

A few large U.S. retailers have established buying operations in the Far East in order to source merchandise directly from the Asian producers. Rooms To Go and Value City are the two most visible when visitors wander through some of the factories. Also, product for some specialty stores like Pottery Barn Kids and Bombay are visible, though agents that act as the quality control middlemen may, in fact, source these products. We do not know of any U.S. furniture store retailer that has an extensive quality control operation abroad.

Chinese Manufacturers Forward Integrating

The success of Chinese entrepreneurs has sparked the thought that some would either buy domestic distribution in terms of retailers and other manufacturer/wholesalers. Indeed, Lacquer Craft bought the distribution arm of Universal. There has not, as yet, been any additional activity, though such actions could happen in the future. We are less convinced that Chinese owners will attempt to enter furniture retailing in the U.S. in a significant way. This avenue has been difficult for U.S. manufacturers — though that avenue is being traveled more often now — and we think it would be far more difficult for an overseas owner.

U.S. Manufacturers Integrating Backward and Forward

Of all of the potential new structures, this is the one that we think may be the most powerful. Much has been written and discussed in the last decade about open and closed distribution in the industry. Open distribution is where retailers do not dedicate space to one or more manufacturer's brands, either in a gallery or store setting, but either merchandise in lifestyle settings or room-specific displays. Closed distribution requires dedicated display square footage, either in an existing in-store gallery or in a dedicated store operation. A departure in the next several years will determine the degree to which domestic manufacturers expend capital to own domestic retail square footage.

Ethan Allen is the prototypical example of closed distribution. As one of the most highly valued and most profitable manufacturers, it has increased its ownership of stores and continues to be the buyer of choice when its independent dealers wish to exit. Bassett Furniture, Furniture Brands International, and several others have made it known that each will own more stores in the future. In addition to capital, each of these organizations will have to develop retail management skills if that strategy is to be successful.

Another issue will be the degree that domestic producers integrate backward to Asian production. To date, there has not been much willingness of U.S.-domiciled makers to integrate backward into ownership of facilities in Asia, particularly China. Furniture Brands owns facilities in the Philippines, but to date has no committed capital for manufacturing in the PRC. The rules in China, as discussed earlier, the amount of OEM capacity, and the potential for some new dumping duties have made managements very cautious. Ultimately, however, that kind of structure makes sense whether it comes in the form of an acquisition, merger, or outright Greenfield startup.

The Chinese Domestic Market Remains the Ultimate Prize

With its nearly 1.3 billion people, rising standards of living, and rapidly commercializing economy, China would appear to be a tantalizing target of opportunity. In the 20 years that China has been open to the outside and began its process of reform, foreign funded enterprises have dominated the development of furniture manufacturing. Nevertheless, the majority of Chinese consumers are yet unable to afford good quality furniture.

According to a somewhat-dated U.S. Department of State analysis, furniture sales in China totaled about $8.4 billion in 1996 (*versus* U.S. retail sales of $69 billion in 1996 or $93 billion currently), with imported furniture accounting for less than 3% of that total and actually declining. That statistic, however, may be somewhat misleading because of the explosion of medium quality makers in the country.

The two factors that will determine the growth and development of the Chinese residential furniture market are (1) rising disposable income of Chinese consumers and (2) housing reform that permits and encourages Chinese citizens to purchase homes and apartments.

According to the State Department report, current income distribution patterns favor the young urban professionals who are under 45 years old. For example, in Shanghai, 51% of the 18-45 year olds are in the mid-to-high income bracket while only 21% of the 45-64 year olds are in the same bracket. This is vastly different than in the U.S., where older consumers are also the most affluent. In China, the younger generation is more attuned to the economic reforms and to other tastes and styles. This generation and the one behind it will be a growing market for Western-styled product including furniture.

Additionally, the report notes that there were about 70 million urban households in 1996. Apparently, housing reform legislation became effective in mid-1998 that permits and encourages Chinese citizens to purchase and own their own homes and apartments. While most still live in state-owned housing, the report suggests that most Chinese in major cities will take ownership of their residence in the next two decades.

Several conclusions seem readily apparent: (1) urban markets present the most fertile opportunity for residential furniture sales; (2) the younger Chinese consumers are the most likely consumers for Western-styled product; (3) that, despite its small size currently, the market will likely develop at a rapid rate for the foreseeable future, and (4) U.S. companies would be well-advised to begin cultivating methods to serve this market.

Industry in Transition or Trouble

Harking back to the Porter analysis, we believe that companies that develop manufacturing capability around the world and have strong distribution links in the largest and most vibrant markets will create nearly unassailable barriers to entry and ultimately “weed out” weaker, less profitable competitors.

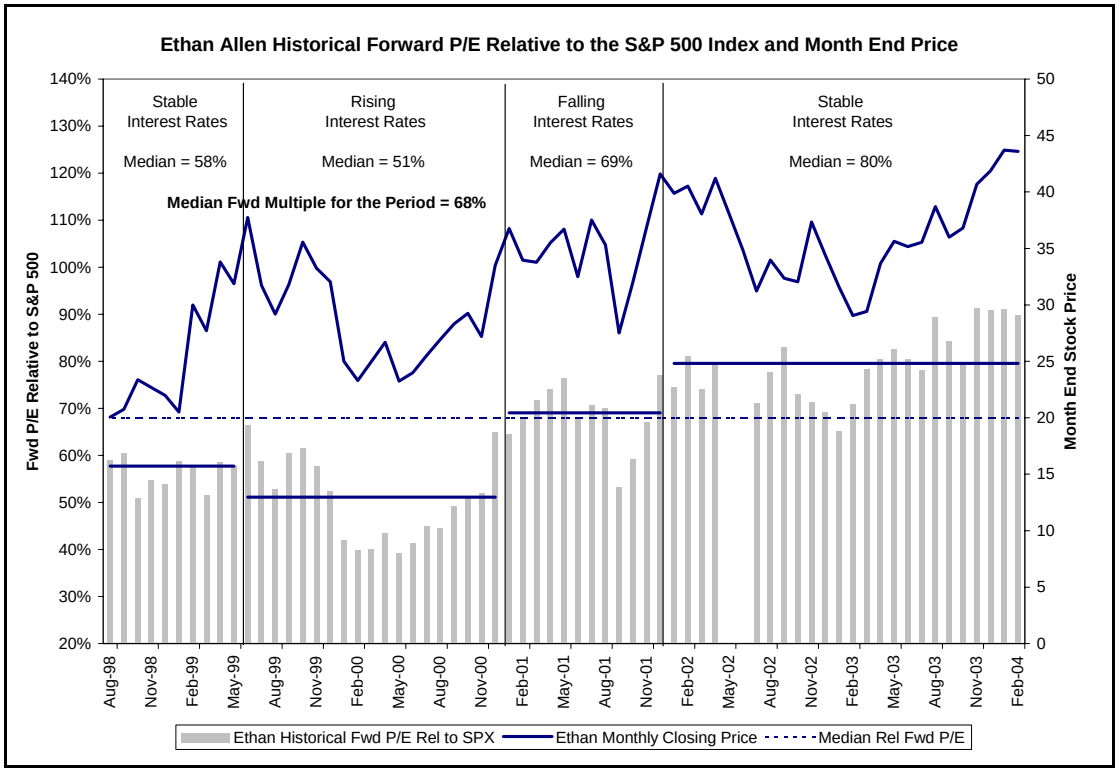
Higher barriers to entry, in turn, will mean that these companies will be able to raise and defend margins, operate at higher levels of profitability, and boost returns on invested capital. Finally, higher returns on invested capital, in conjunction with higher barriers to entry, should translate into improving valuation multiples in the stock market for the shares of surviving companies. The path may be difficult, but it increasingly looks like there really is a light at the end of the tunnel for those companies that pursue this course and execute the transition.

Appendices

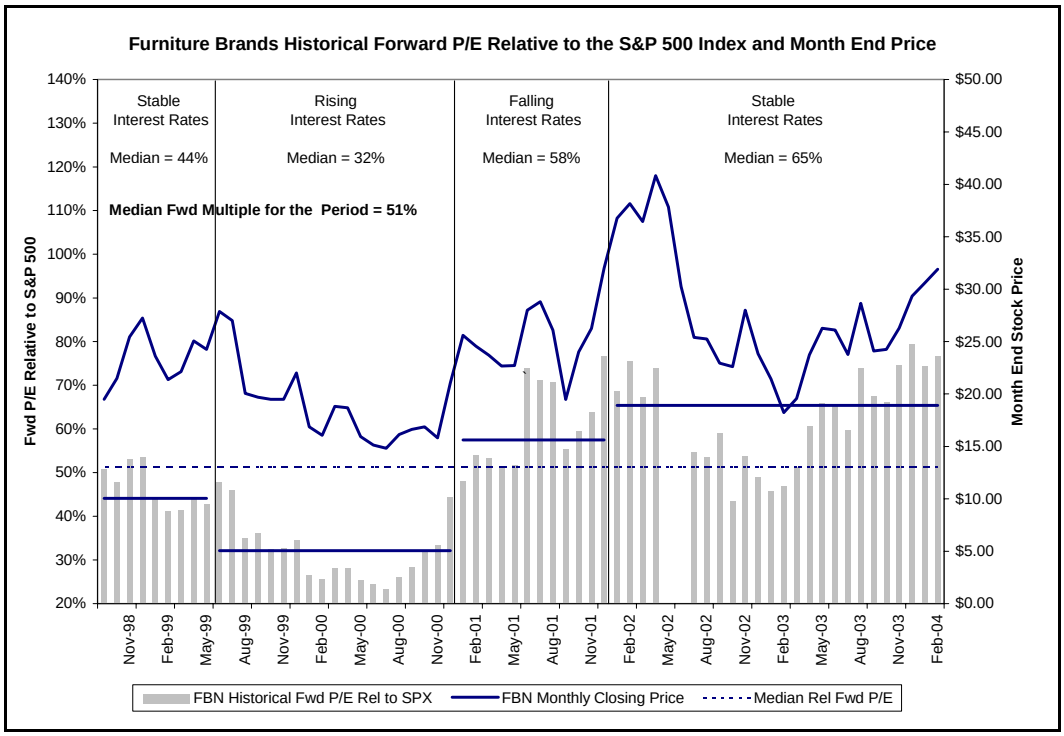
Companies Included in the Raymond James Furniture Manufacturer Index

Constituents	
QFAB	Quaker Fabric Corp.
NTZ	Natuzzi S.p.A.
LEG	Legget & Platt Inc.
BSET	Basset Furniture Industries Inc.
LZB	La-Z-Boy Inc.
CFI	Culp Inc.
BSH	Bush Industries Inc.
FLXS	Flexsteel Industries Inc.
ROW	Rowe Companies
CRC	Chromcraft Revington Inc.
FBN	Furniture Brands International Inc.
STLY	Stanley Furniture Company Inc.
ETH	Ethan Allen Interiors Inc.
HOFT	Hooker Furniture Corp.

Source: Raymond James Research.



Source: Baseline, Raymond James Research.



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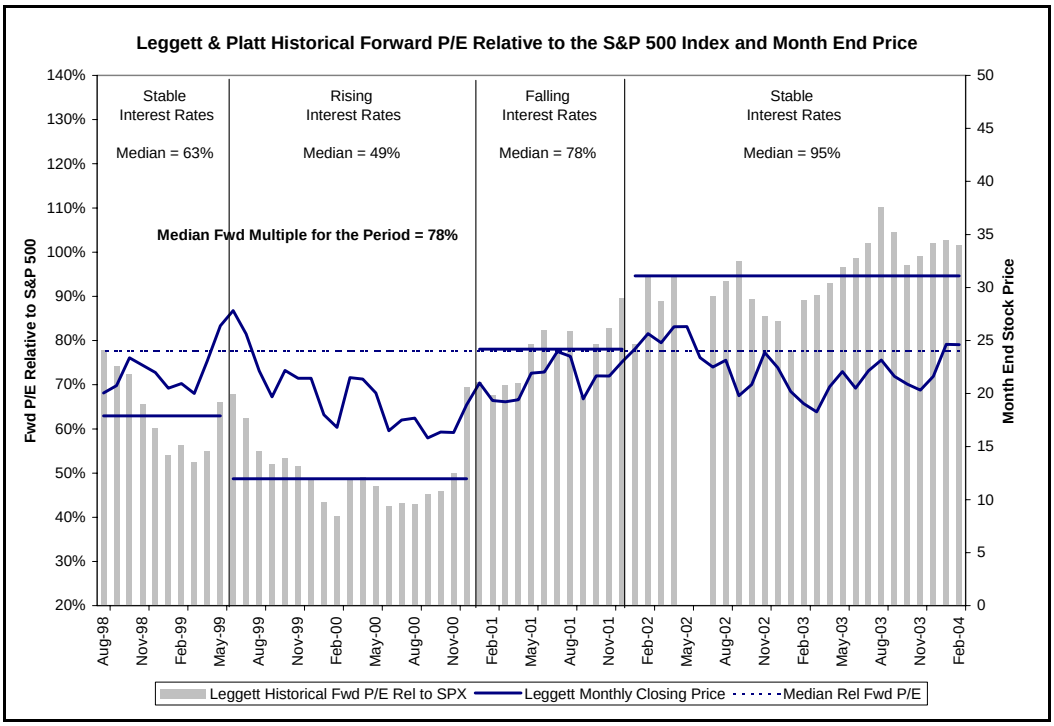

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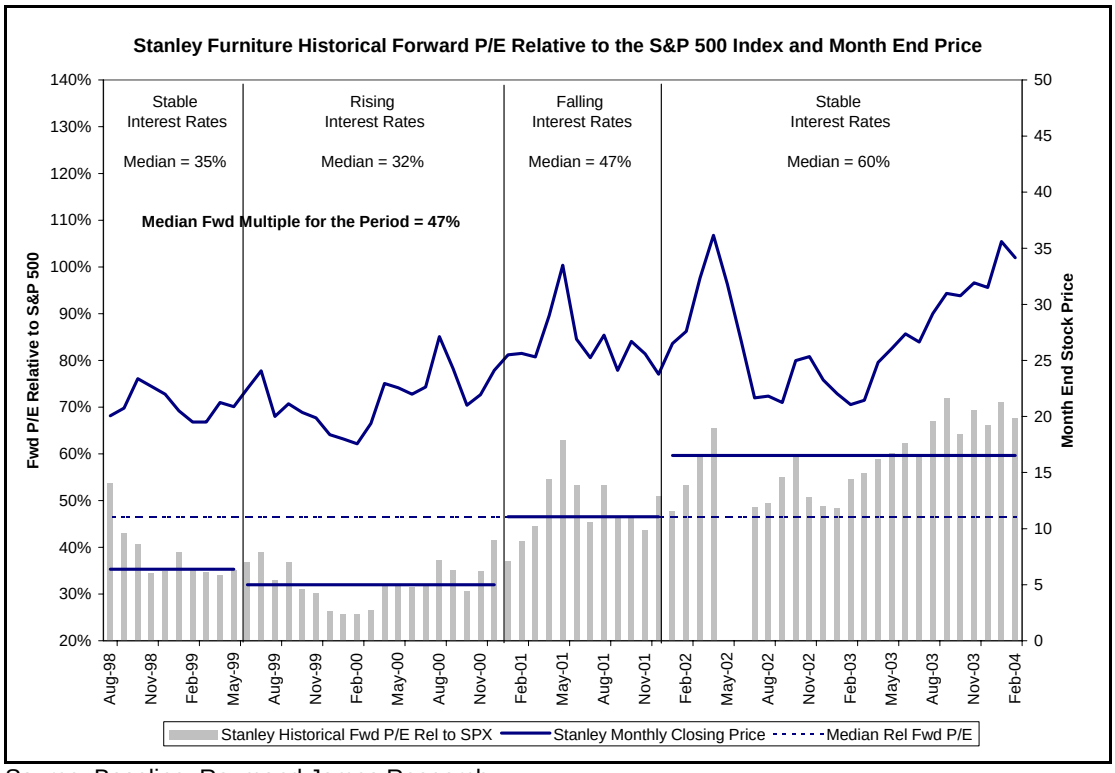

Source: Baseline, Raymond James Research.

METAL AND OTHER FURNITURE								
All Figures in $ Millions								
Imported Finished Goods & Components	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**6 Yr CAGR**
Imported Metal Household Furniture	878	1,127	1,395	1,671	1,923	1,818	2,028	15.0%
Imported Other Materials Household Furniture	382	419	473	583	649	612	635	8.8%
Imported Furniture & Fixtures Not Elsewhere Classified	599	674	816	1,040	1,292	1,248	1,370	14.8%
Total Imported Finished Goods & Components	**1,859**	**2,220**	**2,684**	**3,294**	**3,864**	**3,678**	**4,033**	**13.8%**
Domestic Manufacturers Shipments (AFMA), Net of Imported Components	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**6 Yr CAGR**
Metal & Other Furniture	2,097	2,161	2,118	2,101	2,005	1,800	1,724	-3.2%
Total U.S. Residential Furniture Shipments at Wholesale	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**6 Yr CAGR**
Total Metal & Other Furniture at Wholesale	3,357	3,708	3,987	4,355	4,577	4,230	4,387	4.6%
Imported Furniture & Fixtures Not Elsewhere Classified	599	674	816	1,040	1,292	1,248	1,370	14.8%
Total U.S. Wholesale Metal & Other Furniture Market	**3,955**	**4,381**	**4,803**	**5,395**	**5,869**	**5,478**	**5,757**	**6.5%**
Sources: American Furniture Manufacturers Association (AFMA); Department of Commerce, International Trade Administration; and Raymond James Research								

$ Billions	1996	1997	1998	1999	2000	2001	2002	6 Yr CAGR
Imports of Metal & Other Furniture	1.9	2.2	2.7	3.3	3.9	3.7	4.0	13.8%
Domestic Production of Metal & Other Furniture	2.1	2.2	2.1	2.1	2.0	1.8	1.7	-3.2%
Total U.S. Wholesale Metal & Other Furniture Market	4.0	4.4	4.8	5.4	5.9	5.5	5.8	6.5%
Year-Over-Year % Change:								
Imports of Metal & Other Furniture		19.5%	20.9%	22.7%	17.3%	-4.8%	9.6%	
Domestic Production of Metal & Other Furniture		3.1%	-2.0%	-0.8%	-4.6%	-10.2%	-4.2%	
Total U.S. Wholesale Metal & Other Furniture Market		10.8%	9.6%	12.3%	8.8%	-6.7%	5.1%	
Share of Wholesale Production:								
Imports of Metal & Other Furniture	47.0%	50.7%	55.9%	61.1%	65.8%	67.1%	70.0%	
Domestic Production of Metal & Other Furniture	53.0%	49.3%	44.1%	38.9%	34.2%	32.9%	30.0%	
Total U.S. Wholesale Metal & Other Furniture Market	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	

Sources: American Furniture Manufacturers Association (AFMA); Department of Commerce, International Trade Administration; and Raymond James Research

All Figures in $ Millions									7-Year
Imported Finished Goods, net components	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**CAGR**
Metal Household Furniture	684	897	1,100	1,353	1,542	1,480	1,666	2,032	16.8%
Other Materials Household Furniture	289	317	363	463	517	497	519	517	8.7%
Furniture & Fixtures Not Elsewhere Classified	353	337	432	544	726	655	747	872	13.8%
Total Imported Finished Goods, net components	**1,326**	**1,551**	**1,895**	**2,360**	**2,785**	**2,633**	**2,932**	**3,420**	**14.5%**
Imported Components	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**7-Year CAGR**
Metal Components	194	230	295	317	382	338	362	436	12.3%
Other Materials Components	93	102	110	120	132	115	116	121	3.9%
Components Not Elsewhere Classified	246	337	384	496	565	592	623	686	15.8%
Total Imported Components	**533**	**669**	**789**	**934**	**1,079**	**1,045**	**1,101**	**1,244**	**12.9%**
Total Imports	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**7-Year CAGR**
Metal Household Furniture	878	1,127	1,395	1,671	1,923	1,818	2,028	2,468	15.9%
Other Materials Household Furniture	382	419	473	583	649	612	635	638	7.6%
Furniture & Fixtures Not Elsewhere Classified	599	674	816	1,040	1,292	1,248	1,370	1,558	14.6%
Total All Categories	**1,859**	**2,220**	**2,684**	**3,294**	**3,864**	**3,678**	**4,033**	**4,664**	**14.0%**

Sources: American Furniture Manufacturers Association (AFMA); Department of Commerce, International Trade Administration; and Raymond James Research

Specific Investment Risks Related to the Industry or Issuer

Deflation
Pricing pressure from imported products combined with a low-inflation domestic environment can result in lower selling prices and profit margin compression.

Interest Rates
End-market demand for big-ticket manufactured products can be affected by consumer borrowing costs.

Macroeconomic Cyclicality
Consumer demand for furniture and furnishings is dependent in part on aggregate consumer income and aggregate consumer expectations for future income. These variables are a function of macroeconomic conditions, and are reflected in consumer confidence measurements and other consumer data.

Raw Material Pricing
Furnishings manufacturers' costs can be affected by changes in the prices of input commodities, including hardwoods, plastic resins and steel.

Trade Relations
Furnishings manufacturers are increasingly dependent on production in low-cost locales, including but not limited to China, the Pacific Rim, Eastern Europe and Mexico. Trade relations and international affairs can affect the availability of product from those sources.

For Company Specific Risks please see www.rjcapitalmarkets.com/SearchForDisclosures_main.asp

The views expressed in this report accurately reflect the personal views of the analyst(s) covering the subject securities. No part of said person's compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in this research report.

Public companies mentioned in this report.

Company Name	Ticker	Priced as of 02/24/04	RJ&A Rating (if Applicable)
Bassett Furniture	BSET	$21.47	
Bush Industries	BSH	2.54	
Chromcraft Revington	CRC	13.88	
Dorel Industries	DIIB	32.98	
Ethan Allen Interiors	ETH	43.00	Market Perform
Flexsteel Industries	FLXS	21.34	
Furniture Brands International	FBN	31.80	Strong Buy
Hooker Furniture	HOFT	24.32	
La-Z-Boy	LZB	22.38	
Natuzzi S.p.A.	NTZ	10.65	
Rowe Furniture	ROW	4.30	
Select Comfort	SCSS	25.03	
Stanley Furniture	STLY	36.90	Market Perform
Haverty's	HVT	20.44	Market Perform
Bombay Company	BBA	7.03	Market Perform
Pier 1 Imports	PIR	22.66	Market Perform
Culp	CFI	11.30	Market Perform
Leggett & Platt	LEG	24.43	Strong Buy
Quaker Fabric	QFAB	8.34	
Levitz	LVFIQ	0.0001	
Berkshire Hathaway	BRK.A	95060	
Value City	RVI	6.00	
Restoration Hardware	RSTO	4.18	Market Perform
O'Sullivan	OSULP	0.25	
Wal-Mart	WMT	59.95	
Williams Sonoma	WSM	30.99	Market Perform

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Additional information is available on request.

The Raymond James Consumer Research Team (727) 567-1000

Budd Bugatch, CFA
Director of Furnishings Research - 72527

Sam Darkatsh
Furnishings - 72537

Bryan C. Elliott, CFA
Restaurants - (404) 442-5856

Rex Henderson, CFA
Furnishings-Retail – 72697

Joseph D. Hovorka
Entertainment & Leisure - (404) 442-5863

A. Gerald Marks
Automotive Retailers - 72749

David Schamus, Sr. Research Associate

Morry Brown, Research Associate

Jon Tait, Research Associate

Chris Thornsberry, Research Associate

Raymond James Investment Ratings

1. **Strong Buy**..... Expected to appreciate and produce a total return of at least 15% and outperform the S&P 500 over the next six months. *For higher-yielding and more conservative equities, such as REITs and certain MLPs, a total return of at least 15% is expected to be realized over the next twelve months.*
2. **Outperform** ..... Expected to appreciate and outperform the S&P 500 over the next twelve months. *For higher-yielding and more conservative equities, such as REITs and certain MLPs, an Outperform rating is used for securities where we are comfortable with the relative safety of the dividend and expect a total return modestly exceeding the dividend yield over the next twelve months.*
3. **Market Perform**..... Expected to perform generally in line with the S&P 500 over the next twelve months and is potentially a source of funds for more highly rated securities.
4. **Underperform** ..... Expected to underperform the S&P 500 or its sector over the next six to twelve months and should be sold.

Suitability ratings are not assigned to stocks rated Underperform. Projected 12-month price targets are assigned only to stocks rated Strong Buy or Outperform.

Suitability Categories

Total Return (TR) ..... More conservative investments with dividend yields of 2.5% or more and favorable appreciation prospects.

Growth (G)..... Quality companies with well-above-average appreciation potential, quarterly earnings consistency, and possibly a small dividend.

Aggressive Growth (AG)..... Companies with rapid growth potential and accompanying higher risks.

Cyclical (C) ..... Companies with fundamentals that are unusually sensitive to changes in major economic trends.

Speculative (S) ..... Small companies with high risks including variable earnings, financial and competitive factors as well as liquidity issues.

Venture Risk (VR) ..... Newer companies with a short, unprofitable operating history, limited revenues, and a much higher-than-normal risk associated with success.