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Industry Report: Home Furnishings Retailers

Introduction

Retailers of home furnishings of all kinds—from linens to tabletop items—have struggled in 2008 as consumers increasingly rein in discretionary spending due to myriad economic factors including high gas prices and the credit crisis. Sales of high ticket, durable goods such as furniture have slowed significantly over the past two years as a result of the struggling economy and slumping housing market. *Furniture Today* reported that residential furniture sales first exhibited declines in 2006 and worsened throughout 2007 as the credit crunch expanded and home values dropped. Market volatility in 2008 has resulted in decreased credit lines and downsized inventories as home furnishings retailers weather poor sales figures tied mainly to fewer new home purchases. Government estimates showed a 2.1% decline in the total retail consumption of furniture and bedding over the first quarter of 2008. Meanwhile, retailers of tabletop goods and dinnerware have struggled to maintain historic benchmarks for sales. Overall, high end retailers have fared better than middle-of-the-road stores. For example, Williams-Sonoma's sales have declined less in the second quarter at its luxury chains than at its middle market stores such as Pottery Barn. Same-store sales fell 4.5% at stores operating under the Williams-Sonoma banner while Pottery Barn's comp. sales dropped a chainwide-high 16%. Industry leader Bed, Bath & Beyond's comp. sales decreased 0.1% over the second quarter of 2008 after showing modest increases during the first quarter.

Industry Outlook

Goods of all types, from big ticket furniture and chairs to tabletop items, are likely to experience sales declines during the next year as consumer spending tightens amidst a struggling national economy and ongoing credit crisis. In anticipation of stricter lending requirements and decreased spending, many retailers are scaling back sales projections and planned store openings for 2009. Retailers offering special services such as custom upholstery and in-home consultations may be able to better offset decreases in customer traffic. Meanwhile, companies such as La-Z-Boy have expanded e-commerce operations to save on operating costs. Experts have predicted that chains carrying large selections of gift items, such as tabletop and dinnerware, may struggle to meet historic sales figures.

Appraisal Factors

Based on recent liquidations and appraisal experience, Tiger Valuation offers the following factors for consideration when analyzing home furnishings retailers:

- **Average discounts –** Several home furnishings retailers have liquidated inventory and shuttered stores over the past two years, including Linens 'n Things, The Bombay Company and Wickes Furniture. Department stores with home goods sections such as Goody's, Boscov's and Mervyns have also closed underperforming locations. Increased GOB sale events may saturate the marketplace in 2009 and competing retailers may be forced to increase discounting activity to drive store traffic. Increased average discounts adversely affect recovery values due to the likelihood that customers would require deeper discounts in a GOB event.
- **Augmentation** – Where permitted by law, creditors may benefit from inventory augmentation of domestics, housewares, furniture and tabletop departments. In an augment scenario, the estate would receive a negotiated percentage of net sales in exchange for its support of the inclusion of additional goods in a GOB sale. Augmentation helps to optimize discounting activity on original inventory as complementary merchandise arrives at stores, maintaining an appropriate inventory mix.
- **Inventory aging** – Lenders should closely monitor inventory aging, particularly within furniture categories that may sell through slowly over the next 12 months as consumers tighten spending. A significant percentage of aged goods as a proportion of total inventory can negatively impact recovery values.
- **Brand names** – Furniture, tableware and bedding merchandise with recognizable, well-established brand names typically generate higher recoveries as a percentage of cost than lesser known private label goods.
- **Customer deposits / layaways** – Retailers carrying big ticket items such as living room furniture often require customer deposits for custom-made products or layaways. A large backlog of unfulfilled custom orders or layaways at the beginning of a GOB event may affect recovery values if special orders are cancelled or cannot be completed.

Conclusion

Home furnishings retailers will face considerable challenges throughout the rest of the year and into 2009 due to a declining housing market, overseas imports and increased competition for cash-strapped consumers. The Furniture Buying Index, created by America's Research Group in 1992, recently indicated that demand for furniture in 2008 has dipped to historic lows. National chains offering low-priced furniture and home goods such as IKEA, Target and Costco have increased their market share over the past year due largely to competitor liquidations. As more store closings occur in the marketplace, lenders should closely monitor borrowers' discounting activity to ensure that margins are not sacrificed in order to maintain customer traffic.