Furniture Brands International, Inc.	FBN	Q1 2007 Earnings Call	May 3, 2007
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PARTICIPANTS

W. G. "Mickey" Holliman – Chairman Board and CEO
Denise L. Ramos – SVP and CFO
John Foy – President and COO Director
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MANAGEMENT DISCUSSION SECTION

W. G. "Mickey" Holliman, Chairman of the Board and CEO

Q1 Performance

Net Sales, Interest Expenses and EPS

- Our net sales for Q1 were off significantly from a record sales quarter last year
- As a result, our net earnings were $0.06 per diluted common share, also off significantly from last year
- Before the restructuring charges in the quarter and increased interest expense as a result of previously discussed interest rate swaps, our net earnings per diluted common share were $0.10, within the revised range we gave in early March
- The comparable pro forma number for the 2006 first quarter net EPS was $0.51
- I believe this is the most meaningful y-over-y comparison
  - This has been a very difficult quarter for us
- We understand clearly these are not acceptable results even in spite of business conditions
- We are moving forward much more aggressively with initiatives to address the cost side our business
  - We are also moving ahead with plans to ensure this company's ability to grow and succeed in a rapidly changing industry

Denise L. Ramos, SVP and CFO

Financial Highlights

Net Sales, Pro Forma Gross Margins and SG&A Expenses

- For the quarter, our net sales were off significantly, down 13%, y-over-y
- Pro forma gross margins were also down in the quarter
  - This is due largely to the loss of the normal contribution from the sales shortfall
- Our pro forma y-over-y SG&A expenses in the quarter were down due to the variability associated with the sales shortfall
  - Also, last year's first quarter had a fairly sizable increase to bad debt, which relapsed this quarter
- Those two items were partially offset by the costs associated with additional company-owned stores
- Currently we operate 40 company-owned stores as opposed to 14 stores one year ago
- In the quarter, we acquired 18 stores from three separate dealers and opened one on our own

- Over time, we will continue to acquire stores just as we have in the past, but I would not expect the pace we saw in Q1 to continue
    - This was a timing anomaly, nothing more

Interest and Stock Option Expense

- Interest expense pro forma for no longer accounting for our swaps as a hedge, increased $300,000
- Going forward we will no longer call out the increased interest expense in quarterly earnings as a special item, as the expense will be on a comparable basis with the prior year
    - Excluding restructuring charges, pro forma for stock option expense, and excluding the increased interest expense, net earnings were 4.8mm in Q1 the year, down from last year's 25.3mm
- As Mickey said, we believe this is the most meaningful y-over-y comparison

Balance Sheet Items

- Turning to the balance sheet, our inventories were 496mm, down slightly from the end of the year when we stood at 502mm
- In fact, embedded in the 496mm is approximately 6mm of inventory we picked up with the acquisition of the retail stores
- We have spoken a great deal about inventory and we continue to work to bring the number down
- We are very pleased to report a strong cash flow quarter, around $45mm, owing much to working capital improvements and lower tax payments
    - This afternoon, we will recommend to the Board they once again authorize the payment of a quarterly dividend
- Concerning our debt, we previously disclosed in our 10-K filing last March that we were negotiating a temporary amendment to our borrowings with our banks and senior note holders
- You likely saw the filing two weeks ago, which stated we have successfully negotiated that amendment
- We have until the end of June to put in place more permanent financing arrangements and we expect this will be achieved
    - While we are operating under this temporary amendment, our outstanding debt has been reclassified as a current liability on the balance sheet

Q2 Guidance

- Regarding guidance for Q2, yesterday we indicated our expected net sales will be down around 15% vs Q2 2006
- We estimate net earnings per common share will reflect a loss in the $0.11 to $0.07 range
    - This range includes the effects of $0.02 in previously disclosed restructuring, asset impairment, and severance charges

W. G. "Mickey" Holliman, Chairman of the Board and CEO

Business Highlights

- On our last call, I told you in 2007, our brands were focused on projects designed to reduce working capital and increase profitability
  - I also told you while we will not neglect the top line, we will not seek to grow the business with excessive promotions, unreasonable terms or a proliferation of product SKUs

Inventory Reduction Plans

- Let me follow it up with you now on those items
- Our inventory reduction plans are basically on track
- A prolonged weakness or further deterioration at retail could potentially put that plan at risk
  - I have said on a previous call, I want our inventory at 450mm, and we are still working toward that number
- As of the recently completed spring furniture market, our active SKU count across all product lines was down 9%, vs. that of the preceding market just six months earlier, and was spread fairly evenly across all brands
  - This is good progress, but there's more opportunity here for further consolidation, which will favorably impact supply chain flow, inventories and domestic operating efficiencies
- With respect to promotions and discounts, our markdowns are up vs. the prior year's first quarter, as you would expect, but they are only flat with Q4 last year
- I would like to have reported more progress on this front as we work to find a balance between reducing inventory and protecting margins, but there is more work to be done in this area
  - I will provide additional updates on items of this nature on future calls

Furniture Brands

- Moving on to a separate subject, recently there has been a great deal of speculation, both by the investment community and the media as to the nature and scope of restructuring and strategic initiatives underway at Furniture Brands
  - I intend to address that speculation by spending the remainder of my remarks this morning updating you on some specific initiatives with respect to restructuring and the strategy
- We have two parallel projects underway at Furniture Brands
- One is a cost reduction effort, pieces of which will be announced as they happen
  - The other is a strategic planning project, the outcome of which will be announced within the next few months upon its completion

Cost Reductions

- With respect to cost reductions, last Friday we announced a major head count and manufacturing facility realignment
  - These were difficult, but necessary decisions designed in part to align our costs with our revenues to provide for stronger earnings
- We are constantly reviewing our administrative expenses to ensure we are deploying the proper resources to run our businesses

- The same can be said for the production side of the business
- We cannot maintain excess or obsolete capacity
  - We will leave no stone unturned as we explore opportunities to remove costs now and in the future

Other Initiatives

- Other initiatives underway as we speak include reducing and consolidating our showrooms in North Carolina
- Lane and Broyhill are in the process – are both in the process of subleasing portions of their space
- Our Virginia operations, our Creative Interiors company has moved into a section of Broyhill space
  - And Henredon is moving into a building that will be shared with our Drexel Heritage brand
- Incidentally by their very nature, these showroom initiatives will force further SKU reduction
- We're selling one of our two corporate airplanes, because this plane was just a few months from being fully depreciated
  - When we sell it, we expect to see a modest P&L gain in addition to the one-time cash flow pickup

Retail Stores

- Denise mentioned we had acquired a number of retail stores in the quarter
- A good number of these stores, three Thomasville stores, four Broyhill and four Lane, were all acquired here in St Louis
- We will operate these stores as a single entity under one retail operations group
- Over time, we expect to move the other 30 or so stores under this single group as well
  - This will eliminate costs and will provide a more efficient retail operations platform
    - These and a number of other initiatives are underway, as I suggested earlier
- As we move through these projects, other opportunities to reduce costs will be addressed and announced in due course

Compensation Committee Chair

- On a personal, but related note, I recently advised our compensation committee chair of my intent to reduce my base salary by 25%
- We're in the midst of a highly concentrated effort on cost reduction
  - It is only appropriate that I participate in this process as well
- But let me say one last thing about removing costs from our business
- We will not cost cut Furniture Brands to prosperity
- Though we will be diligent about these and other projects, ultimately we are a company that needs to redefine its strategy
- The industry in which much of our business was designed to compete is disappearing
  - It is this reality that has caused the deterioration in our performance and ultimately what prompted this strategic planning process

Industry Evolution Study

- Last September, we engaged the firm to study this industry's evolution since the late 1990s

- Though much data exists on the period and we all certainly lived it, the aggregation and careful study of these trends provided our leadership with one single set of facts
    - Which treated authoritatively, will inform all of our decisions going forward
- The outcome of this study begs certain questions for Furniture Brands; questions related to brands, the change in retail landscape, and the change in manufacturing landscape
    - Much of this is not news, as you know, but armed with comprehensive research and factual data, our ability to judge the most advantageous course of action has been dramatically improved
- For competitive reasons and because at this point there's more to be – still more to be done, I do not intend to speak further about this work
    - But I will say this
- There is life and an ability to win in this business as a manufacturer
- The same goes for retail and the same goes for the design trade
- And lastly, executed properly, brands do matter in this business
    - I look forward to speaking further about the important choices Furniture Brands will make in the coming months, and I will do so as close to real-time as is practical

Leadership Team

- Finally, we continue to add talent to our leadership team
- Since we last spoke during our January call, we announced the addition of two executives, Jeff Cook from within the industry and Mike McBreen, formerly with Nike
- Jeff takes the leadership role at Broyhill and Mike takes our supply chain lead role
    - Both men have already demonstrated their leadership skills
- I am looking forward to both of their contributions and to working closely with them
- We are fortunate to have them as a part of our leadership team
    - That concludes our prepared remarks, and we thank all of you again for being with us today

QUESTION AND ANSWER SECTION

Analyst: *Justin Speer – Credit Suisse*
Question – Justin Speer: Good morning, gentlemen and Denise. This is Justin Speer in for Ivy. And I just had a question in regard to the implied margins for next quarter in your guidance. Obviously there's tremendous pressure from top line being down but – and you mentioned in Q1 that markdowns were not meaningfully different from Q4, but are your expectations that there is going to be more of a requirement for more markdowns to clear some of this excess inventory in the quarter?
Answer – Denise Ramos: Yes, do you want me to answer that, Mickey?
Answer – W. G. Holliman: Go ahead.
Answer – Denise Ramos: No, we do not expect there to be more markdowns. We do expect the level of markdowns that we've had to pretty much remain throughout Q2.

Analyst: *Budd Bugatch – Raymond James*
Question – Budd Bugatch: Good morning, Mickey. Good morning, Denise.
Answer – W. G. Holliman: Hi, Budd.
Answer – Denise Ramos: Good morning.
Question – Budd Bugatch: Good morning, Marty. Let's talk a little bit about top line and the outlook of top line you said down 15% in Q2, which really is even a deterioration from Q1. My expectation is that it's still a difficult climate, but maybe at a run rate because last year you compared it so heavily against Q1, which was good. Can you kind of talk about the outlook and what drove you down 15%, some view?
Answer – W. G. Holliman: The quarter obviously is the weakest of the four, as has traditionally been the case. I don't see it any different this time. We experienced a continuation of difficulty of writing business in the month of April, and I would think as we go through May and June that we could expect that certainly to continue and maybe to gain some momentum. All of my communications across the country and talking with retailers, Budd, sort of confirms that to me. And so, we are just saying that we think the quarter is going to be very, very challenging, more so, possibly than what took place in Q1. I don't really have anything to give any further perspective on what we expect to see happen than what I have just said.

Analyst: *Laura Champine – Morgan Keegan*
Question – Laura Champine: Good morning. Denise, I'm a little surprised at the comment that markdowns should be roughly equal to Q1, given how low the earnings guidance is for Q2. Is there something special happening with SG&A or do you expect SG&A dollars to be able to show the typical sequential decline in Q2 or maybe if you could just put more color on the margin expectations for this quarter?
Answer – Denise Ramos: Yeah, with the sales decline that we're expecting, that's going to put pressure on the margins that we're anticipating for Q2. We continue to deal with some of these inventory challenges that we have. And as I said, we don't expect further markdowns in Q2, but we do expect, as we continue to look at the balance between inventory levels that we have and the markdowns and other challenges that we have with the inventory levels that that will still apply some pressure to the margin line for us in Q2.
Answer – W. G. Holliman: Let me comment a little bit further on that. Our inventories last year in Q4, even though we reported at the end of the quarter a number at year-end of 502mm, within the quarter I believe that number got up to as high as around 540mm. And this, in light of the business conditions being such as they are, we have made some significant improvement in that area, and we are determined that as we move forward this target of 450mm, we're going to get there. So the emphasis within the company right now is to continue to keep a huge focus on this whole issue of working capital as it is as it relates to inventories and to generate positive cash during this window

of time that we are dealing with because we are looking at Q2. So I just, I guess, underlining the importance of continuing to focus and that is going to require that we probably participate in some – a good bit of markdown activity as we work our way through this next 60 days.

Analyst: *Budd Bugatch – Raymond James*
Question – Budd Bugatch: Yeah. Denise you did you talk about contribution margin. Would you care to tell us what you think the contribution margin is going forward and give us a little bit of a clue as to what's in your thinking?
Answer – Denise Ramos: Yeah, in terms of a trend standpoint, as we get into Q3 and Q4, we do expect to see some improvement in contribution margins, but we are starting from a pretty low base with where we are in Q1. And so, while we do expect to see that improvement, we still have a ways to go to get it at a level that we think is the right level.

Analyst: *Jeremiah McWilliams – St. Louis Post-Dispatch*
Question – Jeremiah McWilliams: Good morning, everyone. Thanks for taking my call. I was wondering the number of stores that you guys bought was pretty impressive in the quarter. Why was that? Why was the number so high? And Denise, I think you mentioned that pace would not keep up, but do you have any expectation as to how many stores you may buy in the upcoming quarters?
Answer – W. G. Holliman: We took control of 11 stores here in the St. Louis area. I think I alluded to that in my opening remarks. And I believe in addition to that, in the case of Drexel Heritage, we took possession of three stores that were based in North Carolina. That was the largest piece.
Answer – John Foy: Four at Thomasville in Virginia.
Answer – W. G. Holliman: That's correct. A owner who continues to own stores from Thomasville that's primarily concentrated in New Jersey and Delaware had stores in Washington, DC, the Greater Washington area and felt that they weren't given the proper leadership to that group of stores. So they opted to seek relief and we felt comfortable in providing that and go ahead and took possession of those stores. So the 11 here, the three at Drexel Heritage in North Carolina, and once again, from an owner who has 17 of our Thomasville stores was relieved of those three and then the four in DC. That should represent pretty close to the number.
Answer – John Foy: And we opened one store....
Answer – W. G. Holliman: Okay. And they are telling me that the other one was a store up in Minnesota – Woodbury, Minnesota, which is a Thomasville home furnishings store. I would add further that I would not rule out the possibility that we see over the course of the remainder of the year other cases, but I think it will be in a much more limited way than what we have seen take place in Q1, and the stores in St. Louis was the huge thrust behind that large number that we had in the quarter.

Analyst: *Justin Speer – Credit Suisse*
Question – Justin Speer: Hi, this is Justin again. Just in terms of these new store additions, is this possibly what's also going to be weighing on margin? And maybe you could quantify that. And also your tax rate expected for next quarter. I think you were looking for a 35% tax rate last quarter. Has that changed at all?
Answer – W. G. Holliman: As far as the – I will let Denise comment on the tax issue. As far as the stores and their impact on the earnings results, I don't see anything significantly different than what we have seen occur in Q1.
Answer – Denise Ramos: From a tax rate standpoint, we still would advise that 35% is about the average rate for us. We saw it go up a little bit in Q1 for, just some adjustments that were taking place, but 35% is really what you should be looking at and thinking about going forward.

Analyst: *Bruce Baughman – Franklin Advisory Services*
Question – Bruce Baughman: Hi, good morning.
Answer – W. G. Holliman: Good morning.
Answer – Denise Ramos: Good morning.
Question – Bruce Baughman: With regard to the study you referred to and the store acquisitions, can you give us some color around these acquisitions in terms of; first of all, whether you had a choice in buying these stores? Whether – what kind of strategic advantage they provide and how the decision to buy them may be in sync with or contrary to what comes out of that study?
Answer – W. G. Holliman: I do think there were cases where there were options. We felt like in the case in St. Louis, and the three stores of Drexel in the Carolinas and the ones in Washington, that with our retail platform that we could do things with those stores that possibly we have not seen take place in the past that would be favorable to what's in the best interest of the company. As far as how this plays into the strategic thinking of the – of what I have made reference to earlier, I would suggest that we hold that in abeyance until we provide you additional information on this entire matter with regard to our strategic thinking. And so we will just put that on hold for the time being. It's not that far away before we give you good answers on the question. But for the moment, we will put it on hold.
Answer – Denise Ramos: I would just add one thing in the comment on stores, when we look at buying or taking over stores we do them on a case by case basis. So, each one has its own unique circumstances and situations that we consider and evaluate before making a decision on that.

Analyst: *John Baugh – Stifel Nicolaus*
Question – John Baugh: Good morning. And I apologize I joined late. So, if this question was addressed, apologizes. But related to Thomasville, I believe some of the plant closures were tied to Thomasville and upholstery specifically. I was wondering, does that imply something about that business, how is Thomasville doing overall? It seems to me, strategically, it's your most vertical, most viable maybe long range business unit, but it appears to be struggling. Any color on Thomasville would be great. Thank you.
Answer – W. G. Holliman: Yeah. Good morning to you, John. With regard to the closing of the plants, one of the plants was a comparatively small woodworking operation. The other one was an upholstery plant. What we are doing is consolidating the work that was being done in both those operations into another larger, much larger factory in Hickory, North Carolina, that had some capacity available to us. And we think that by doing some things maybe a little bit differently than we have done in the past that we can generate the same kind of output that we were getting from that plant that was a producing plant that we are closing, we can generate that output using some what we refer to as stretched overtime. It's just a different kind of way of addressing those second shift operations. And eliminate a lot of cost in the process, and become a lot more efficient. So that's the answer to the question with regard to the closure of the two plants.
Thomasville has had a difficult quarter, no question about it. Our business has been very difficult there. We've had some issues in terms of productivity at retail around some new collections that are a little older that have probably had some kind of dragging type effect on its results. I will tell you that they have rebounded with an excellent month of April, where their sales were up very significantly high doubled – in the double digit range. So I think that's temporary. We just came out of a market in the spring. I don't recall whether you were there or not. We had three case goods collections that Nancy Webster brought to market, two of which were highly successful. Two of the most successful introductions we've had at Thomasville in a long time and a contemporary group that was a little more of a love/hate type thing. Some retailers of some stores around the country loved it, others didn't quite as much. But the fact remains that there were two highly successful collections. And I think you will see that reflected in Thomasville's business as we move forward. I

do share your thinking with regard to the value of the brand, and to its potential in the future and we'll make sure that we take marked advantage of that opportunity in dealing with that company.

Analyst: *Jeremiah McWilliams – St. Louis Post-dispatch*
Question – Jeremiah McWilliams: Thank you guys, once again. Mr. Holliman, I wanted to ask you about the closure of the upholstery plants and the consolidation of that. I was wondering, given that you've said you are going to look for opportunities to cut costs across the company. Are you guys looking harder now at upholstery or I don't know if you could elaborate on that? I don't want you to have to let the cat out of the bag necessarily, but if you could elaborate on what you think about upholstery, that would be great.
Answer – W. G. Holliman: I think the only comment I would make here is that we continue to evaluate all of our issues; rent, capacity and demand. Upholstery would be no different than what has been the case in case goods, not that it's a much different kind of a issue. And a lot of the demand for upholstery continues to come from domestic made products. There is some transition underway in some percentage of our total volume that is being sourced. The rate at which that will continue, I'm not prepared to suggest to you. The only thing I can tell you is we have to be competitive in whatever it takes in order to do that is what we will do going forward. And I think I will let the matter rest with that.