

Citron Chimes in on Lumber Liquidators

Do Not Remove Your Lumber Liquidators Floors, Says California Air Resources Board (CARB)

A persuasive **60 Minutes** exposé on Lumber Liquidators (NYSE:LL), aired on March 1st, wreaked havoc on the company's stock price, and uncertain damage to its business. Since then, the stock price has dropped from \$51.80 to \$27.90, a whopping 46% decline, and a loss of more than 60% since the CEO initially warned about the upcoming **60 Minutes** episode. The sensational reportage focused on apparently formaldehyde contaminated non-compliant Chinese laminate flooring products sold by Lumber Liquidators. But the Company has since disputed **60 Minutes** findings, alleging improper testing methods.

We are by no means experts on testing methods, and quite possibly some products sold by Lumber Liquidators may well be formaldehyde non-compliant. That being said, we can't help noticing a wide disconnect between the torrent of negative sentiment on Lumber Liquidators in the markets and the reality of its business.

In the [60 Minutes episode](#), the conversation between Anderson Cooper and Denny Larson of Global Community Monitor resonated with many investors and consumers alike.

Anderson Cooper: "You want the company to remove all the flooring?"

Denny Larson: "Every single board. At their cost and replace it with clean flooring."

Anderson Cooper: "How much is that going to cost?"

Denny Larson: "You know what? I don't care. Because they're guilty of selling people product that could make them sick."

"These worried California homeowners, who didn't want to be identified, aren't waiting for Lumber Liquidators. They are ripping up their floors now. But many can't afford to replace the flooring on their own."

From an investor's perspective, Lumber Liquidators appears to be caught in an avalanche of unlimited contingent liability; from a consumer's perspective, maybe customers should consider ripping out their floors bought from Lumber Liquidators to avoid getting sick. Over the past week and half, financial and local media have been on a frenzy seeking out stories related to Lumber Liquidators.

Interestingly enough, nobody noticed or reported on the relevant excerpt of a document posted by the California Air Resources Board on its website three days after the *60 Minutes* episode aired.

Consider this excerpt:



FACTS ABOUT

Flooring Made with Composite Wood Products

... " As a general rule, we do not recommend removing a flooring product unless there are noticeable health effects (i.e. nose and

throat irritation, a burning sensation of the eyes, wheezing, and difficulty in breathing), and other measures (see below) taken to alleviate them have failed and there is good reason to believe the flooring is the source of the problem.” ...

“There are several steps that can be taken to alleviate emissions from indoor air pollutants such as formaldehyde. Proper ventilation, such as opening up windows, bringing fresh air through a central ventilation system, and running exhaust fans will expedite formaldehyde off-gassing from finished goods in your home as well as the odors from any finishes such as varnish or lacquer. Extended ventilation may be needed. Keeping indoor temperatures and humidity low, such as by using an air conditioner and/or dehumidifier to draw the moisture out of the air when humid, may help decrease the amount of formaldehyde that off-gasses into the indoor air. You may also leave your new product(s) in the garage or under a covered carport for a while to let it off-gas before bringing it inside the house. Panel products, flooring products and other finished goods that are covered with impermeable facing such as synthetic laminates may further reduce emissions.”...

http://www.arb.ca.gov/html/fact_sheets/composite_wood_flooring_faq.pdf

In sharp contrast to Mr. Larson’s statement on 60 Minutes, **CARB, the only currently active formaldehyde emission regulatory agency in the U.S., clearly states that it does not recommend removing non-compliant flooring products. In most situations, absent any observable health reactions they simply recommend ventilating closed-in indoor space until they outgas.**

The CARB position calls into question the basis of a substantial number of consumer class-action lawsuits. If ultimately, Lumber Liquidators’ laminate

flooring products are found to be non-compliant with CARB standards, the resolution most likely isn't going to be the unlimited liability of removing all affected floors, as was suggested on the **60 Minutes** episode, in light of CARB's very own statement, posted on its website, after the airing of the **60 Minutes** episode.

Investors and short sellers take note:

Let us take this logic a step further. We can only assume that the California Air Resources Board has known about the **60 Minutes** piece for a few months now. We would speculate with near certainty that **60 Minutes** reached out to the agency. Not only have they advised consumers not to rip out their floors, they have not even ordered Lumber Liquidators China import product off the shelves in California. If in fact the company was "poisoning" people, as some investors would have you believe, then at the least CARB would immediately halt all sales of non-compliant product.

Let's keep in mind that 49 other states, and the Federal EPA, are all without any currently enacted regulation relevant to the matter. California is responsible for 37 out of 354 company stores (10.5%),. From data in filings we can extrapolate that laminates comprise appx. 22% of Lumber Liquidators' overall sales volume (hardwood floors, solid bamboo, cork and vinyl plank are not affected, nor are moldings and other flooring accessories and supplies). Therefore, the financial impact of laminates sold in California, the only active jurisdiction for formaldehyde content regulation currently in force, **represents less than 2.5% of the company's overall revenues**. Even if tighter formaldehyde compliance narrows future margins in its laminates sales, with those only 22% of revenues, clearly the effect on overall margins will not move the needle that far.

Most importantly, if CARB believed this was as imminent danger as the media has purported it to be, than they would have simply told LL at the least to remove that small piece of total overall inventory. Plain and Simple.

Given the current short position in the stock (~34% float) and substantially reduced market cap (\$700 million), should Lumber Liquidators survive this episode with a somewhat moderate sales impact, and less than anticipated damage settlement, we will most likely see a substantial recovery in share price from current levels.

Conclusion

Citron has many times been on the wrong side of thinking a company is “going out of business”. We are not falling into that trap this time, especially when weighing the comments and actions of the only relevant regulatory agency in this scenario.

Cautious investing to all...long or short.