SINGULAR DILIGENCE

Ekornes (OSLO: EKO)

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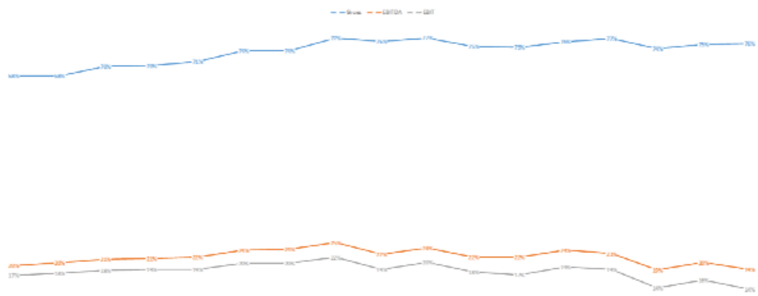
Stock Price: 97.75 NOK



	EV/Sales	EV/Gross Profit	EV/EBITDA	EV/EBIT	EV/Owner Earnings
Natuzzi	0.15	0.51	5.25	NMF	NMF
Flexsteel Industries	0.52	2.28	8.61	10.23	9.51
La-Z-Boy	0.90	2.61	10.47	13.03	12.76
Select Comfort	1.32	2.11	10.49	14.11	12.96
Tempur Sealy	1.76	4.54	14.65	18.72	11.70
Minimum	0.15	0.51	5.25	NMF	NMF
Maximum	1.76	4.54	14.65	18.72	12.96
Median	0.90	2.28	10.47	13.03	11.70
Mean	0.93	2.41	9.90	10.80	5.88
Standard Deviation	0.64	1.44	3.41	7.82	13.15
Variation	68%	60%	34%	72%	224%
Ekornes	1.18	1.56	6.31	8.64	6.34

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	Min	Max	Median	Mean	Standard	Variation
Sales	1,050	1,216	1,327	1,536	1,710	1,828	2,021	2,248	2,292	2,507	2,574	2,673	2,588	2,869	2,758	2,813	2,661	1,050	2,869	2,292	2,157	604	28%
Gross Profit	709	821	928	1,076	1,215	1,349	1,492	1,731	1,745	1,932	1,927	1,997	1,968	2,206	2,049	2,121	2,013	709	2,206	1,745	1,605	494	31%
EBITDA	207	247	282	329	373	431	481	572	514	605	561	583	609	651	512	574	497	207	651	512	472	137	29%
EBIT	180	216	245	286	318	370	408	488	427	513	465	463	500	534	387	449	363	180	534	408	389	108	28%
Receivables					221	231	241	251	281	316	352	387	358	344	372	389	392	221	392	344	318	65	20%
Inventory					166	170	177	194	216	223	218	249	264	270	281	290	310	166	310	223	233	48	21%
PP&E					482	581	675	739	771	782	816	893	928	923	932	919	885	482	932	816	794	144	18%
Working Liabilities					184	192	211	220	246	284	308	302	274	284	289	277	288	184	308	277	258	43	17%
Net Tangible Assets					686	790	882	964	1,021	1,037	1,078	1,227	1,276	1,254	1,296	1,321	1,299	686	1,321	1,078	1,087	212	20%
MARGINS																							
Gross Profit/Sales	68%	68%	70%	70%	71%	74%	74%	77%	76%	77%	75%	75%	76%	77%	74%	75%	76%	68%	77%	75%	74%	3%	0.04
EBITDA/Sales	20%	20%	21%	21%	22%	24%	24%	25%	22%	24%	22%	22%	24%	23%	19%	20%	19%	19%	25%	22%	22%	2%	0.09
EBIT/Sales	17%	18%	18%	19%	19%	20%	20%	22%	19%	20%	18%	17%	19%	19%	14%	16%	14%	14%	22%	19%	18%	2%	0.12
TURNS																							
Sales/Receivables					7.72	7.91	8.38	8.95	8.17	7.94	7.32	6.91	7.23	8.35	7.41	7.24	6.79	6.79	8.95	7.72	7.72	0.64	8%
Sales/Inventory					10.31	10.76	11.42	11.58	10.61	11.22	11.82	10.73	9.79	10.61	9.81	9.69	8.57	8.57	11.82	10.61	10.53	0.90	9%
Sales/PPE					3.55	3.15	2.99	3.04	2.97	3.21	3.15	2.99	2.79	3.11	2.96	3.06	3.01	2.79	3.55	3.04	3.08	0.18	6%
Sales/NTA					2.49	2.31	2.29	2.33	2.24	2.42	2.39	2.18	2.03	2.29	2.13	2.13	2.05	2.03	2.49	2.29	2.25	0.14	6%
RETURNS																							
Gross Profit/NTA					177%	171%	169%	180%	171%	186%	179%	163%	154%	176%	158%	161%	155%	154%	186%	171%	169%	10%	0.06
EBITDA/NTA					54%	55%	54%	59%	50%	58%	52%	47%	48%	52%	40%	43%	38%	38%	59%	52%	50%	7%	0.13
EBIT/NTA					46%	47%	46%	51%	42%	49%	43%	38%	39%	43%	30%	34%	28%	28%	51%	43%	41%	7%	0.17
GROWTH																							
Sales		16%	9%	16%	11%	7%	11%	11%	2%	9%	3%	4%	-3%	11%	-4%	2%	-5%	-5%	16%	8%	6%	7%	1.08
Gross Profit		16%	13%	16%	13%	11%	11%	16%	1%	11%	0%	4%	-1%	12%	-7%	4%	-5%	-7%	16%	11%	7%	8%	1.11
EBITDA		20%	14%	17%	13%	16%	12%	19%	-10%	18%	-7%	4%	5%	7%	-21%	12%	-14%	-21%	20%	12%	6%	13%	1.99
EBIT		20%	13%	17%	11%	16%	10%	19%	-12%	20%	-9%	-1%	8%	7%	-28%	16%	-19%	-28%	20%	11%	6%	15%	2.69
Receivables					-1%	10%	0%	9%	15%	11%	12%	8%	-22%	19%	-1%	10%	-7%	-22%	19%	9%	5%	11%	2.33
Inventory					1%	4%	4%	15%	8%	-1%	-4%	34%	-15%	22%	-11%	19%	-3%	-15%	34%	4%	6%	14%	2.44
PP&E					25%	17%	16%	4%	5%	-2%	10%	9%	0%	0%	2%	-5%	-2%	-5%	25%	4%	6%	9%	1.50
Working Liabilities					-3%	12%	8%	0%	23%	9%	8%	-11%	-7%	15%	-10%	2%	6%	-11%	23%	6%	4%	10%	2.50
Net Tangible Assets					18%	13%	11%	8%	4%	-1%	8%	19%	-9%	6%	1%	3%	-6%	-9%	19%	6%	6%	8%	1.44

SINGULAR DILIGENCE

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Ekornes's (OSLO: EKO) Stressless Brand is the "Hidden Champion" in Recliners

OVERVIEW

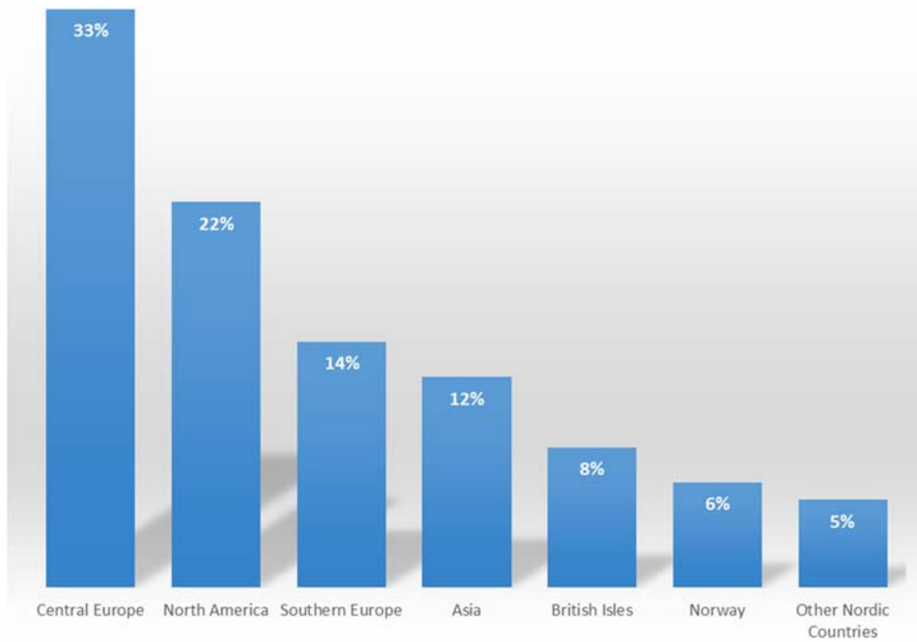
Ekornes is really Stressless. The company gets 84% of its sales – and even more of its profit – from Stressless brand products. Ekornes is a Norwegian furniture maker. The company gets 62% of sales from Stressless branded recliners. A typical Stressless recliner retails for more than $1,700. Ekornes's second biggest sales category is Stressless branded motion sofas, loveseats, and sectionals. The company gets 22% of its sales from these non-recliner Stressless branded products. A typical Stressless sectional retails for more than $7,000. The remaining 16% of Ekornes's sales are divided between Svane branded mattresses (9% of sales), Ekornes branded fixed back sofas (4%), and all other furniture (3%). Because Stressless branded furniture contributes 85% of sales – and more than 85% of profit – this issue will focus solely on Ekornes's Stressless brand. And because almost 75% of the Stressless brand's sales – and even more of its profits – come from Stressless recliners, this issue will focus primarily on Stressless recliners. Ekornes gets about two-thirds (62%) of its sales – and more than two-thirds – of its profits from Stressless branded recliners. Stressless recliners are the key to Ekornes's future.

A Stressless recliner is the most comfortable chair in the world. Ekornes introduced Stressless recliners in 1971. The company went bankrupt in 1990. Competitors from around the world were able to produce recliners of varying quality. Norway has some of the very highest labor costs in the world. So a Norway based furniture maker like Ekornes could not compete on price. When Ekornes emerged from bankruptcy in the 1990s, it focused on making the world's most comfortable chair. By competing on comfort instead of price, Ekornes was able to make Stressless a viable brand despite the high cost of production in Norway. Ekornes filed for the "plus system" patent in 1991. This system provides neck and lower back support automatically as the customer shifts their body's position in the Stressless recliner. In 1991, Stressless also filed for a patent on the "glide system". The glide system provides automatic adjustment based on body weight. This eliminates the need for buttons and levers. The combination of the "glide system" and the "plus system" allows Stressless recliners to adjust to changes in body position – for reading, watching TV, resting, etc. – and for changes in the placement of body weight to allow reclining without any buttons or levers. In 2001, Ekornes filed for a patent on its "sleep function". This system keeps the head rest active while the chair is reclined and disconnects the head rest – turning the recliner into a sleeper – when the customer pulls the head rest slightly forward.

Over its entire history, Ekornes has manufactured more than 6.5 million Stressless seats at its Norwegian factory. The facility uses 110 robots. That means this one Stressless factory accounts for more than 10% of all industrial robots in the entire nation of Norway. Ekornes's factory is highly automated. All parts are transported around the factory by robot. The robots – which Ekornes purchases for between $100,000 and $250,000 a piece – bend steel rods, weld steel parts, sand wooden parts, polish chair parts, apply surface coatings, cut fabric, and mold foam plastic. The only labor intensive part of Ekornes's manufacturing process is cutting and sewing. Recently, Ekornes has invested in automated sewing. The company has a long-term objective to replace 50% of human sewing with robot sewing. Stressless's robotic labor is much cheaper than its human labor. For example, a recently retired Ekornes robot worked for 80,000 hours – around the clock for 11 years – while polishing 3.5 million chair legs. Since each Ekornes robot costs $100,000 to $250,000 to buy, the capital cost of a robot spread over its useful life is probably in the $1.25 to $3.25 an hour range. In comparison, Norwegian GDP per capita in purchasing power parity terms is almost exactly equivalent to GDP per capita in the U.S. However, the Norwegian Krone is one of the strongest currencies in the world – defined as the premium at which the Krone trades in foreign exchange markets above the level at which it would be at purchasing power parity with the U.S. Dollar. This means that, at times, although the average Norwegian worker might earn enough money to support a lifestyle comparable to the average U.S. worker inside their respective countries – the Norwegian worker could trade their Krone for dollars and visit the United States where their annual income of say $50,000 U.S. Dollar would suddenly buy them the equivalent of an American worker making $75,000 or $100,000 a year. This difference between purchasing power parity and the foreign exchange rate is a key concept to understand in evaluating Ekornes.

Ekornes shares trade on the Oslo stock exchange in Norwegian Krone. The company pays its Norwegian workforce in Norwegian Krone. However, the company only takes in 6% of its revenue in Norwegian Krone. Most of Ekornes's sales come in the form of Euros, U.S. Dollars, and other – much weaker – currencies. Ekornes gets 33% of sales from Central Europe (largely Germany). North America (largely the U.S.) accounts for 22% of sales. Southern Europe contributes 14% of sales. Asia provides 12% of sales. The British Isles contribute 8% of sales. Ekornes's home market of Norway generates just 6% of sales. And the other Nordic countries generate the final 5% of sales. So, 94% of sales come from outside Norway. And 89% of sales come from outside Nordic countries. Sales are generated in countries like Germany, the U.S., the U.K., and Japan in those countries local currencies (the Euro, the Dollar, the Pound, and the Yen respectively). All of those countries have much, much weaker currencies than Norway does.

The strength of the Norwegian Krone can confuse foreign investors interested in buying Ekornes's shares. Ekornes's stock is bought and sold in Krone. And Ekornes reports its results in Krone. This does not, however, mean that the Norwegian Krone is especially important to Ekornes's business. Labor cost is the only part of Ekornes's business that really fluctuates with the Krone. Other parts of the business only appear to fluctuate with the Krone because Ekornes translates its costs and revenue into Krone. For example, Ekornes focuses a large part of its capital spending on robots. The price of industrial robots – which are sold to much larger economies like Japan, Germany, and the U.S. – are not primarily set in Norwegian Krone. Likewise, leather is a major input cost for Ekornes. The most important force in the worldwide supply of leather is the size of the U.S. beef cattle herd. Demand for leather mostly comes from shoe makers, car makers, furniture makers, and fashion accessories companies. Most buyers and sellers of leather do not transact their business in Norwegian Krone. They do business in U.S. dollars, Euros, and Yen.



Ekornes makes 94% of its sales in currencies other than the Norwegian Krone

In the last year, the Norwegian Krone has declined against major currencies. Including – almost certainly – the currency in which you (the reader) save and invest. As an investor, you may wonder what this movement in the Krone versus your home currency would do had you been invested in Ekornes shares. The share price of Ekornes has risen in local currency on the Oslo Stock Exchange. However, the share price has not risen enough to keep the company's market cap consistent relative to the likely constant currency sales levels. Putting aside the temporary impact of hedges, a decline in the Norwegian Krone lowers Ekornes's labor cost in all other currencies. It has no impact on sales levels. Germans and Americans do not care how many Krone they are spending on Stressless recliners at retail, because they are not spending Krone – they are spending Euros and Dollars. At the same time, Ekornes probably does not care that sales prices in Germany and the U.S. will now provide fatter margins than in the past. Ekornes prices Stressless products in the way that generates the best gross profit for its local dealers, makes the most sense relative to competitors (in particular, that the price point positions Stressless at the premium end of the market), and that maximizes revenue in the country. Stressless does not primarily compete on price. So, there is no reason for Ekornes to lower the price of Stressless recliners in Dollars and Euros simply because the chair is now cheaper to make in Krone.

In fact, Ekornes's entire bonus system is based on the company's operating margin. No bonus is paid below a 10% operating margin. Historically, Stressless has made an 18% to 20% EBIT margin. Asset turnover is acceptable at a little over 2 times. So, Ekornes is capable of 40% pre-tax returns on capital. The company does not use leverage. Taxes are normally 25%. So, the after-tax return on equity can be around 30%.

Today, Ekornes sells for less than 7 times "normal" EBIT and less than 9 times 2013 EBIT. This is equivalent to an after-tax P/E ratio of 9 to 12. The current dividend yield is over 6%. Ekornes generally pays out all of its free cash flow in dividends. This means – under normal conditions – the stock is capable of having a dividend yield closer to 8% to 10% on today's share price.

Ekornes is clearly cheap. There are two possible reasons for this. One, the Ekornes name is unknown worldwide because the company's main brand – Stressless – is different from the name under which the company is listed. Two, Ekornes trades on the Oslo Stock Exchange. Norway is a tiny country of just 6 million people. Very few investors outside Norway buy shares of Norwegian companies in Oslo. For example, half of Ekornes's shares are held by Norwegians. Only 50% of Ekornes's shares are in foreign hands. If Ekornes listed in Frankfurt, London, or New York – it would probably get more attention from investors outside Norway. The share price might be higher.

Foreign investors have missed out on an excellent buy and hold stock. Since listing on the Oslo Stock Exchange in 1995, Ekornes's share price has grown at a compounded rate of 16% a year over the last 20 years. The company has also paid a lot of dividends. So, the total return to shareholders has been greater than 15% a year for 20 years.

The biggest reason why a foreign investor might avoid Ekornes is concern that the stock – which is bought and sold in Krone – will fluctuate in the investor's home currency along with the exchange rate between that home currency and the Krone. So, for example, an American investor might feel certain that Ekornes's share price of 100 Norwegian Krone will one day expand beyond 125 Norwegian Krone, but that investor fears a 25% drop in the Krone versus the Dollar – like the drop from 17 cents to 13 cents in the past year – would more than wipe out his gain. This is a valid short-term concern. Ekornes's share price in dollars will fluctuate even when the price in Oslo stays the same in Krone. However, this is not a valid long-term concern. In the long-run, a stock's intrinsic value will follow its earning power. Ekornes's earning power comes from the gap between its sales – made in Euros, Dollars, Pounds, Yen, etc. – and its costs. Ekornes gets 94% of its sales in currencies other than Krone. Only the company's labor cost is tied to the Krone. So, it is misleading to think of Ekornes's intrinsic value as being a primarily Krone based figure. For this reason, a buy and hold investor should not worry about movements in Norway's currency. In the long-run, Ekornes stock will make money for a foreign investor regardless of the currency that investor must sell to buy Ekornes shares in Oslo. This makes Ekornes a good buy and hold investment for readers living in any country.

DURABILITY

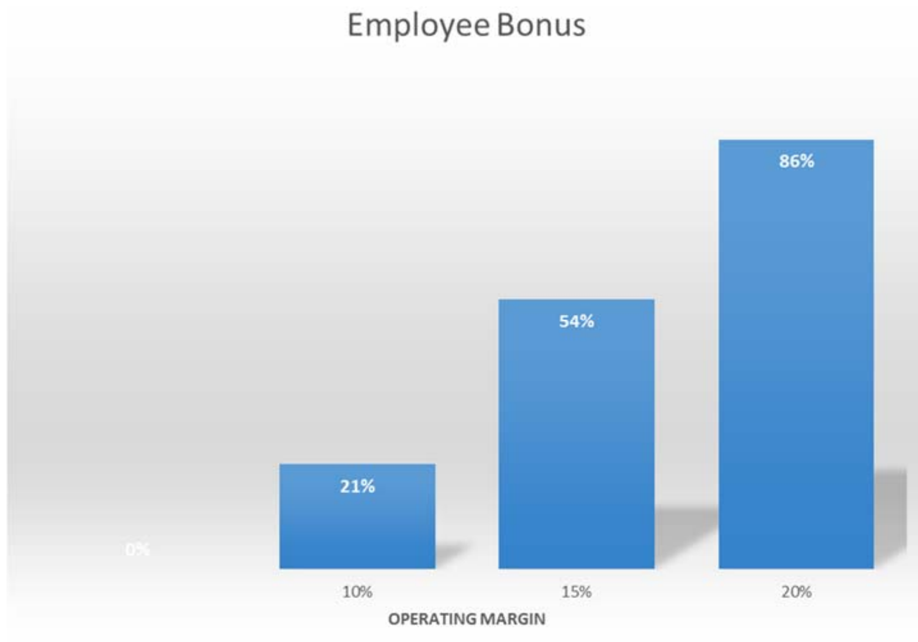
Stressless is Only as Durable as Its Reputation for High Quality Comfort

The greatest risk to Ekornes's durability is a repeat of its past. Ekornes went bankrupt in 1990. The company cannot compete on price. Ekornes is a Norwegian company. The company's factory workers are paid in Norwegian Krone. Although Norwegian workers only make about as much as Americans on a purchasing power parity basis – that is, when taking into account the cost of goods and services within their own country – Norwegians are higher paid than almost any other workers in the world when it comes to the foreign exchange rate. On this basis, the cost of Norwegian labor can contribute twice as much to the cost of a finished chair as would the labor of a worker in some other highly developed economy. Workers in developing economies are even lower paid. There is no way that Ekornes could ever successfully compete on the basis of price. Ekornes must price its recliners higher than the competition. The company will never be able to sell a mass market chair if it uses Norwegian labor.

Ekornes competes on the perceived quality of its chairs. The perception of Ekornes's quality depends on 3 factors. The most important factor is the comfort of its chairs. The second most important factor is the design – the actual look – of the chairs. The final factor is the strength of the Stressless brand name.

Ekornes has a large lead in quality over its competitors. The company invests more money in a narrower line of products than its competitors do. Big manufacturers like La-Z-Boy which sell a lot of recliners are not as focused on quality. They compete on price, delivery speed, high availability, and broad selection. For example, La-Z-Boy sells chairs made from over 400 different frames. Customers can choose different options for a recliner's back (channeled or contoured), its seat (chaise or pillow top), its arm (rounded or tapered), the way it reclines (recliner-rocker, wall-hug recliner, swivel and glide), the cover (fabric or leather), and so on. Ekornes offers far fewer options. The company has a variety of models to choose from. They are available with minimal customization. And Ekornes does not add to the overall number of models each year. As Ekornes introduces a few new models each year it eliminates a few obsolete models.

La-Z-Boy is a mass market brand. Ekornes's Stressless brand is focused on the luxury end of the recliner market. In the U.S., manual recliners often sell for between $400 and $700. Fabric recliners start around $400. Leather recliners start around $700. Power recliners cost $1,000 and up. Stressless recliners are $1,700 and up. The U.S. recliner market is around $4 billion at retail. It is a big market. However, most of that market is not available to Ekornes. A 2013 consumer survey



Ekornes employees only get paid bonuses when the company's operating profit margin is above 10%

found that 70% of Americans expect to pay less than $800 for a leather recliner. Chairs using the most popular synthetic fiber – microdeniers – account for 44% of the low-end (under $800) recliner market. Chairs using leather or suede account for 64% of the market for chairs priced $1,500 and over. As a result, there is little similarity in recliners priced under $800 and recliners priced over $1,500. Stressless chairs are truly luxury goods in the sense that they have a different country of origin (Norway), are made from a different material (leather), and cost more than double the price of a "typical" recliner. No low end recliners are made in Norway. No low end recliners use leather. And Ekornes does not make any low end products under the Stressless name. Stressless recliners are positioned at the high end of the market in 3 ways. One: leather is exclusively a high end material. Two, Norway is exclusively a high end country of origin. Three, Stressless is exclusively a high end brand. None of these things will change. It is not economically possible for Norway to compete in low end goods. It is not possible for Ekornes – unless it moves manufacturing out of Norway – to sell low end products under the Stressless brand name. And, finally, it is not possible – because the key input is a natural product (cattle) – for leather to be used in low end products.

For Ekornes, competition is less of a concern than loss of focus. This is because of the very, very small unit market share that Ekornes has. There is a lot of room for the luxury part of the recliner market to grow in most of the countries Ekornes competes in. In that way, the luxury segment of the recliner market could accommodate another competitor without putting Ekornes in danger of unprofitability. This is not true of a loss of focus. Ekornes is a durable company within its niche at the very highest end of the recliner market. However, it is a fragile company outside this niche. Ekornes has a labor cost disadvantage. It also lacks scale in marketing and retail. Ekornes's scale in research and development is strong. So is Ekornes's scale in manufacturing. The company is focused on a single brand and a single production plant. It has a lot of R&D – 23 full-time employees – for such a small line of chairs. And Ekornes has a huge number of robots for a manufacturer of its size. Other furniture companies do not make use of industrial robots. And they invest less in research and development and spread it over a much wider range of products. Again, La-Z-Boy is a good comparison. La-Z-Boy spent less than $8 million on research and development in 2014. La-Z-Boy had $1.36 billion of sales that same year. So they spent about 0.6% of their sales on R&D. The U.S. spends 2.8% of GDP on research and development. La-Z-Boy has plenty of marketing aspects to its business. It runs stores. It is far from a pure manufacturer. But, this number helps illustrate the basic fact. The owners of furniture brands do not generally spend more on R&D than companies in most other industries. In fact, they probably tend to spend less. They certainly use fewer robots than manufacturers in other industries. And yet Ekornes makes heavy use of robots because of its centralized manufacturing and its need to reduce human labor hours (because they are so expensive in Norway).

Ekornes has an incentive scheme that should encourage employees to stay focused on quality over price. Employee bonuses use just one criterion: operating margin. When Ekornes's operating margin is less than 10%, employees get no bonus. Bonuses rise with the company's operating margin above this 10% threshold. So, at a 15% operating margin, employees get 50% of their base salary as a bonus. At a 20% operating margin, they would get about 85% of their base salary as a bonus. Bonuses are capped at around 140% of the annual base salary if the operating margin exceeds 25%. Management targets a net margin of 15%. From 1997 through 2013, Ekornes's median operating margin was 19%. So, in a typical year, each Ekornes employee gets a bonus of between 60% and 75% of their base salary. In other words, employees would be conditioned over time to expect that about 40% of their total annual pay is tied directly to the company's operating margin. This singular focus on margin instead of sales or earnings growth probably encourages a focus on profitability over growth. On the other hand, special incentives for management and share ownership among executives is not high at Ekornes in comparison to most American public companies. All employees are strongly incentivized to maximize operating margin. And management sets targets in terms of profit margin, returns on assets, and revenue growth. At Ekornes, return on assets is largely the result of the operating margin (because asset turnover is not high and varies less than margin does). Management has a 5% annual sales growth target. Other than that sales growth target, incentives and announced targets are almost exclusively based on operating margins. This suggests Ekornes is focused on not repeating its past mistakes and engaging in price competition that can lead only to bankruptcy – as it did in 1990.

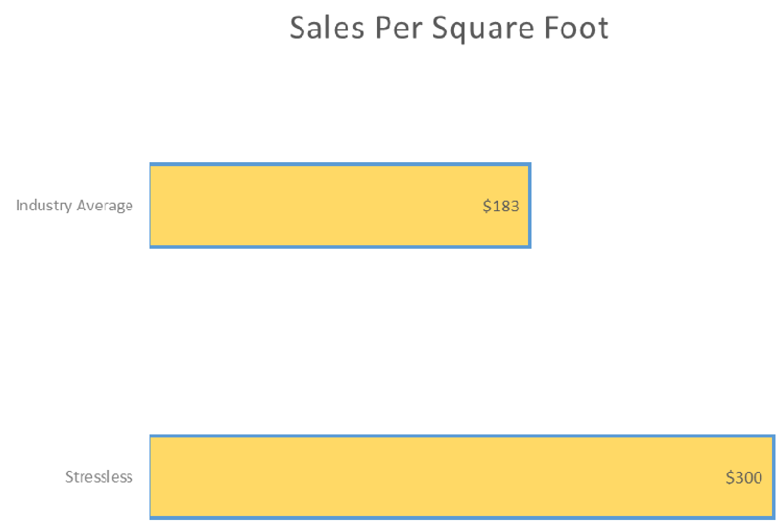
MOAT

Stressless Makes More Money for its Dealers than Other Brands Do

Ekornes's moat is the Stressless brand's reputation for comfort. The company may also have a cost advantage in its highly automated Norwegian factory. However, this advantage – if it exists – is a distant second to the reputational advantage Stressless enjoys.

It is difficult to prove whether or not Stressless has a cost advantage in its manufacturing. The difficulty comes from the fact that a recliner is not a commodity product. It is possible to compare Ekornes's financial results to its closest competitor, Hjellegjerde, for the years 1997-2001. It is also possible to compare the retail prices of those two competing brands. This comparison shows that Hjellegjerde could – and did – underprice Stressless by as much as 30%.

It is worth mentioning here that because dealers would almost certainly have the same mark-up on a Stressless product and a competing product sold in the same store – it would be necessary for a company like Hjellegjerde to sell 43% more units per square foot at each dealer to provide the same profit to that dealer that selling Ekornes recliners would. This is a key point we will return to later. Stressless dealers make more money selling for Ekornes than they would for a competitor. When a Stressless chair sells for $2,000 and a competitor's chair sells for $1,400 – as is often roughly the case – the dealer tends to make exactly 43% more. There is no evidence that cheaper premium recliners generate more unit sales per square foot of retail space. In fact, some dealers report that when selling a brand ranging from $800 to $1,500, the bestselling model in the line is closer to $1,500 than $800.



A furniture retailer can generate 64% more profit for its floor space by selling Stressless

Returning to the example of a competitor who underprices Ekornes by 30% – that that underpricing would be both 30% at wholesale and 30% at retail. So, when you see one chair selling for $2,000 and one chair selling for $1,400 at the same store – it is usually the case that the dealer paid 30% less for the $1,400 chair just as you will be paying 30% less for it. The best example we have of a direct comparison of a manufacturer pricing about 30% below Ekornes is Hjellegjerde around the turn of the millennium. From 1997 through 2001, Ekornes's operating margin ranged from 17% to 19%. Hjellegjerde's ranged from negative 4.6% to positive 4.3%. The competitor's average EBIT margin over those 5 years was 1%. Ekornes's was 18%. So, Ekornes had a 17% operating margin advantage. In other words, Ekornes could have lowered its prices by 17% and sold the exact same number of chairs at that price and still matched the profit performance of its competitor. This is a good acid test for the cost advantage. Hjellegjerde was selling inferior recliners during these years. If we assume the products from the two companies were truly comparable – a commodity – then the competitor may have had as much as a 10% cost advantage. In reality, the lower cost of the competing product was due to cheaper inputs and other factors. Using the commodity analogy – the chair could cost 30% less at retail because the competitor made 18% less (operating at breakeven versus a good profit for Ekornes) and because they were selling a somewhat inferior "grade" of recliner. No major global competitor sells recliners of equal quality to Ekornes.

In fact, competitors do not generally claim to sell a better product than Ekornes. Instead, some claim to sell an equally good substitute at a lower price. They adopt this value strategy – similar to Rayovac versus Energizer and Duracell in batteries and the various competitors to Tempur-Pedic in mattresses – because they do not differentiate themselves from Ekornes except on price. An advertisement for one of Stanley's leather recliners is a good illustration: "Ergonomically designed, the chair provides correct lumbar and head support in all positions. Featuring a style similar to Ekornes Stressless Recliners at a fraction of the price." This is a competitor of Ekornes voluntarily using the Stressless name to help sell its own substitute. That is generally a sign of a very strong (premium) brand. Stressless's strong brand position and high price are obvious on the internet. Two of the more popular Google searches involving the Stressless name are "Stressless recliner knockoff" and "Stressless recliner second hand". This illustrates Stressless's strength and is weakness. The weakness is price. Stressless recliners are the most expensive recliners out there. The advantage is reputation. Customers looking for the best recliners use Stressless as the benchmark. When they want a lower price than Ekornes charges, they judge other recliners by how far they deviate from being a Stressless. They are hoping for a cheaper copy.

This is unlikely to happen. No competitor can produce an economically viable duplicate of a Stressless chair. They are not set up for it. Stressless uses one large manufacturing facility, many robots, and a small number of models. Compared to other furniture manufacturers, Stressless's production method is highly standardized. Many different models use the same component parts. Another problem with a knockoff gaining ground against Stressless is the very low "close rate" in the furniture industry. For every 5 people who walk into a furniture store – only one will buy anything this trip. Many customers make repeat trips. Because of the internet, more customers are now going into furniture stores with an idea of what brand they would like to buy. However, it still remains very hard for salesmen in a furniture store to convert a total non-sale into a sale. This is important, because it means that comfort – which a customer can test for themselves in the store – and brand name can be important in increasing profit per square foot for a furniture dealer. Simply put, it is easier for a furniture store to make more money by becoming a dealer for the right brand than it is for them to hire the right salespeople.

One of Ekornes's goals is to be the most profitable brand its dealers sell. The 100 biggest furniture retailers in the U.S. average $210 in sales per square foot. The industry as a whole does worse. A good estimate is that the median performing furniture store picked from a random sample would be closer to $180 per square foot. In 2012, La-Z-Boy did about $200 per square foot. Their long-term target is for $275 or higher. Stressless already does $300 per square foot in the U.S. Some Stressless dealers do $500 to $600 per square foot. So there is wide variation in results. Ekornes's CFO claims the average dealer has been with Stressless for 10 to 20 years. We were able to find dealers who had been selling Stressless products from anywhere between 3 and 20 years. There are about 2,500 Stressless dealers worldwide. Churn is higher than you might expect among dealers. However, the company says – and everything we could gather supports this idea – that churn is due to either a) Ekornes terminating the agreement or b) the dealer going out of business. Exact numbers are hard to come by in this area. However, all of the evidence suggests that Stressless dealers believe the brand helps them make a lot of money. There is no evidence for brands that sell more per square foot than Stressless. And there is no evidence of dealers terminating the agreement by their choice. So, it seems dealers are mostly happy with the money they make on Stressless products.

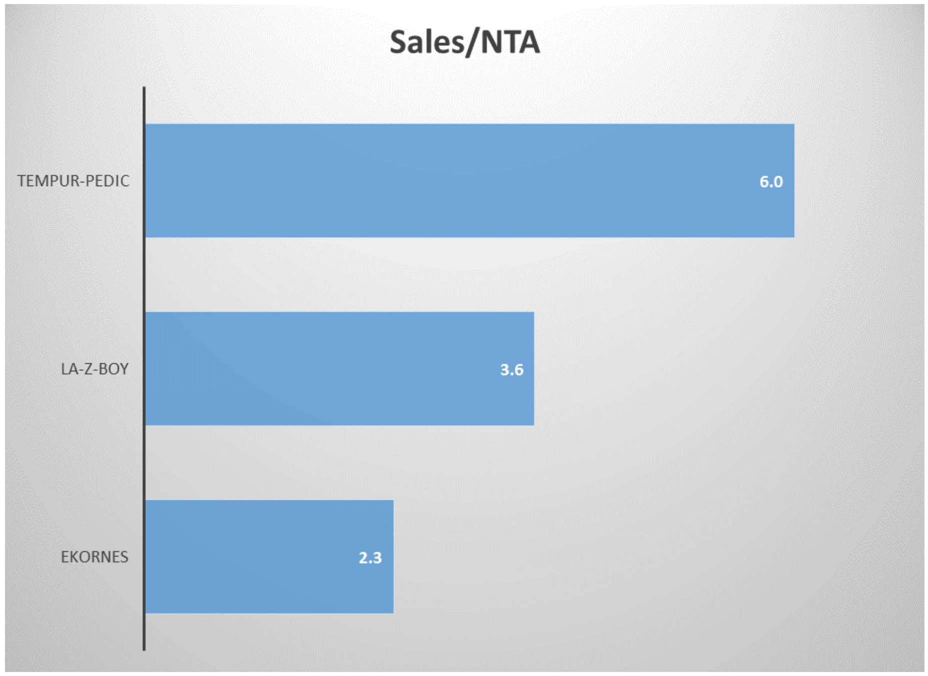
Stressless also advertises its brand on TV. The company has run infomercials on channels like Discovery, A&E, and HGTV. These channels target richer and older Americans. Most recliner brands are not big enough to advertise on TV. They rely on their dealers to run ads instead of doing manufacturer sponsored advertising. It is hard to gauge the long-term impact of this advertising. The vast majority of potential recliner buyers are never exposed to these ads. However, advertising can increase sales leads coming into Stressless dealers (who each cover an exclusive territory). This can reinforce Stressless's high sales per square foot advantage. It can also help Stressless get the best dealers and the most space. That can certainly improve Stressless's brand image over time.

QUALITY

Ekrnes Can Earn 15% to 35% Returns on Equity without Using Any Debt

Different types of furniture businesses earn different returns on capital. Ekornes makes upholstery. When we talk about upholstery furniture we are generally talking about seats. We are talking about fixed back chairs, recliners, and couches. This furniture is comfortable. That comfort is provided by combinations of material like fabric and leather covers on the outside and engineered elements like pads and springs on the inside. Upholstery is defined in opposition to case goods. Case goods are furniture with compartments for storage. A chest, dresser, bookshelf, or cabinet is a case good. A recliner is a piece of upholstery. The economics of case goods and upholstery are very different. A third category – mattresses for beds – can also be added to this discussion. Today's memory foam mattresses are an example of a furniture product with excellent economics. Furniture makers with a strong position in the mattress market tend to earn the greatest returns on capital. Next comes furniture makers with a strong competitive position in the upholstery market. And last and definitely least come makers of case goods.

The easiest way to show the difference in profitability between case goods and upholstery is to compare two parts of the same company. La-Z-Boy makes both upholstery and case goods. From 1998 to 2014, the EBIT margin of La-Z-Boy's upholstery business ranged from a low of 4% to a high of 10.7%. In those same years, the EBIT margin of La-Z-Boy's case goods business ranged from a low of negative 14.9% to a high of 7.7%. The median margin – which is the unit's return on sales in its most middling year – was 8.3% for the upholstery business. During those same 16 years, the median margin for the case goods business was 4%. On average, La-Z-Boy's upholstery business earned twice as much per dollar of sales as its case goods business. The case goods business is both less profitable and more volatile than the upholstery business. La-Z-Boy's upholstery margin is actually very stable. The company's coefficient of variation – think of this as the standard deviation of the margin (its wobbliness) relative to the mean (its central tendency) – over those 16 years was 0.21. That is a very low level of EBIT margin variation for any business. Plenty of wide moat consumer goods companies – businesses in defensive industries with leading brands – experience the same amount of relative lumpiness in their annual return on sales. Meanwhile, La-Z-Boy's case goods had an EBIT margin coefficient of variation of 1.81. That is a shockingly high number. Many weaker competitors in difficult and cyclical industries have less variation than that in their annual return on sales. If we were to graph La-Z-Boy's margins from 1998 to 2014 it would tell two different stories. The upholstery unit would look like a leading competitor in a good industry. The case goods unit would look like a marginal competitor in a bad industry. It is important to separate furniture companies into those that sell case goods and those that sell upholstery. Both products are types of furniture. However, there is no similarity in the economics of producing case goods and the economics of producing upholstery. The financial results of companies that focus on upholstery look less like the financial results of companies that focus on case goods than they look like the financial results of companies in unrelated industries. If you were to see a 10-year series of financial data for an



Ekornes squeezes less sales from each dollar of its net tangible assets than other furniture makers do

upholstery furniture maker and a 10-year series of financial data for a case goods maker but were not allowed to see the names of the two companies – if you had to judge them blindly – you would never guess they were in the same industry. The La-Z-Boy example makes this clear. On the evidence of financial results alone, no one could correctly guess that those two very different businesses – the good upholstery business and the bad case goods business – are part of the same public company.

Unlike La-Z-Boy, Ekornes does not have a case goods business. In fact, Ekornes has a small upholstery business outside of recliners. Ekornes is essentially Stressless. And Stressless is essentially recliners. Recliners have better product economics than other types of upholstery. La-Z-Boy's management has said that their "core recliner product….generate(s) a better gross margin." This is certainly true at Ekornes. Ekornes breaks down its products by "contribution margin" the same way that John Wiley explains the financial results of its different units. Contribution margin is the selling price per unit – the price Ekornes charges its customers, not the retail price of the product – minus the variable cost per unit. Contribution margin gives a good idea of the profitability of the products Ekornes sells. However, it leaves out the allocation of fixed costs – the overall cost of running a factory and a corporate headquarters regardless of which particular products you sell. A company's eventual operating margin is therefore always lower than its contribution margin. This does not mean contribution margin is a useless number. It is very helpful in comparing the profitability of different products sold by the same company. Ekornes sells chairs, sofas, and mattresses. Every one dollar sale of a mattress contributes 32 cents to Ekornes's profits. Every one dollar sale of a sofa contributes 36 cents to Ekornes's profits. While every one dollar sale of a chair contributes 55 cents to Ekornes's sales. In other words, the contribution margin is 55% for chairs, 36% for sofas, and 32% for mattresses. Stressless recliners are the highest margin product Ekornes sells just as La-Z-Boy recliners are the highest margin product La-Z-Boy sells.

As an upholstery company focused on recliners, Ekornes's business quality is higher than both case goods makers and more diversified upholstery makers. Ekornes is a better business than La-Z-Boy because Ekornes does not sell any case goods and the upholstery Ekornes sells is skewed toward high priced recliners. So Ekornes is a better business than most furniture makers. It is even a better business than La-Z-Boy. However, Ekornes is not a better business than a mattress maker. Companies like Tempur-Pedic, Select Comfort, and Sealy can and do earn higher returns on capital than Ekornes does.

A company's return on capital is the product of two factors: 1) Margin 2) Turns. For example, a company's pre-tax return on assets can be stated as the product of Operating Margin (Operating Profit / Sales) times Asset Turnover (Sales / Assets). As shareholders, it is a company's return on net tangible assets that matters most. This is the form of capital the shareholder is financing with their own equity. So, the company with the highest return on its net tangible assets (NTA) is best positioned to outperform as a stock. Note that this is only true if shareholders pay the same price for each dollar of net tangible assets at each company. But that is a separate issue. The long-term return in a stock tends to reflect 1) The company's return on its net tangible assets and 2) How expensive the stock was relative to its net tangible assets when the shareholder first bought their shares in the company. You as the investor control the second matter. The company only controls the first matter. Therefore, the quality of a business is best reflected numerically in its return on net tangible assets.

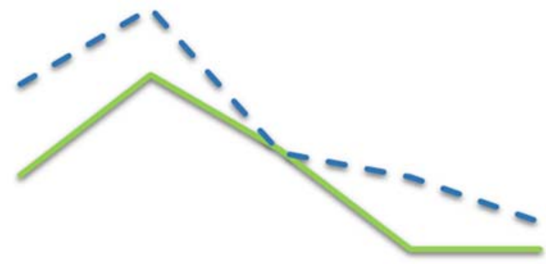
Ekornes has a higher margin than La-Z-Boy does. HowHowever, Ekornes's sales are only 2.3 times its net tangible assets. It only "turns" each $1 tangible investment of its shareholders into $2.30 of sales per year. Meanwhile, La-Z-Boy has a Sales/Net Tangible Assets ratio of 3.6. Tempur-Pedic turns its net tangible assets 6 times. And Select Comfort does not really use net tangible assets. It has often financed its daily operations with "float". Mattress companies generally have higher margins and very, very high turns. They often spend more than 10% of their sales on advertising the way the best known consumer brands in the world do. The mattress market is by far the most valuable furniture market to dominate. The downside is the competition this attracts. In recent years – Tempur-Pedic, Sealy, and Select Comfort have faced more competition from copycats who try to match those companies products as best they can while advertising their version is as good as the leading brand and costs much less. As discussed earlier this is the Rayovac approach to batteries. No one believes a Rayovac battery is better than an Energizer or Duracell battery. But enough people believe it might be close enough – or close enough for their purposes – while clearly costing less to take some share from the two leading brands. Ekornes is a better business than La-Z-Boy and a worse business than the mattress companies. However, Ekornes may have a surer – and more defensible – competitive position than the leading mattress companies. Ekornes has a small share of the recliner market. The recliner market is much smaller than the mattress market. And Ekornes faces no competitors of truly comparable comfort levels. Compared to the mattress companies, Ekornes is a bigger fish in a much smaller and slightly less attractive pond. However, the pond Ekornes lives is more profitable than the markets most companies compete in. Ekornes can hit 10% to 25% operating margins and 2 times asset turnover year after year. This should result in returns on pre-tax returns on capital in the 20% to 50% range. That translates into a 15% to 35% unleveraged return on equity.

CAPITAL ALLOCATION

Ekornes Uses All of its Free Cash Flow to Pay Dividends – Not to Buy Back Shares

Ekornes's capital allocation is simple. The company does not dilute shareholders. The number of shares outstanding has stayed exactly the same for more than 10 years. The share count does not increase as a result of executive bonuses coming in the form of stock options as is the case at many American companies. Ekornes pays out its free cash flow in dividends. From 2000 through 2014, Ekornes's cumulative dividends paid equaled 103% of reported free cash flow. On a cash basis, the company essentially has a 100% dividend payout policy. It pays out all of its cash earnings to shareholders. Ekornes does not use debt. The only long-term obligation on the balance sheet is a very small – less than a month's free cash flow – pension commitment. Ekornes had a low dividend payout during the 2008 financial crisis. By 2009, the company was paying 79% of its reported earnings out in dividends. After 2009, the dividend payout stayed at 80% of reported earnings or higher. Ekornes has even paid out more in dividends than it earned in a given year. This helps make up for any underpayment in some years. The net result is that Ekornes should – over the long life of your investment in the stock – pay out all of its free cash flow to you as dividends. The payout will be close to reported earnings. So, Ekornes's EPS is a good gauge of expected future dividends. As earnings per share grow, so should dividends. Right now, Ekornes's dividend yield is 6%. This understates the likely future dividends. The dividend yield using today's price and the past peak dividend per share in any one year would be 9.4%. The dividend yield using today's price and the average annual dividend of the past 5 years is 7.2%. These are more realistic estimates of the likely future dividend yield. Ekornes's earnings and dividends per share are both lower now than they were in the past. This is normal for a furniture company. Many furniture makers have generated lower earnings in the period from 2008-2013 than they did in the 5 year period before that. Furniture sales in countries like the U.S. were down by huge percentages from the peak of the housing bubble to the bottom of the financial crisis. At the moment, Ekornes has a dividend yield of 6%. However, a more realistic expectation of the future dividend is simply the future earning power since Ekornes generally pays 85% or more of its earnings in dividends. For this reason, it makes more sense to assume Ekornes will have a cash yield more like 7% to 9% of your purchase price fairly soon. When comparing the stock's dividend yield to bonds and the dividends yields of other stocks that do not pay out all earnings in dividends – this range of a 7% to 9% dividend yield is the number to use. Ekornes's dividends may be lumpier than the dividends of other companies because most companies do not have to cut dividends when earnings decline. This is because many companies pay out anywhere from one -third to two-thirds of earnings in dividends while Ekornes pays out more than five-sixths of its earnings as dividends. Despite this lumpiness, the long-term predictability of Ekornes's dividend payments is actually higher. That is because it is obviously the company's policy to pay out all cash earnings as dividends. Ekornes does not take on debt. So cash never needs to be used to pay down debt. This means year-to-year dividends vary along with reported earnings rather than changes in capital allocation decisions by the board.

Compared to other furniture companies, Ekornes invests a lot in its brand and its factory. Ekornes spends money advertising the Stressless brand. It also invests in robots. Ekornes uses more capital than its competitors to generate the same level of sales. However, Ekornes has higher margins than competitors. Much of this difference can be explained by investing in robots instead of hiring humans. Robots are purchased upfront as a single cash outlay. They are then capitalized on the balance sheet as an asset. In other words, robots are treated as capital in the financial reports. Humans are not. Humans are not paid up front. And human workers



	2009	2010	2011	2012	2013
Dividends per Share	kr 7.00	kr 9.00	kr 7.50	kr 5.50	kr 5.50
Earnings per Share	kr 8.82	kr 10.34	kr 7.44	kr 6.95	kr 6.05

Over the last 5 years, Ekornes paid out 83% of its earnings in dividends

are not capitalized on a company's balance sheet no matter how long an employee may be expected to work at the company. Instead, humans are paid very little upfront and quite a lot in wages every quarter. Companies that use human labor tend to have lower asset levels – and therefore higher asset "turns" – than companies that invest in robots. The downside for companies using human labor is the high wages paid out as an expense every year. This results in lower margins. So, a human labor heavy company tends to have lower cash margins and higher asset turns than a company that uses robots. A company that uses robots is more asset heavy. It ties up more shareholder money to do the same amount of sales. However, it "pays" much less in wages for a robot. In fact, the capitalized cost of the robots Ekornes uses are expensed over time at levels that translate per hour of work done into much lower labor expenses than humans could ever be hired for. Ekornes is in a higher wage country. But the hourly expense of its robots – mostly the upfront cost of buying the robot expensed over the number of hours of work provided by the robot before it is retired – is much lower than what workers in much lower wage developed countries would make. Ekornes has a labor cost disadvantage when it comes to the work done by human labor. However, it has a labor cost advantage when it comes to the work done by robots. Ekornes's robots cost less over their lifetime per hour of work done than employees in low wage countries cost their employers.

Ekornes recently made one big capital allocation change. It bought IMG. IMG was a close competitor. IMG was founded in 2006 by the former CEO of Hjellegjerde. Hjellegjerde is the now failed Norwegian furniture company headquartered just 2 miles down the road from Ekornes we mentioned earlier when analyzing Ekornes's possible cost disadvantage. Hjellegjerde could charge about 30% less than Ekornes and barely break even. When the Great Recession hit, this was no longer true. Hjellegjerde failed. This is not surprising considering the company made close to nothing in relatively good years. Nils Gunnar Hjellegjerde – a grandson of one of the founders of Hjellegjerde – was once CEO of Hjellegjerde. But he sold his ownership and left the company. In 2006, he founded IMG. IMG sells the same Norwegian style furniture Ekornes does at a lower price. The quality and price range is similar to what Hjellegjerde offered. IMG sells recliners for between $1,000 and $1,500.

Stressless recliners start at over $1,700. IMG outsources manufacturing to places like Vietnam and Thailand. From its founding in 2006 to 2013, IMG was successful. It managed to grow revenue to $38 million USD while generating $11 million in EBITDA. Considering how difficult the years 2006 to 2013 were in the furniture business and that the company is still less than 10 years old – this is an impressive result. In some ways, IMG is obviously very similar to Hjellegjerde. The CEO's name is Hjellegjerde. He ran Hjellegjerde. And when Hjellegjerde failed and was sold to Interstil (a large Scandinavian furniture retailer), IMG moved its headquarters into the old Hjellegjerde factory. So, by 2014, you had a member of the Hjellegjerde family running a furniture business out of the old Hjellegjerde headquarters. In some ways, IMG is a spiritual successor to Hjellegjerde. Ekornes bought IMG in 2014. It looks like a good deal. The two companies most like Ekornes had been Hjellegjerde and then – after 2006 – the new company (IMG) founded by a former CEO of Hjellegjerde. Hjellegjerde failed and had to be bought by Interstil. And then Ekornes bought IMG. This eliminates potential Norwegian competitors that grew up – almost literally – in the same neighborhood as Ekornes. Ekornes paid 400 million Norwegian Krone for IMG with the possibility of consideration of 150 million more Norwegian Krone. This means the price was between 4.7 and 6.4 times EBITDA. Ekornes intends to keep IMG separate from Stressless. The sales force, production, and distribution will all be separate. The selling CEO will stay for at least 3 years. It is unclear if there are any real cost synergies beyond corporate ones. But, it is clear that Ekornes got a former CEO of Hjellegjerde and then a Founder/CEO of IMG and eliminated a new, growing competitor while paying 6.5 times EBITDA. It seems like a solid acquisition. The one potentially odd part of the deal (to Quan and I at least) – which will be discussed later – is that Ekornes did not install Nils Gunnar Hjellegjerde (the CEO of the acquired IMG) as head of Ekornes itself when they needed a replacement CEO.

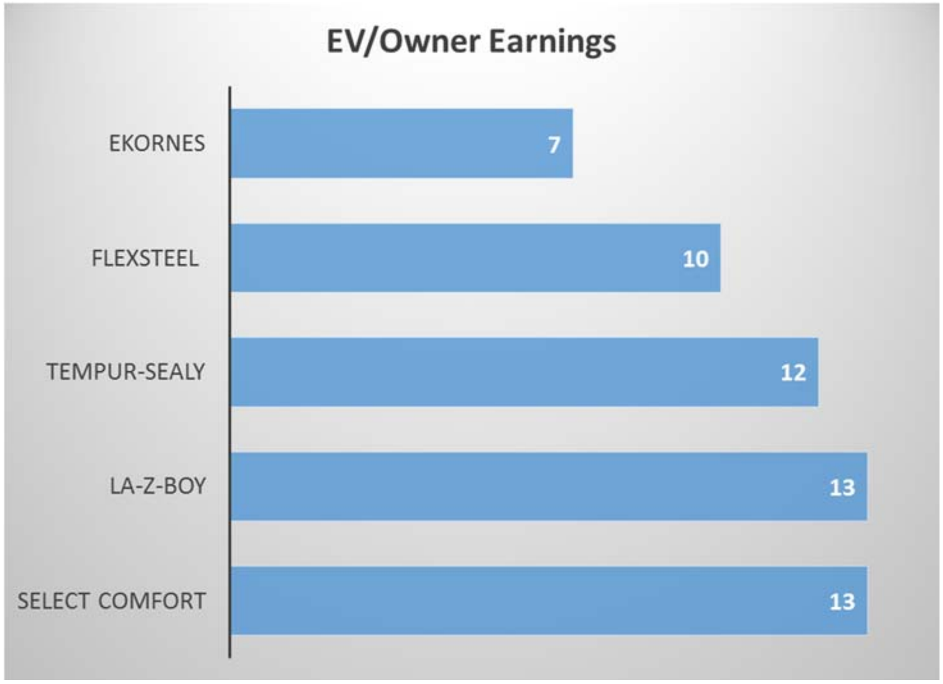
VALUE

Ekornes Deserves to Trade at 11 Times EBIT Instead of Today's Price of 7 Times EBIT

Ekornes is one of the cheapest stocks we have written about in Singular Diligence. There are several ways to measure this cheapness. One is to use the earning power and enterprise value of Ekornes without including the impact of the IMG acquisition. Before the IMG acquisition, Ekornes had no meaningful debt or net cash. So, the company's market cap was a good stand in for its enterprise value. Ekornes shares now trade at 96 Norwegian Krone. The company has 36.83 million shares outstanding. So, the enterprise value – ignoring the IMG acquisition – is a little over 3.5 billion Norwegian Krone. Ekornes's normal pre-tax earnings are about 500 million Norwegian Krone. So, the company trades at about 7 times normal EBIT.

Normal EBIT can be calculated in a few ways. One of the simplest is to take the long -term average – in this case, 1997 through 2013 – EBIT margin and apply it to the company's most recent sales result. This adjusts for any cyclicality in margin. It does not adjust for cyclicality in the overall sales level. In other words, a company's growth in sales may be particularly strong coming out of the low point in the cycle and particularly weak falling off the high point of the cycle. This approach ignores that. It simply assumes that last year's sales result is treated – arbitrarily – as being normal. There is no special reason for assuming last year's sales were normal. But there is a good reason for assuming that the long-term average margin of a company is more accurate than any one year's margin. This is especially true for Ekornes. Ekornes has had very low EBIT margin variation over the last 15 years or more. Since 1997, Ekornes's EBIT margin has varied much less than almost all public companies around the world. The mean EBIT margin from 1997 to 2013 was 18.2% while the standard deviation was 2.1%. Even a three standard deviation move from the mean EBIT would only be about one-third of the margin. Putting aside the sales volume – which can also vary – this would mean that years with 30% or 40% higher or lower earnings from the long-term earnings should be extremely unusual. And that is what we see in Ekornes's actual past results. The mean EBIT margin from 1997 to 2013 was 18.2% and the standard deviation was 2.1%. The minimum result – the very worst year in terms of return on sales – was a 13.6% EBIT margin. This is less than two and a half standard deviations below the mean. And it includes the worst global recession – and the worst hit to global demand for furniture – in more than a lifetime. The maximum result of a 21.7% margin is also fairly close to the long-term trend. It is less than two standard deviations from the mean. Ekornes's results should not be expected to follow an actual "normal" or "Gaussian" distribution in the probabilistic sense. The real world results for the company will not be so tidy. But, it is not unreasonable – for the purposes of comparing Ekornes to other companies – to believe that the company's margin in most future years is likely to fall within three standard deviations of the mean margin of the past 17 years. In other words, with a history of an 18.2% mean EBIT margin and a 2.1% standard deviation – an investor would not be wrong to assume that Ekornes has a much better chance than most companies of having its EBIT margin fall between 11.9% and 24.5%. That is a reasonable range for any one year's margin result. Bad years should not be expected to be worse than about 12% (the worst since 1997 was 13.6%) and good years should not be expected to be better than 24.5% (the best since 2013 was 21.7%). Results outside of a 12% to 24% margin range would be unlikely to occur except in truly extraordinary circumstances. Ekornes's employee bonus scheme supports this sort of thinking. The company pays no bonus at all when the EBIT margin is below 10% (which has not happened in the last 15 or so years) and does not mention what the bonus would be above a 25% margin (because the company has never achieved such a margin).

Ekornes's margin has been low in recent years. It was 18.6% in 2010, 14.0% in 2011, 16.0% in 2012, and 13.6% in 2013. The contribution margin from Stressless chairs actually increased during these years. The company's overall contribution margin was stable at 48% in both 2011 and 2013. The problem has been other – below the line – costs. In 2009, Ekornes's costs below its contribution margin line were 30% of revenue. They have since risen to over 34% of revenue. The median since 1998 was spending 29.6% of sales on expenses below the contribution line. It is possible that Ekornes has gained 4% of sales as a permanent inefficiency in their system. But this is unlikely. For one thing, a permanent expense increase of about 4% of sales could be offset with a little more than 4% increase in price and the same level of unit sales. Stressless recliners are the most expensive chairs at retail. They are sold in local currency. And Ekornes has had to face a strengthening Norwegian Krone for most of the last 20 years. There is no doubt that Stressless chairs have continually increased at rates equal to or greater – often greater – than the local rate of inflation in the countries in which they are sold. Since the oil price crash, the Norwegian Krone has weakened. It is important to remember that in the long -run this simply decreases Ekornes's costs without creating any incentive for them to lower their prices. Ekornes's competitors do not benefit from a decline in the Krone. So they do not move their prices when the Krone drops. There is no reason for Ekornes to change the price of Stressless chairs when competing chairs sold next to Stressless in local retail stores do not change their prices. In fact, it is important for Ekornes to always keep Stressless priced above the next best alternative sold in the store to maintain Stressless's premium price positioning in recliners. In the short-term, Ekornes uses foreign currency hedges. But, this is not important to long-term investors. Ekornes has not increased revenue as fast as salaries. The company has been investing in markets like the U.S., Australia, Singapore, and China. It is likely that costs like the overhead of a new warehouse in the U.S. contribute to the increasing in operating expense before they help create any increase in sales in that country. For these reasons, we will apply a normal EBIT margin of about 18% to Ekornes's sales instead of using the 13.6% margin recorded in 2013.



Ekornes trades at a valuation that is 30% to 45% cheaper than that of its closest peers

Ekornes's current valuation is about 7 times normal EBIT. Publicly traded peers of Ekornes include Natuzzi, Flexsteel, La-Z-Boy, Select Comfort, and Tempur-Pedic. Natuzzi is a premium upholstery maker. It runs stores like La-Z-Boy. Natuzzi has lost money in 8 of the last 10 years. So its valuation relative to Ekornes – which has been profitable every year for more than 15 straight years – is irrelevant. Flexsteel is an average furniture company focused on upholstery. It lost money in 2009 and earns about a 5% return on sales in normal times. The company trades at 9 to 10 times EBIT. Flexsteel is probably inferior to both Ekornes and La-Z-Boy. La-Z-Boy makes both case goods and upholstery. Case goods do not add much value to the company. So its valuation is backed mostly by its upholstery unit. La-Z-Boy trades at 12 to 13 times EBIT. However, the company is cheap relative to peak EBIT. La-Z-Boy trades at just 7.5 times its 2003 EBIT. The furniture business – especially in case goods – has changed a lot since 2003. So, it is possible that La-Z-Boy's price-to-peak earnings is irrelevant. Ekornes is a better business than La-Z-Boy. Ekornes is not necessarily a better business than Select Comfort. Select Comfort lost money in 2008. It has a lower average margin than Ekornes. However, Select Comfort is focused on the U.S. bedding market. The U.S. bedding market has grown 5% a year since 1992. This is faster than other types of furniture. And Select Comfort grew sales more than 10% a year from 2001 to today. So, Select Comfort is more of a growth stock. The company trades at 13 to 14 times EBIT. Tempur-Sealy has similar growth to Select Comfort. Sealy is not a better business than Ekornes. However, Tempur-Pedic is. Tempur-Pedic has been losing share in North America. Margin has also been declining. Conservative buy-and-hold type value investors will prefer Ekornes over Tempur-Sealy. However, growth investor may prefer Tempur-Sealy over Ekornes. Tempur-Sealy trades at between 18 and 19 times EBIT. However, in the past, management had put out aggressive future targets. Using the top range of these aggressive targets as the upper bound of an "optimistic" EBIT that a growth investor in Tempur-Sealy might dream of, we can say that the stock trades at about 12 times this optimistic EBIT. A range of 12 times optimistic EBIT and 18 times pessimistic EBIT is a good way of describing the stock. So, from most expensive to cheapest we have: Tempur-Sealy (18 times EBIT), Select Comfort (13 times EBIT), La-Z-Boy (12 times EBIT), Flexsteel (9 times EBIT), and then Ekornes at 7 times normal EBIT. Ekornes is the cheapest of these 5 companies despite being a better business than either Flexsteel or La-Z-Boy. In 2012, Tempur-Pedic paid more than 12 times current EBIT and 9 times normal EBIT for Sealy. In terms of financial results, Ekornes's past is more comparable to Sealy's past than to the past of those other peers mentioned above. The corporate tax in Norway is 27%. Ekornes is an above average business. It deserves to trade at 15 to 20 times P/E when – as is usually the case – it has no debt. The average U.S. public company has historically traded at a P/E of about 15. Ekornes is definitely better than the average U.S. public company. To have an unleveraged P/E of 15, Ekornes would need to trade at 11 times normal EBIT. Right now, Ekornes trades at 7 times normal EBIT and has a 6% dividend yield. It is clearly a cheap stock.

GROWTH

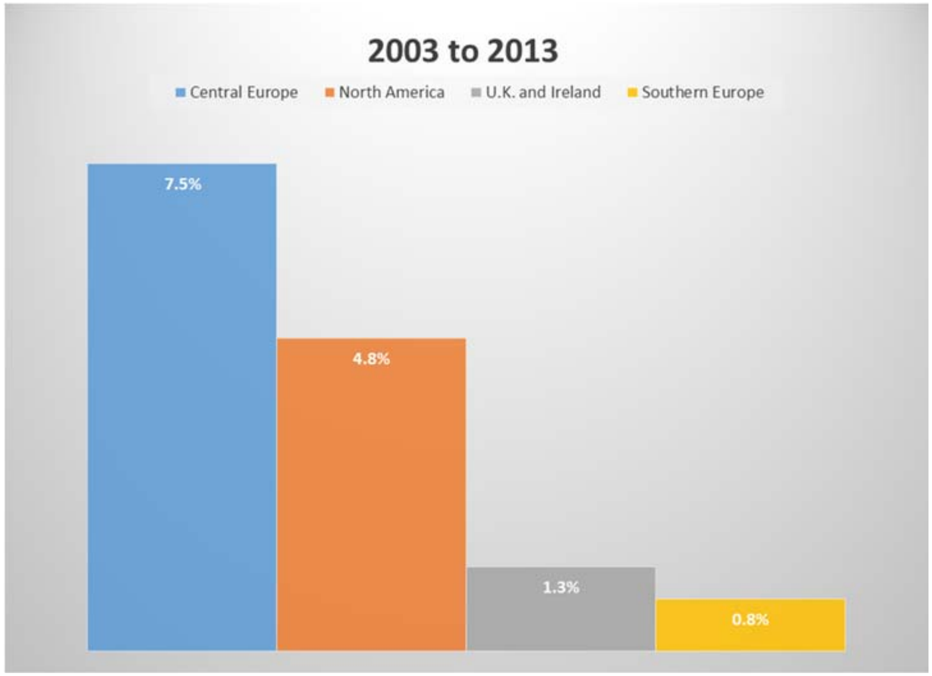
Investors Should Focus on Ekornes's Sales Growth in Local Currencies – Never in Norwegian Krone

Over the last 10 to 15 years, Ekornes has grown its physical unit sales by between 3% and 4% a year. In 2001, the company made 1,061 seats per day. In 2014, it made 1,736 seats per day. Dung that same time period, the wholesale price of a Stressless chair increased about 1% a year in Norwegian Krone. This 3% to 4% a year increase in production volume and 1% increase in average sale price lead to sales growth of 4% to 5% a year over the least 15 years. The Norwegian Krone strengthened during much of this period. So, the retail price of a Stressless recliner must have increased faster in local currency. Exact price comparisons between the same model sold in the same store are impossible to find. However, it is possible to compare references in articles from the early 2000s to retail prices today in that same country. This kind of comparison usually shows something closer to a 2% to 3% a year increase in a local currency – such as the U.S. Dollar – rather than a rate of growth closer to the 1% a year increase in Norwegian Krone revenue per seat sold that Ekornes actually reported during this time. In other words, an investor buying and selling his stocks in U.S. dollars would have probably seen local currency sales growth from Ekornes of more like 5% to 7% a year. This is a combination of 3% to 4% growth in the number of seats sold each year and 2% to 3% growth in the average selling price per seat in local (for example, U.S. Dollar) currency.

As the Norwegian Krone increased, Ekornes had to offset this constant expense gain with some productivity gains. From 2001 to 2011, Ekornes's employees became 2.7% more productive per year. The company made 0.84 seats per full-time equivalent day in 2001 and 1.10 seats per full-time equivalent day in 2011. The increase in productivity – measured in seats – per employee was steady till about 2011. Since then, the level of production per employee has declined less than 1% per year. Since the number of seats made per employee increased almost every year – the amount of revenue per employee also increased almost every year. From 2001 to the 2010 peak in sales per employee, Ekornes had 3.6% annual growth in sales per employee stated in Krone terms. Revenue per employee was 1.36 million Norwegian Krone in 2001. It rose to 1.87 million Norwegian Krone in 2010. Revenue per employee has since dropped to 1.75 million Norwegian Krone today. That is equivalent to sales of over $209,000 per employee. Ekornes's contribution margin is over 50% per Stressless chair and close to 50% for the company overall. So, the average employee is capable of contributing about $105,000 of additional profit. Of course, at higher corporate profit margins – employees receive higher bonuses. This approach to bonuses evens out results for owners more than at companies that do not tie employee bonuses to profit margins. In good years, employees are paid higher bonuses which makes a cyclically fat year somewhat leaner for owners. In bad years, employees are paid lower bonuses which makes a cyclically lean year somewhat fatter for owners. Reported results can be confusing due to currency. This can make analyzing long-term growth harder.

From 2001 to 2011, a Norwegian Krone increased in value from 11 U.S. cents to 18 U.S. cents. A Norwegian Krone still bought 17 U.S. cents as late as 2013. Today, a Norwegian Krone buys only 12 U.S. cents. In fact, the same U.S. dollar sales translated into Norwegian Krone result in the lowest figure since before 2003. The U.S. Dollar – issued by a major oil importing country – has strengthened since the oil price crash. The Norwegian Krone – issued by a country dependent on oil exports – has weakened since the oil price crash. It is important that investors do not take the wrong lesson from this story. The Norwegian Krone is now worth about 12.4 U.S. cents. That is low compared to every year before 2003. However, this does not mean the Norwegian Krone is undervalued versus the U.S. Dollar. In fact, the Norwegian Krone is still overvalued in terms of the number that matters most: purchasing power parity.

The Economist publishes a “Big Mac Index” from time-to-time. In January of this year, The Economist reported a Big Mac costs 48 Norwegian Krone inside Norway and $4.79 in the U.S. This means an American wanting to buy a Big Mac in Norway would have to buy 48 Norwegian Krone to do so. Each U.S. dollar buys 8.12 Norwegian Krone at today’s foreign exchange price. So, an American would have to spend $5.91 to buy the 48 Norwegian Krone needed to buy a Big Mac inside Norway. In other words, the Norwegian Krone is still 23% stronger against the U.S. Dollar than it should be. What should cost an American $4.79 to buy inside Norway actually costs $5.91. For this price difference to be justified, the rates of inflation (or deflation) inside the Norwegian and American economies would need to be different enough in the future to support such a large foreign exchange difference today. One way to think of this is to consider what rate of inflation for what period of time the U.S. would need to experience inflation at while Norwegian prices stayed stable. In this case, the U.S. would need to have inflation of 2% a year for 11 years while Norway experienced literally zero inflation for those same 11 years to even out prices inside the two countries. That is a possible outcome. But it seems an unwise one to bet on. Inflation expectations in the U.S. are not high. Looking 10 years ahead, expectations are for inflation of about 2% a year. That means someone who prefers to hold Norwegian Krone over U.S. dollars would – if U.S. inflation over the next decade occurs at the rate expected – need to have an inflation rate of zero inside Norway and then wait for a decade to justify his initial decision to Norwegian Krone instead of U.S. dollars today. The biggest problem for believing the Norwegian Krone is fairly



Ekornes’s annual sales growth in the local currencies of some weak economies has been close to zero

valued or undervalued against the dollar is the price of oil. Throughout the period 2003 through 2103 – when the Norwegian Krone was strong against the dollar – oil prices were high. Today’s oil price is much closer to the longer-term average real price per barrel of oil than it was during this 2003 to 2013 period. The market price of oil – which is traded in U.S. dollars – is also closer to cost of extracting an additional barrel of oil than it was during the 2003 to 2013 period. For these reasons, investors buying Ekornes need to be careful how they think about the currency.

Ekornes uses currency hedges. Throughout this issue, we have needed to restate results before the past few years to adjust for changes in the way Ekornes now reports currency gains and losses from the way it once did. The important number for an investor in Ekornes to keep in mind is 19%. It is reasonable to expect the Norwegian Krone can and will fall as much as 19% against the U.S. Dollar without Ekornes needing to change the price of Stressless chairs sold in the U.S. In the long-run, changes in the Norwegian Krone affect Ekornes’s labor costs. They do not have any influence over the price at which Ekornes should – and likely will – charge for their chairs in local currency. Put another way, a Stressless chair should cost an American the equivalent of about 350 Big Macs regardless of what the price of Big Macs are in Norway. Stressless does not report long-term sales growth in local currency by geographic region. However, it is possible to estimate these figures. Central Europe – largely German – sales probably increased more than 7% a year since 2003. North American – largely U.S. – sales increased close to 5% a year since 2003. Southern European sales grew just over 1% over this same time period. Sales in the U.K. – including Ireland – grew even less. These sales figures largely reflect the strength of the furniture markets and economies of those countries. Germany was strongest followed by the U.S. Southern Europe and Ireland were very weak during the 2000s. Sales in Asia – mostly Japan – increased more than 4% a year. So, major markets like Central Europe, North America, and Asia experienced 4% to 7% annual growth in their local currencies during the 2000s. This was not an especially strong time for furniture sales. The market was good in the first half of that period and terrible in the second half. It is reasonable to expect Ekornes to grow sales by about 4% a year in the local currency of its major markets. Investors should ignore annual growth in Norwegian Krone terms and focus instead on the long-term growth in sales by local currency. In other words, investors should expect sales growth of about 4% a year from Ekornes. Opportunities are highest in Asia – where the furniture market is growing fastest – and the U.S. (where Stressless has a strong brand name but low market penetration in terms of per capita sales). Stressless may be able to grow U.S. sales by as much as 5% a year. Asian sales – outside of Japan – can grow by 10% a year for some time. These regions can help drive worldwide sales growth of 4% a year.

MISJUDGMENT

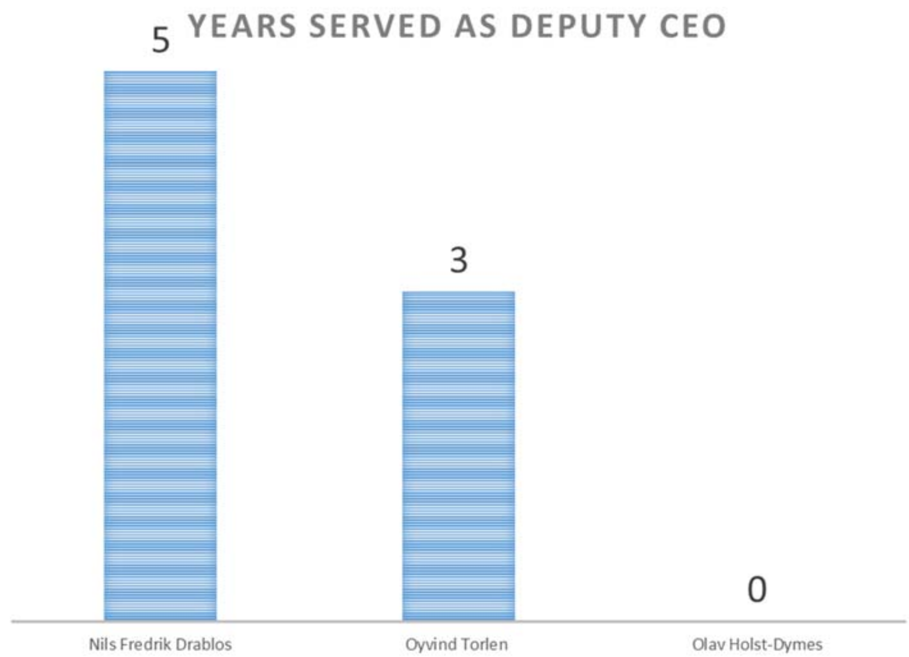
Hiring CEOs from Outside the Company Risks Diluting Ekornes's Corporate Culture

The biggest risk in misjudging Ekornes is misjudging the management. Ekornes went bankrupt in the early 1990s. The company is headquartered in Norway. But – more than that – Ekornes actually makes its recliners in a Norwegian factory using Norwegian labor. Norway is a very high wage country. Ekornes can only survive if it competes on aspects other than price. It needs to do a good job of research and development, design, brand building, and – most importantly – comfort. Ekornes can be successful if it sells the most comfortable recliners in the world. The danger to the company from competitors is not as great as the danger to the company from its own possible mistakes. Ekornes can "diworsify" into other areas of the furniture business. It can dilute the Stressless brand. It can focus less on comfort and more on price. Ekornes has a small market share in most countries. If it stays focused on what it does best – the company can grow sales and profits for many years. But if Ekornes veers off into more general areas of competition – such as competing on price against recliner makers like La-Z-Boy – the company's fragility will be obvious. Ekornes is a fragile company in the sense that its moat is really a niche. Ekornes can not compete effectively in most parts of the furniture business against most companies. It can – and does – successfully occupy a small niche selling some of the highest priced most comfortable chairs in the world. This is a small niche in every country in which Ekornes competes. But Ekornes is able to compete in most developed markets around the world. That makes Ekornes a sort of hidden champion in comfort. It would be very hard for other furniture makers to dislodge Ekornes from its strong competitive position in recliners. They would need to replicate a brand equal in strength to Ekornes. They would need to centralize their manufacturing, expand their research and development per model, limit their distribution to exclusive dealer territories, and so on. The rewards for all this work would be small. A successful competitor would probably have to share the high comfort niche in each country with Ekornes. Only by stringing together a strong competitive position in many countries is it possible to replicate the scale Ekornes has in premium recliners. The rewards for doing all this are small compared to the high cost and uncertain odds of success. A bigger obstacle than uncertainty is the time it could take to build a brand like Stressless and the limited size of the market for super comfortable chairs in each country. For most of the biggest furniture makers – competing directly with Ekornes would only be transformative for their company if they ended up with a similar market share position as Ekornes in a lot of different countries. For example, Ekornes only gets about one-fifth of its sales from the U.S. La-Z-Boy is a big company. It is bigger than Ekornes. If La-Z-Boy succeeded in matching Stressless with a new brand in the highest end chairs – this would not re-invent La-Z-Boy as a company unless it expanded such a brand beyond the U.S. For these reasons, the danger to Stressless from competitors is much less than the possible danger to Stressless from its own management. The greatest risk is a loss of focus.

Ekornes's new CEO is Olav Holst-Dymes. He was previously the CEO of Havfisk. Havfisk is a Norwegian fishing company. It is a public company listed on the Oslo Stock Exchange. Havfisk has no real similarity to Ekornes other than the fact that both companies are Norwegian public companies. However, Olav Holst-Dymes does have experience in the furniture industry. He worked for 6 years as sourcing manager for Stokke. Stokke is the Norwegian furniture maker that makes Tripp-Trapp adjustable high chairs for children. The Tripp-Trapp chair is the bestselling piece of furniture inside Norway. Holst-Dymes has a master's degree in Engineering from the Norwegian Institute of Technology. He served in the Norwegian army for 10 years. He was made Ekornes's CEO at age 44. This is young for a public company CEO. There is certainly nothing wrong with hiring a young CEO. For one thing, it allows for a long tenure. Many public company CEOs serve 5 years or less. A 44 year -old CEO who does a good job could continue to do a good job for 20 or more years. Olav Holst-Dymes has some furniture experience. But he is an outsider. He was not promoted from within Ekornes. This is often a bad sign for "hidden champion" type companies. Ekornes competes in a specific niche of the furniture business. Any shift in strategy away from that niche could be disastrous. As mentioned many times before – Ekornes can not compete on price against furniture makers from other countries. If a low price is the main thing a customer is looking for in a chair – that customer is not a viable target for Ekornes. Ekornes must not seek to serve such price conscious customers. It has to focus on always widening its moat in areas other than price.

We know little about Olav Holst-Dymes or why he was chosen. We do know he is an outsider who was not promoted from within Ekornes. We also know he is a permanent CEO. Ekornes had an acting CEO before it made Olav Holst-Dymes the permanent CEO. This acting CEO was Nils Fredrik Drablos. He was Deputy CEO of

Ekornes from 1991 to 1996, CEO from 1996 to 2009, and then acting CEO starting in December 2012. So they brought back the long-term CEO who had run Ekornes during 13 of its most successful years. Drablos had to be brought back because another outsider – Oyvind Torlen – who was brought into Ekornes as Deputy CEO in 2007 and then promoted to CEO in 2010 ended up leaving in 2012. Oyvind Torlen was a 37 year old outsider when he was brought in as Deputy CEO. Just 3 years later – at the age of 40 – he became CEO. This is a bad pattern for a company to have. The most recent CEO was brought in directly at the CEO level. Olav Holst-Dymes never worked at Ekornes before being made CEO. The last permanent CEO – Oyvind Torlen – was brought in directly as Deputy CEO. Ekornes uses this as its second highest management position in the sense that the Deputy CEO has tended to become the CEO within 5 years or less. So, the Deputy CEO is like a named successor. When this transition was used in the 1990s during which Nils Fredrik Drablos became Deputy CEO in 1991 and then CEO in 1996 – it obviously worked fine. He went on to run Ekornes for 13 years. It is difficult for investors to evaluate outsider candidates for the CEO position. But it is often a bad sign when a company repeatedly uses outsiders. This is especially true when outsiders are brought into the company at the CEO level or one rung below that and have little time to learn about the company's culture. This is not a theoretical concern. There is evidence it already happened once at Ekornes. Here is a quote from the 2013 annual report where Ekornes's board announced the firing of Oyvind Torlen: "Oyvind Torlen and the board of Ekornes have jointly decided that, with effect from today…Mr. Torlen shall step down as CEO of the company. This decision has been prompted by a difference of views with respect to the group's future strategy. Former CEO Nils-Fredrik Drablos has been appointed acting CEO from today and until a new CEO has been appointed.



Ekornes's current CEO – Olav Holst-Dymes – was brought directly into the company at the CEO position

The search for a new chief executive starts immediately." This was a clash over the company's future strategic direction – where to take the company – between an outsider CEO who had been brought in as Deputy CEO in 2007 and then quickly promoted to CEO in 2010 and the company's board led by a chairman who had been with the company since 1990. At the time Oyvind Tolen joined Ekornes as Deputy CEO, the company's chairman had already been leading the board for 17 years. Unfortunately, that chairman died in 2014. The board is now led by a woman – Kjersti Kleven – who served for the last 7 years as Vice Chairman. She is new to the chairman role. The CEO is new to the entire company. There is no share based incentive compensation at Ekornes. The CEO's bonus is caped when return on assets is below a certain threshold. So, you have an outsider hired at the CEO level to run the company without any share ownership in the company and with little financial incentive to maximize profit. This is very different from many companies – Progressive, John Wiley, Ark, Village, etc. – we have talked about in the past. Most of the companies written about by Singular Diligence have long-term management promoted from within the company. Many have share based compensation or simply use managers who already own a lot of the company. None of this is true at Ekornes today. Olav Holst-Dymes may prove to be an excellent CEO. There is no reason to believe he will not be great. But Ekornes has a much higher risk of cultural drift than most of the companies we write about. When you bring new executives into the company at very high levels – you dilute the existing corporate culture.

CONCLUSION

It is Worth the Extra Effort to Buy Ekornes Shares in Oslo

Ekornes is a Norwegian stock. Shares are bought on the Oslo Stock Exchange using Norwegian Krone. If you are reading this newsletter – you almost certainly do not live in Norway. You do not have Norwegian Krone. To buy shares of Ekornes you must exchange some of the currency you do have – your Euros for instance – into Norwegian Krone. You can then use those newly acquired Norwegian Krone to buy the shares of Ekornes you want. You will need to make a special effort to buy Ekornes stock. That is why very few foreigners own shares of Ekornes. Norway is a country of only 6 million people. The economy of Norway is no bigger than that of a single U.S. state of the economic importance of say New Jersey. And yet about half of the shares of Ekornes are held by Norwegians. All the investors from all the rest of the world combined own only half the company. This is not because Ekornes is disliked. It is because Ekornes is unknown in most of the world. The company is not well known for 3 reasons. One, it does business under the Stressless name and trades under the Ekornes name. So even investors who recognize the Stressless name do not immediately recognize the Ekornes name. Two, it trades on the Oslo Stock Exchange. Oslo is a small stock exchange. If you are reading this right now – chances are you have never bought a stock on the Oslo Stock Exchange. You may never have thought about the Oslo Stock Exchange till now. Finally, Ekornes is not well known because it trades in Norwegian Krone. The Krone is not a popular medium of exchange. It is not a currency foreigners normally speculate in or hold in their brokerage accounts. Many investors who do not live in the United States have occasion to possess U.S. dollars. Many investors who do not live in Japan – who may not even speak a word of Japanese and who have never visited that country – have had occasion to exchange their home currency for Japanese Yen to make a trade on the Tokyo Stock Exchange. Unless you have a personal connection with Norway – chances are you have never had a Norwegian Krone in any account of yours. You have never bought or sold a Norwegian stock in Norway. This can lead you to follow the example of most foreign investors and ignore Ekornes. You should not do that. You should call up your broker and insist that he figure out how to get shares of Ekornes into your account. A good broker should have access to the systems needed to make a trade for you in Oslo. It may cost a little more than most of your trades. And it will certainly mean more work for your broker to do. But it is worth doing. It is worth insisting that you want shares of Ekornes and he needs to make the trade happen for you.

The extra hassle of getting your broker to make the trade in Oslo may deter some readers from buying shares of Ekornes. The other hurdle that might turn them off the stock is the currency. Many stock investors do not need to worry about fluctuations of foreign currencies. They are used to seeing the positions in their brokerage account quoted for them in their home currency. And so the idea of a stock that will fluctuate – in Dollar terms, Euro terms, Pound terms, etc. – along with the fortunes of the Norwegian Krone may be alarming. It should not be. Ekornes is more likely to benefit from fluctuations of the Krone than to suffer from it. As explained earlier – Ekornes gets very little of its sales and profits from Norway. The company's earning power is backed by sales in currencies like the Euro, U.S. Dollar, and Japanese Yen. Revenue does not come in the form of Krone. Some of Ekornes's costs – mainly its labor cost – do come in the form of Norwegian Krone. A decline in the Norwegian Krone versus currencies like the Euro, U.S. Dollar, and the Yen would increase Ekornes's profits. It would reduce costs in terms of Euros, Dollars, and Yen while keeping sale prices in Euros, Dollars, and Yen untouched. This is because Ekornes has no incentive to pass any labor savings in the form of a cheaper Krone into price reductions in the form of a lower Euro price for Stressless recliners sold in Germany. If the Norwegian Krone strengthens, Ekornes can try to raise prices and reduce the amount of human labor in its manufacturing process. If the Norwegian Krone weakens, Ekornes can keep prices steady. The company's earnings will then increase as labor costs decline while retail prices do not change. This will benefit a foreign buy and hold investor. However, the benefit will not be obvious at the same moment as the decline in the Krone. A steep one-day drop in the Krone may not coincide with a steep one-day increase in the price of Ekornes. Theoretically, this should tend to happen. Ekornes uses currency hedges. But, it gets its sales from outside of Norway. The value of Ekornes's future cash flows should reflect a fairly stable basket of earnings coming in the form of Euros, Dollars, Yen, etc. For this reason, investors should simultaneously bid up the price of Ekornes shares in Oslo – which are quoted in Norwegian Krone – at the same moment the Krone is falling in value against this basket of the currencies of the countries Ekornes sells into. The stock market is not as perfect as that. There are plenty of examples in the stock chart of Ekornes where you can find the share price rising and rising as the Norwegian Krone falls. But it may often be the case that on a bad day for the Norwegian Krone your brokerage account – should you choose to hold Ekornes shares in it – will show a bad result in your home currency. Ignore this. A 5% decline in the Norwegian Krone absolutely does not mean that your Ekornes shares are worth 5% less. The company's earning power does not decline – in terms of your home currency – when the Norwegian Krone falls. In fact, a decline in the Norwegian Krone would benefit you over time.

The natural next question is whether you should hedge your exposure to the Norwegian Krone. The answer is no. One, it is a mistake to think you have exposure to hedge. If you put $100,000 U.S. Dollars into buying Ekornes stock, your exposure to the Norwegian Krone is not the equivalent of $100,000 U.S. Dollars. Remember that 94% of Ekornes's sales are in currencies other than the Norwegian Krone. To illustrate this point – let's assume you are an American. You put $100,000 U.S. dollars into Ekornes stock. You believe you now have $100,000 U.S. Dollars worth of exposure to Norway's currency. In reality, Ekornes gets about 22% of its sales from North America (which is overwhelmingly done in the U.S.). In terms of sales, you have $22,000 of exposure to your own currency compared with only $4,000 worth of exposure to sales in Norwegian Krone. Yes. Ekornes does have costs in Norwegian Krone. But consider that this cost is actually an inverse exposure – essentially a short position – in Norwegian Krone. Also, only direct human labor costs are completely linked to the Norwegian Krone. When Ekornes buys leather – nobody cares what the value of a Krone is when they tell Ekornes what the price of that leather will be. The only meaningful long-term exposure you have to currency fluctuations is the "short" position in the Norwegian Krone you have through Ekornes's human labor costs inside Norway. Your exposure on the revenue side of the income statement is essentially nil. Your exposure on the expense side is only labor. And your position is really a bet against the Norwegian Krone. That is a good bet to make. Let me be more specific. If you are an American buy and hold investor reading this newsletter – Quan and I can both endorse owning shares of Ekornes without a Norwegian Krone hedge as a benefit to you rather than a risk. The Norwegian Krone is overpriced against the U.S. Dollar. In the long-run, it should decline. You will benefit from this decline. And an unhedged position costs you nothing. You do not have to pay to speculate on the currency. You do not have to use leverage. Simply by buying shares of Ekornes you can benefit from a long-term decline in the Norwegian Krone against the U.S. Dollar. So please take the extra time and effort to buy this obscure Norwegian stock. And please do not give a moment's thought to hedging.

Ekornes (OSLO: EKO) Appraisal:149 NOK

Margin of Safety: 34%

Owner Earnings	(in millions of NOK)
Revenue	NOK 2,661
* Normal EBIT margin	18.6%
= EBIT	NOK 495

Business Value

Ekornes' business value is NOK 5,445 million.

- Pre-tax owner earnings are NOK 495 million
- Fair multiple = 11x pre-tax owner earnings
- NOK 495 million * 11 = NOK 5,445 million

Fair Multiple

Ekornes' business is worth at least 11x pre-tax owner earnings

- Ekornes is one of the best businesses in the furniture industry
- Ekornes deserves at least 15x after-tax owner earnings
- Norwegian tax rate is 27%
- 15x after-tax owner earnings is equal to 11x pre-tax owner earnings

Share Value

Ekornes' stock is worth NOK 149 a share

- Business value is NOK 5,445 million
- Net cash is NOK 30 million
- Equity value is million
- NOK 5,445 million + NOK 30 million = NOK 5,475 million
- Equity Value = NOK 149/share
    - 36.83 million outstanding shares
    - NOK 5,475 million / 36.83 million = NOK 149

Margin of Safety

Ekornes' stock has a 42% margin of safety.

- Business Value = NOK 5,445 million
- Enterprise Value = NOK 3,137 million
- Discount = NOK 2,308 million (NOK 5,445 million – NOK 3,137 million)
- Margin of Safety = 42% (NOK 2,308 million / NOK 5,445 million)

	EV/Sales	EV/Gross Profit	EV/EBITDA	EV/EBIT	EV/Owner Earnings
Natuzzi	0.15	0.51	5.25	NMF	NMF
Flexsteel Industries	0.52	2.28	8.61	10.23	9.51
La-Z-Boy	0.90	2.61	10.47	13.03	12.76
Select Comfort	1.32	2.11	10.49	14.11	12.96
Tempur Sealy	1.76	4.54	14.65	18.72	11.70
Minimum	0.15	0.51	5.25	NMF	NMF
Maximum	1.76	4.54	14.65	18.72	12.96
Median	0.90	2.28	10.47	13.03	11.70
Mean	0.93	2.41	9.90	10.80	5.88
Standard Deviation	0.64	1.44	3.41	7.82	13.15
Variation	68%	60%	34%	72%	224%
Ekornes (Market Price)	1.18	1.56	6.31	8.64	6.34
Ekornes (Appraisal Value)	2.05	2.71	10.95	14.99	11.00

ABOUT THE TEAM

Geoff Gannon, Writer

Geoff is a writer, blogger, podcaster, and interviewer. He has written hundreds of articles for Seeking Alpha and GuruFocus. He hosted the Gannon On Investing Podcast, The Investor Questions Podcast, and The Investor Questions Podcast Interview Series. He wrote the Gannon On Investing newsletter in 2006 and two GuruFocus newsletters from 2010-2012. In 2013, he co-founded The Avid Hog (the predecessor to Singular Diligence) with Quan Hoang. Geoff has been blogging at Gannon On Investing since 2005.

Quan Hoang, Analyst

Quan is a stock analyst. Quan won first prize in Vietnam's National Olympiad in Informatics in 2006. He graduated from Manhattanville College in 2012 with a B.A. in finance and a minor in math. In 2013, Quan co-founded The Avid Hog (the predecessor to Singular Diligence) with Geoff Gannon.

Tobias Carlisle, Publisher

Tobias Carlisle is the founder and managing director of Eyquem Investment Management LLC, and serves as portfolio manager of the Eyquem Fund LP and the separately managed accounts.

He is best known as the author of the well regarded website Greenbackd, the book Deep Value: Why Activists Investors and Other Contrarians Battle for Control of Losing Corporations (2014, Wiley Finance), and Quantitative Value: a Practitioner's Guide to Automating Intelligent Investment and Eliminating Behavioral Errors (2012, Wiley Finance). He has extensive experience in investment management, business valuation, public company corporate governance, and corporate law.

Prior to founding Eyquem in 2010, Tobias was an analyst at an activist hedge fund, general counsel of a company listed on the Australian Stock Exchange, and a corporate advisory lawyer. As a lawyer specializing in mergers and acquisitions he has advised on transactions across a variety of industries in the United States, the United Kingdom, China, Australia, Singapore, Bermuda, Papua New Guinea, New Zealand, and Guam. He is a graduate of the University of Queensland in Australia with degrees in Law (2001) and Business Management (1999).