

Industry Report: Floor Coverings Retailers

Introduction

Retailers of area rugs, carpets and other floor covering materials have been deeply affected by the struggling economy and the prolonged slump in the real estate market. According to Floor Covering Weekly, industry data suggests that carpet sales were down about 20 percent during the second quarter of 2009 as compared to the year prior. Within the area rugs sector, Home Textiles Today reported that direct sales channels (catalog, e-commerce) grew approximately 19 percent in 2008 while discount retailers increased their market share by 8 percent. Independent freestanding stores continue to struggle to maintain normal levels of foot traffic amidst the national economic recession. Generally, high end designer-focused retailers and off-price, salvage retailers (Home Goods, Costco) have fared best within the recent market conditions.

Appraisal Factors

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

- **Discounting activity** – Rug and carpet stores often utilize going-out-of-business (GOB) sale signage in order to drive foot traffic in stores. These promotions are often unrelated to bankruptcy filings, which has led to heightened consumer expectations of discounts at many of these retailers. Legitimate GOB sale events have further saturated the marketplace over the last 12-24 months. With foot traffic at a premium, especially within the area rug sector, competing retailers are often forced to increase discounting activity. In a true GOB event, discounts would need to exceed historical levels in order to efficiently sell through inventory balances. Thus, the net recovery value of merchandise within retailers who have already employed deep discounts is likely to be negatively affected by the heightened promotional activity.
- **Multi-level pricing** – Particularly within major consumer markets, rug and carpet stores routinely include a MSRP or "list" price on merchandise tags to accompany the company's day-to-day price (e.g. "our price"). Retailers generally include MSRP prices on merchandise tickets to convey to consumers the everyday value of the goods. In determining the discounting structure for a GOB sale, it is important for liquidators to identify the actual "retail value" of a company's stock ledger and whether merchandise tags reflect original price points or the day-to-day price as it will ring up at the point-of-sale.
- **Inventory aging / relevance** – Lenders should closely monitor inventory aging, particularly within the category of area rugs. Salability of area rugs is closely linked to transitory styles and fashion trends. Area rugs, both machine and handmade, are made in every style, color and design imaginable and what is "hot" today could fall out of fashion within a matter of months. Inventories can become outdated or obsolete relatively quickly, thus greatly reducing GOB sale recovery values. Hand-woven rugs of exemplary quality are less impacted by design trends because demand typically outpaces supply. Meanwhile, the recovery values for carpeting and hard surfaces are less sensitive to aging and design trends. Therefore, the proportion of products susceptible to fashion trends versus more stable merchandise types such as carpeting and hardwood flooring should be taken into consideration when valuing inventory balances.
- **Brand names** – Area rugs, carpeting and hard surfaces with recognizable, well-established brand names such as Tufenkian, Karastan and Mirage Floors typically generate higher recoveries as a percentage of cost than lesser known brands. For hand-knotted rugs, true Persian rugs (those woven in Iran), although a statement of origin rather than a name brand, may generate higher recoveries in a GOB sale than generic brands or private labels.
- **Installation services** – Sales of flooring materials such as hardwood paneling and wall-to-wall carpet are often dependent upon the availability of installation services. If hardwood flooring and carpeting retailers were to discontinue install activities in the event of a GOB sale, recovery values would be adversely affected. In instances where install options could not be offered, the inventory may only carry a minimal wholesale value.

Conclusion

Sales of flooring, carpet and area rugs are likely to remain soft until the housing market improves significantly. As the retail market recovers and consumers limit discretionary spending, items such as big ticket area rugs are likely to be marketed mainly as practical, lifestyle decorations rather than as long-term investments or heirlooms. Meanwhile, experts predict that furnishing options such as resilient flooring and laminate flooring will continue to gain market share over carpeting during the next several years, which will positively impact sales of area rugs. According to data estimates collected by Easy Analytic Software Inc., area rug sales could grow as much as 12 percent into a \$5.6 billion industry by 2013.