

ETHAN ALLEN INTERIORS INC  
Form 10-Q  
January 28, 2019

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

**FORM 10-Q**

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934**

For the quarterly period ended December 31, 2018

**OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 1-11692

Ethan Allen Interiors Inc

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

06-1275288

(I.R.S. Employer Identification No.)

Edgar Filing: ETHAN ALLEN INTERIORS INC - Form 10-Q

25 Lake Avenue Ext., Danbury, Connecticut 06811-5286  
(Address of principal executive offices) (Zip Code)

(203) 743-8000

(Registrant's telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.  Yes  No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or such shorter period that the registrant was required to submit such files).  Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer", "smaller reporting company", and "emerging growth company" in Rule 12b-2 of the Exchange Act

Large accelerated filer  Accelerated filer   
Non-accelerated filer  Smaller reporting company   
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). [  ] Yes [  ] No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

At January 16, 2019, there were 26,579,544 shares of Common Stock, par value \$.01, outstanding.

---

**Table of Contents**

**PART I - FINANCIAL INFORMATION**

Item 1. Financial Statements	2
Consolidated Balance Sheets	2
Consolidated Statements of Comprehensive Income (Unaudited)	3
Consolidated Statements of Cash Flows (Unaudited)	4
Consolidated Statements of Shareholders' Equity	5
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	13
Item 3. Quantitative and Qualitative Disclosures About Market Risk	22
Item 4. Controls and Procedures	22

**PART II - OTHER INFORMATION**

Item 1. Legal Proceedings	23
Item 1A. Risk Factors	23
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	23
Item 3. Defaults Upon Senior Securities	23
Item 4. Mine Safety Disclosures	23
Item 5. Other Information	23
Item 6. Exhibits	24
SIGNATURES	25

**PART I - FINANCIAL INFORMATION****Item 1. Financial Statements****ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES****Consolidated Balance Sheets****(In thousands)**

	December 31, 2018 (Unaudited)	June 30, 2018
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 38,763	\$ 22,363
Accounts receivable, net	9,234	12,364
Inventories, net	159,174	163,012
Prepaid expenses and other current assets	15,925	16,686
Total current assets	223,096	214,425
Property, plant and equipment, net	262,972	267,903
Goodwill and other intangible assets	45,128	45,128
Other assets	3,295	2,977
Total assets	\$ 534,491	\$ 530,433
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Current maturities of long-term debt	\$ 538	\$ 584
Customer deposits	54,242	61,248
Accounts payable	16,407	18,768
Accrued compensation and benefits	21,238	18,926
Accrued expenses and other current liabilities	47,811	21,734
Total current liabilities	140,236	121,260
Long-term debt	796	1,096
Other long-term liabilities	23,794	24,207
Total liabilities	164,826	146,563
Shareholders' equity:		
Common stock	490	490

Edgar Filing: ETHAN ALLEN INTERIORS INC - Form 10-Q

Additional paid-in-capital	378,558	376,950
Less: Treasury stock (at cost)	(656,551 )	(656,551 )
Retained earnings	653,193	669,013
Accumulated other comprehensive income (loss)	(6,119 )	(6,171 )
Total Ethan Allen Interiors Inc. shareholders' equity	369,571	383,731
Noncontrolling interests	94	139
Total shareholders' equity	369,665	383,870
Total liabilities and shareholders' equity	\$ 534,491	\$ 530,433

See accompanying notes to consolidated financial statements.

## ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

## Consolidated Statements of Comprehensive Income (Unaudited)

(In thousands, except per share data)

	Three months ended		Six months ended	
	December 31,		December 31,	
	2018	2017	2018	2017
Net sales	\$197,152	\$198,481	\$384,937	\$379,783
Cost of sales	88,292	90,690	174,627	171,669
Gross profit	108,860	107,791	210,310	208,114
Selling, general and administrative expenses	92,732	90,253	182,383	179,027
Operating income	16,128	17,538	27,927	29,087
Interest and other income (expense)	233	183	259	239
Interest and other related financing costs	81	33	134	218
Income before income taxes	16,280	17,688	28,052	29,108
Income tax expense	4,090	2,826	7,022	6,831
Net income	\$12,190	\$14,862	\$21,030	\$22,277
Per share data:				
Basic earnings per common share:				
Net income per basic share	\$0.46	\$0.54	\$0.79	\$0.81
Basic weighted average common shares	26,574	27,472	26,556	27,466
Diluted earnings per common share:				
Net income per diluted share	\$0.45	\$0.54	\$0.78	\$0.80
Diluted weighted average common shares	26,923	27,728	26,932	27,742
Comprehensive income:				
Net income	\$12,190	\$14,862	\$21,030	\$22,277
Other comprehensive income				
Currency translation adjustment	(1,195 )	(1,392 )	52	(1,522 )
Other	(19 )	(18 )	(45 )	(32 )
Other comprehensive income (loss) net of tax	(1,214 )	(1,410 )	7	(1,554 )
Comprehensive income	\$10,976	\$13,452	\$21,037	\$20,723

See accompanying notes to consolidated financial statements.

## ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

## Consolidated Statements of Cash Flows (Unaudited)

(In thousands)

	Six months ended December 31,	
	2018	2017
<b>Operating activities:</b>		
Net income	\$21,030	\$22,277
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	9,925	10,040
Compensation expense related to share-based payment awards	807	1,082
Provision (benefit) for deferred income taxes	(79 )	224
(Gain) loss on disposal of property, plant and equipment	43	119
Other	(16 )	(150 )
Change in operating assets and liabilities, net of effects of acquired businesses:		
Accounts receivable	3,130	(2,164 )
Inventories	3,838	(11,360)
Prepaid and other current assets	719	488
Customer deposits	(7,006 )	(4,373 )
Accounts payable	(2,361 )	42
Accrued expenses and other current liabilities	1,676	(1,442 )
Other assets and liabilities	(231 )	(628 )
Net cash provided by operating activities	31,475	14,155
<b>Investing activities:</b>		
Proceeds from the disposal of property, plant & equipment	1	326
Capital expenditures	(4,954 )	(4,981 )
Other investing activities	94	102
Net cash provided by (used in) investing activities	(4,859 )	(4,553 )
<b>Financing activities:</b>		
Payments on long-term debt and capital lease obligations	(310 )	(14,195)
Purchases and retirements of company stock	-	(1,100 )
Payment of cash dividends	(10,137)	(10,482)
Other financing activities	274	137
Net cash provided by (used in) financing activities	(10,173)	(25,640)
Effect of exchange rate changes on cash	(43 )	57
Net increase (decrease) in cash, cash equivalents, and restricted cash	16,400	(15,981)
Cash, cash equivalents, and restricted cash at beginning of period	22,363	65,031
Cash, cash equivalents, and restricted cash at end of period	\$38,763	\$49,050



See accompanying notes to consolidated financial statements.

## ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

## Consolidated Statements of Shareholders' Equity

Six Months Ended December 31, 2018

(Unaudited)

(In thousands)

	Common Stock	Additional Paid-in Capital	Treasury Stock	Accumulated Other Comprehensive Income (loss)	Retained Earnings	Non- Controlling Interests	Total
Balance at June 30, 2018	\$ 490	\$376,950	\$(656,551)	\$ (6,171 )	\$669,013	\$ 139	\$383,870
Stock issued on share-based awards	-	801	-	-	-	-	801
Compensation expense associated with share-based awards	-	807	-	-	-	-	807
Dividends declared on common stock	-	-	-	-	(36,850 )	-	(36,850 )
Comprehensive income	-	-	-	52	21,030	(45 )	21,037
Balance at December 31, 2018	\$ 490	\$378,558	\$(656,551)	\$ (6,119 )	\$653,193	\$ 94	\$369,665

See accompanying notes to consolidated financial statements.

## **ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES**

### **Notes to Consolidated Financial Statements (Unaudited)**

#### **(1) Basis of Presentation**

Founded in 1932, Ethan Allen Interiors Inc. ("Interiors") is a Delaware corporation incorporated on *May 25, 1989*. The consolidated financial statements include the accounts of Interiors, its wholly owned subsidiary Ethan Allen Global, Inc. ("Global"), and Global's subsidiaries (collectively "we", "us", "our", "Ethan Allen", or the "Company"). All intercompany accounts and transactions have been eliminated in the consolidated financial statements.

We prepare our consolidated financial statements in conformity with accounting principles generally accepted in the United States, which requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Due to the inherent uncertainty involved in making those estimates, actual results could differ from those estimates. Areas in which significant estimates have been made include, but are *not* limited to, revenue recognition, the allowance for doubtful accounts receivable, inventory obsolescence, tax valuation allowances, useful lives for property, plant and equipment and definite-lived intangible assets, goodwill and indefinite-lived intangible asset impairment analyses, the evaluation of uncertain tax positions and the fair value of assets acquired and liabilities assumed in business combinations.

#### **(2) Interim Financial Presentation**

In our opinion, all adjustments, consisting only of normal recurring adjustments necessary for fair presentation, have been included in the consolidated financial statements. The results of operations for the *three* and *six* months ended *December 31, 2018* are *not* necessarily indicative of results that *may* be expected for the entire fiscal year. The interim consolidated financial statements should be read in conjunction with the consolidated financial statements and accompanying notes included in our Annual Report on Form *10-K* for the year ended *June 30, 2018*.

#### **(3) Income Taxes**

The Company reviews its expected annual effective income tax rates and makes changes on a quarterly basis as necessary based on certain factors such as changes in forecasted annual operating income; changes to actual or forecasted permanent book to tax differences; impacts from future tax audits with state, federal or foreign tax

authorities; impacts from tax law changes; or change in judgment as to the realizability of deferred tax assets. The Company identifies items which are non-recurring in nature and treats these as discrete events. The tax effect of such items is recorded in the quarter in which the related events occur. Due to the volatility of these factors, the Company's consolidated effective income tax rate can change significantly quarter over quarter.

The Company conducts business globally and, as a result, the Company and its subsidiaries files income tax returns in the U.S. and in various state and foreign jurisdictions. In the normal course of business, the Company is subject to periodic examination in such domestic and foreign jurisdictions by tax authorities. The Company and certain subsidiaries are currently under audit in the U.S. from 2015 through 2016. While the amount of uncertain tax impacts with respect to the entities and years under audit *may* change within the next *twelve* months, it is *not* anticipated that any of the changes will be significant. It is reasonably possible that some of these audits *may* be completed during the next *twelve* months and that various issues relating to uncertain tax impacts will be resolved within the next *twelve* months as exams are completed or as statutes expire and will impact the effective tax rate.

The Company is subject to a Federal Tax Rate of 21% for fiscal years ending *June 30, 2019* and thereafter, and a blended Federal Tax Rate of 28% for fiscal 2018, due to changes made to the U.S. Internal Revenue Code. The Company's consolidated effective tax rate was 25.1% and 25.0% for the *three* and *six* months ended *December 31, 2018* and 16.0% and 23.5% for the *three* and *six* months ended *December 31, 2017*. The current period's effective tax rate primarily includes tax expense on the taxable year's net income, tax and interest expense on uncertain tax positions and tax expense on the cancelation of stock options. The prior period's effective tax rate primarily includes tax expense on the taxable year's net income, the tax benefit lost on the cancelation of stock options, and also includes tax and interest expense on uncertain tax positions partially offset by the tax benefit from the re-measurement of deferred tax assets and liabilities and the vesting of restricted stock units.

**ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements (Unaudited)****(4) Restricted Cash**

Prior to *June 30, 2018* we held restricted cash and investments in lieu of providing letters of credit for the benefit of the provider of our worker's compensation and other insurance liabilities. By *June 30, 2018*, this obligation had been reduced to \$5.9 million, which was then exchanged for a letter of credit for the benefit of this provider, and the restrictions were removed. The following table presents the components of total cash, cash equivalents, and restricted cash as set forth in our consolidated statements of cash flows. See also Note 12.

	December 31, 2018	June 30, 2018	December 31, 2017	June 30, 2017
Cash and cash equivalents	\$ 38,763	\$ 22,363	\$ 41,987	\$ 57,701
Restricted cash	-	-	7,063	7,330
Total cash, cash equivalents, and restricted cash	\$ 38,763	\$ 22,363	\$ 49,050	\$ 65,031

**(5) Inventories**

Inventories at *December 31, 2018* and *June 30, 2018* are summarized as follows (in thousands):

	December 31, 2018	June 30, 2018
Finished goods	\$ 122,406	\$ 124,640
Work in process	10,960	12,057
Raw materials	27,321	27,947
Valuation allowance	(1,513 )	(1,632 )
Inventories	\$ 159,174	\$ 163,012

**(6) Borrowings**

Edgar Filing: ETHAN ALLEN INTERIORS INC - Form 10-Q

Total debt obligations at *December 31, 2018* and *June 30, 2018* consist of the following (in thousands):

	December 31, 2018	June 30, 2018
Capital leases	\$ 1,334	\$1,680
Total debt	1,334	1,680
Less current maturities	538	584
Total long-term	\$ 796	\$1,096

On *December 21, 2018*, the Company and most of its domestic subsidiaries (the “Loan Parties”) entered into a Second Amended and Restated Credit Agreement (the “Facility”). The Facility amends and restates the existing Amended and Restated Credit Agreement, dated as of *October 21, 2014*, as amended. The Facility provides a revolving credit line of up to \$165 million, subject to borrowing base availability, and extends the maturity of the Facility to *December 21, 2023*.

At the Company’s option, revolving loans under the Facility bear interest, based on the average availability, at an annual rate of either (a) the London Interbank Offered rate (“LIBOR”) plus 1.5% to 2.0%, or (b) the higher of (i) the prime rate, (ii) the federal funds effective rate plus 0.5%, or (iii) LIBOR plus 1.0% plus in each case 0.5% to 1.0%.

The availability of credit at any given time under the Facility will be constrained by the terms and conditions of the Facility, including the amount of collateral available, a borrowing base formula based upon numerous factors including the value of eligible inventory and eligible accounts receivable, and other restrictions contained in the Facility. All obligations under the Facility are secured by assets of the Loan Parties including inventory, receivables and certain types of intellectual property.

The Facility contains various restrictive and affirmative covenants, including required financial reporting, limitations on the ability to grant liens, make loans or other investments, incur additional debt, issue additional equity, merge or consolidate with or into another person, sell assets, pay dividends or make other distributions or enter into transactions with affiliates, along with other restrictions and limitations similar to those frequently found in credit agreements of this type and size. Loans under the Facility *may* become immediately due and payable upon certain events of default (including failure to comply with covenants, change of control or cross-defaults) as set forth in the Facility.

**ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements (Unaudited)**

The Facility does *not* contain any significant financial ratio covenants or coverage ratio covenants other than a fixed charge coverage ratio covenant based on the ratio of (a) EBITDA, plus cash Rentals, minus Unfinanced Capital Expenditures to (b) Fixed Charges, as such terms are defined in the Facility (the “FCCR Covenant”). The FCCR Covenant only applies in certain limited circumstances, including when the unused availability under the Facility drops below \$18.5 million. The FCCR Covenant ratio is set at 1.0 and measured on a trailing *twelve*-month basis.

We incurred financing costs of \$0.6 million under the Facility, which are being amortized over the remaining life of the Facility using the effective interest method.

At both *December 31, 2018* and *June 30, 2018*, there was \$6.2 million of standby letters of credit outstanding under the Facility. Total availability under the Facility was \$148.7 million at *December 31, 2018* and \$108.8 at *June 30, 2018*.

At both *December 31, 2018* and *June 30, 2018*, we were in compliance with all the covenants under the Facility.

The following table summarizes, as of *December 31, 2018*, the timing of cash payments related to our outstanding long-term debt obligations for the remaining *six* months of fiscal *2019*, and each of the *five* fiscal years subsequent to *June 30, 2019*, and thereafter (in thousands).

Periods ending June 30,	
2019	\$268
2020	550
2021	437
2022	59
2023	20
2024 and thereafter	-
Total scheduled debt payments	\$1,334

**(7) Litigation**

We are routinely party to various legal proceedings, including investigations or as a defendant in litigation, in the ordinary course of business. We are also subject to various federal, state and local environmental protection laws and regulations and are involved, from time to time, in investigations and proceedings regarding environmental matters. Such investigations and proceedings typically concern air emissions, water discharges, and/or management of solid and hazardous wastes. Under these laws, we and/or our subsidiaries are, or *may* be, required to remove or mitigate the effects on the environment of the disposal or release of certain hazardous materials.

Regulations issued under the Clean Air Act Amendments of 1990 required the industry to reformulate certain furniture finishes or institute process changes to reduce emissions of volatile organic compounds. Compliance with many of these requirements has been facilitated through the introduction of high solids coating technology and alternative formulations. In addition, we have instituted a variety of technical and procedural controls, including reformulation of finishing materials to reduce toxicity, implementation of high velocity low pressure spray systems, development of storm water protection plans and controls, and further development of related inspection/audit teams, all of which have served to reduce emissions per unit of production. We remain committed to implementing new waste minimization programs and/or enhancing existing programs with the objective of (i) reducing the total volume of waste, (ii) limiting the liability associated with waste disposal, and (iii) continuously improving environmental and job safety programs on the factory floor which serve to minimize emissions and safety risks for employees. To reduce the use of hazardous materials in the manufacturing process, we will continue to evaluate the most appropriate, cost-effective control technologies for finishing operations and production methods. We believe that our facilities are in material compliance with all such applicable laws and regulations. Our currently anticipated capital expenditures for environmental control facility matters are *not* material.

On a quarterly basis, we review our litigation activities and determine if an unfavorable outcome to us is considered “remote”, “reasonably possible” or “probable” as defined by FASB ASC Topic 450, *Contingencies*. Where we determine an unfavorable outcome is probable and is reasonably estimable, we accrue for potential litigation losses. The liability we *may* ultimately incur with respect to such litigation matters, in the event of a negative outcome, *may* be in excess of amounts currently accrued, if any; however, we do *not* expect that the reasonably possible outcome of these litigation matters would, individually or in the aggregate, have a material adverse effect on our financial condition, results of operations or cash flows. Where we determine an unfavorable outcome is *not* probable or reasonably estimable, we do *not* accrue for any potential litigation loss.



**ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements (Unaudited)**

Although the outcome of the various claims and proceedings against us cannot be predicted with certainty, management believes that the likelihood is remote that any existing claims or proceedings, individually or in the aggregate, will have a material adverse effect on our financial position, results of operations or cash flows.

**(8) Share-Based Compensation**

All options are issued at the closing stock price on each grant date, and have a contractual term of *10* years. A summary of stock option activity occurring during the *six* months ended *December 31, 2018* is presented below:

	Shares
Outstanding as of June 30, 2018	561,595
Granted	25,590
Exercised	(48,750 )
Canceled (forfeited/expired)	(121,032)
Outstanding as of December 31, 2018	417,403
Exercisable as of December 31, 2018	300,971

A summary of non-vested stock unit award activity occurring during the *six* months ended *December 31, 2018* is presented below.

	Units	Weighted Average Grant Date Fair Value
Non-vested units at June 30, 2018	330,369	\$ 26.15
Granted	107,204	18.60
Vested	-	-
Canceled (forfeited/expired)	(33,607 )	23.31

Non-vested units at December 31, 2018 403,966 \$ 24.38

At *December 31, 2018*, there were *1,469,484* shares of common stock available for future issuance pursuant to the Stock Incentive Plan.

**(9) Earnings Per Share**

Basic and diluted earnings per share are calculated using the following weighted average share data (in thousands):

	Three months ended		Six months ended	
	December 31,		December 31,	
	2018	2017	2018	2017
Weighted average shares of common stock outstanding for basic calculation	26,574	27,472	26,556	27,466
Effect of dilutive stock options and other share-based awards	349	256	376	276
Weighted average shares of common stock outstanding adjusted for dilution calculation	26,923	27,728	26,932	27,742

As of *December 31, 2018* and *2017*, stock options to purchase *277* and *256* common shares, respectively, were excluded from the respective diluted earnings per share calculations because their impact was anti-dilutive.

**ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements (Unaudited)****(10) Accumulated Other Comprehensive Income (Loss)**

Accumulated other comprehensive income consists of foreign currency translation adjustments which are the result of changes in foreign currency exchange rates related to our operations in Canada, Belgium, Honduras, and Mexico, and exclude income taxes given that the earnings of non-U.S. subsidiaries are deemed to be reinvested for an indefinite time. The following table sets forth the activity in accumulated other comprehensive income (loss) for the fiscal year-to-date period ended *December 31, 2018* (in thousands).

Balance June 30, 2018	\$(6,171)
Changes before reclassifications	\$52
Amounts reclassified from accumulated other comprehensive income	\$-
Current period other comprehensive income (loss)	\$52
Balance December 31, 2018	\$(6,119)

**(11) Segment Information**

Our wholesale and retail operating segments represent strategic business areas of our vertically integrated enterprise that operate separately and provide their own distinctive services. This vertical structure enables us to offer our complete line of home furnishings and accents more effectively while controlling quality and cost. We evaluate performance of the respective segments based upon revenues and operating income. Inter-segment transactions result, primarily, from the wholesale sale of inventory to the retail segment, including the related profit margin.

As of *December 31, 2018*, the Company operated 146 design centers (our retail segment) and our independent retailers operated 159 design centers. Our wholesale segment net sales include sales to our retail segment, which are eliminated in consolidation, sales to our independent retailers and unaffiliated *third* parties. Our retail segment net sales accounted for 79% of our consolidated net sales in the *six* months ended *December 31, 2018*. Our wholesale segment net sales accounted for 21%.



**ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements (Unaudited)**

Segment information for the *three* and *six* months ended *December 31, 2018* and *2017* is provided below (in thousands):

	Three months ended December 31,		Six months ended December 31,	
	2018	2017	2018	2017
<b>Net sales:</b>				
Wholesale segment	\$107,658	\$117,965	\$225,730	\$229,552
Retail segment	158,508	152,991	303,722	294,566
Elimination of inter-company sales	(69,014)	(72,475)	(144,515)	(144,335)
Consolidated Total	\$197,152	\$198,481	\$384,937	\$379,783
<b>Operating income:</b>				
Wholesale segment	\$8,821	\$15,568	\$23,136	\$29,030
Retail segment	3,311	(635)	1,752	(3,408)
Adjustment of inter-company profit (1)	3,996	2,605	3,039	3,465
Consolidated Total	\$16,128	\$17,538	\$27,927	\$29,087
<b>Depreciation &amp; Amortization:</b>				
Wholesale segment	\$1,896	\$1,838	\$3,857	\$3,825
Retail segment	3,029	3,116	6,068	6,215
Consolidated Total	\$4,925	\$4,954	\$9,925	\$10,040
<b>Capital expenditures:</b>				
Wholesale segment	\$831	\$764	\$1,681	\$1,515
Retail segment	1,346	1,564	3,273	3,466
Consolidated Total	\$2,177	\$2,328	\$4,954	\$4,981

	December 31, 2018	June 30, 2018
<b>Total Assets:</b>		
Wholesale segment	\$253,918	\$241,616
Retail segment	305,299	317,590
Inventory profit elimination (2)	(24,726)	(28,773)
Consolidated Total	\$534,491	\$530,433

- (1) Represents the change in wholesale profit contained in the retail segment inventory at the end of the period.
- (2) Represents the wholesale profit contained in the retail segment inventory that has *not* yet been realized. These profits are realized when the related inventory is sold.

**(12) Recently Adopted Accounting Pronouncements**

In *May 2014*, the Financial Accounting Standards Board (“FASB”) issued accounting standard ASU *2014-09, Revenue from Contracts with Customers* (Accounting Standards Codification Topic *606*), which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The new standard supersedes virtually all existing authoritative accounting guidance on revenue recognition and requires additional disclosures and greater use of estimates and judgments. We adopted the new standard in the *first* quarter of fiscal *2019*. We reviewed substantially all of our contracts and other revenue streams and determined that while the application of the new standard did *not* have a material change in the amount of or timing for recognizing revenue, it did impact our financial statement disclosures related to revenue and related accounts. See Note *13* for information on these disclosures.

## ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements (Unaudited)

In November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash*. It is intended to reduce diversity in the presentation of restricted cash and restricted cash equivalents in the statement. The statement requires that restricted cash and restricted cash equivalents be included as components of total cash and cash equivalents as presented on the statement of cash flows. The Company had *not* previously included restricted cash as a component of cash and equivalents as presented on the statement of cash flows. The new guidance was adopted by the Company effective July 1, 2018 under the retrospective adoption method, and prior year restricted cash has been reclassified to conform to current year presentation. See also Note 4.

### (13) Revenue Recognition

We implemented ASU 2014-09, *Revenue from Contracts with Customers* (Accounting Standards Codification Topic 606, "ASC 606"), in the first quarter of fiscal 2019 using the cumulative effect approach, which required us to apply the new guidance retrospectively to revenue transactions completed on or after July 1, 2018. Adopting this new standard did *not* have a material impact on our consolidated financial statements but did result in enhanced presentation and disclosures.

Our revenue consists substantially of product sales. We report product sales net of discounts and recognize them at the point in time when control transfers to the customer. For sales to our customers in our wholesale segment, control typically transfers when the product is shipped. For sales in our retail segment, control generally transfers upon delivery to the customer.

Estimated refunds for returns and allowances are recorded using our historical return patterns. Under the new standard, we record estimated refunds for sales returns on a gross basis rather than on a net basis, and have recorded an asset for product we expect to receive from customers in "Prepaid expenses and other current assets", and a corresponding refund liability in "Accrued expenses and other current liabilities" on the Consolidated Balance Sheets. At December 31, 2018, these amounts were *not* material.

In many cases we receive deposits from customers before we have transferred control of our product to our customers, resulting in contract liabilities. These contract liabilities ("Customer Deposits") are reported within current liabilities on our Consolidated Balance Sheet. At June 30, 2018 we had Customer Deposits of \$61.2 million, of which we recognized revenue of \$9.6 million and \$58.7 million respectively, during the three and six months ended December 31, 2018. We had Customer Deposits and \$54.2 million that were recorded as a liability at December 31, 2018.

Upon adoption of ASC 606, we have elected the following accounting policies and practical expedients:

We recognize shipping and handling expense as fulfillment activities (rather than as a promised good or service) when the activities are performed even if those activities are performed after the control of the good has been transferred. Accordingly, we record the expenses for shipping and handling activities at the same time we recognize revenue.

We exclude from the measurement of the transaction price all taxes imposed on and concurrent with a specific revenue-producing transaction and collected by the entity from a customer, including sales, use, excise, value-added, and franchise taxes (collectively referred to as sales taxes).

We do *not* adjust revenue for the effects of financing components if the contract has a duration of *one* year or less, as we believe that we will receive payment from the customer within *one* year of when we transfer control of the related goods.

The following table disaggregates our revenue by product category by segment for the *three* months ended *December 31, 2018*:

<b>(Unaudited, amounts in thousands)</b>	<b>Wholesale</b>	<b>Retail</b>	<b>Total</b>
Upholstery furniture	\$50,953	\$69,169	\$120,122
Case goods furniture	38,758	48,294	87,052
Accents	18,833	34,160	52,993
Other	(886 )	6,885	5,999
Total	\$107,658	\$158,508	266,166
	Eliminations		(69,014 )
	Consolidated Net		\$197,152
	Sales		



**ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements (Unaudited)**

The following table disaggregates our revenue by product category by segment for the *six months ended December 31, 2018*:

<b>(Unaudited, amounts in thousands)</b>	<b>Wholesale</b>	<b>Retail</b>	<b>Total</b>
Upholstery furniture	\$ 109,746	\$ 133,316	\$ 243,062
Case goods furniture	78,751	90,770	169,521
Accents	39,258	67,616	106,874
Other	(2,025 )	12,020	9,995
Total	\$ 225,730	\$ 303,722	529,452
Eliminations			(144,515)
Consolidated Net Sales			\$ 384,937

Upholstery furniture includes fabric-covered items such as sleepers, recliners and other motion furniture, chairs, ottomans, custom pillows, sofas, loveseats, cut fabrics and leather.

Case goods furniture includes items such as beds, dressers, armoires, tables, chairs, buffets, entertainment units, home office furniture, and wooden accents.

Accents includes items such as window treatments and drapery hardware, wall décor, florals, lighting, clocks, mattresses, bedspreads, throws, pillows, decorative accents, area rugs, wall coverings and home and garden furnishings.

Other includes revenue for product delivery, the Ethan Allen Hotel room rentals and banquets, *third*-party furniture protection plans, non-inventoried parts, and consulting and other fees, net of discounts, allowances and other sales incentives.

**(14) Subsequent Events**

None

## **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following discussion of financial condition and results of operations should be read in conjunction with (i) our Consolidated Financial Statements, and notes thereto, included in Item 1 of Part I of this Quarterly Report on Form 10-Q and (ii) our Annual Report on Form 10-K for the year ended June 30, 2018.

### **Forward-Looking Statements**

Management's discussion and analysis of financial condition and results of operations and other sections of this Quarterly Report on Form 10-Q contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), which represent our management's beliefs and assumptions concerning future events based on information currently available to us relating to our future results. Such forward-looking statements are identified in this Quarterly Report on Form 10-Q and in documents incorporated herein by reference by use of forward-looking words such as "anticipate", "believe", "plan", "estimate", "expect", "intend", "will", "may", "continue", "project", "target", "outlook", "forecast", "guidance", and similar expressions and the neg such forward-looking words. These forward-looking statements are subject to management decisions and various assumptions about future events, and are not guarantees of future performance. Actual results could differ materially from those anticipated in the forward-looking statements due to a number of risks and uncertainties including, but not limited to: competition from overseas manufacturers and domestic retailers; our anticipating or responding to changes in consumer tastes and trends in a timely manner; our ability to maintain and enhance our brand, marketing and advertising efforts and pricing strategies; changes in global and local economic conditions that may adversely affect consumer demand and spending, our manufacturing operations or sources of merchandise and international operations; changes in U.S. policy related to imported merchandise; an economic downturn; potentially negative or unexpected tax consequences of changes to fiscal and tax policies; our limited number of manufacturing and logistics sites; fluctuations in the price, availability and quality of raw materials; environmental, health and safety requirements; product safety concerns; disruptions to our technology infrastructure (including cyber attacks); increasing labor costs, competitive labor markets and our continued ability to retain high-quality personnel and risks of work stoppages; loss of key personnel; our ability to obtain sufficient external funding to finance our operations and growth; access to consumer credit; the effect of operating losses on our ability to pay cash dividends; additional impairment charges that could reduce our profitability; our ability to locate new design center sites and/or negotiate favorable lease terms for additional design centers or for the expansion of existing design centers; the results of operations for any quarter are not necessarily indicative of our results of operations for a full year; possible failure to protect our intellectual property; and those matters discussed in "Item 1A – Risk Factors" of our Annual Report on Form 10-K for the year ended June 30, 2018, and elsewhere in this Quarterly Report on Form 10-Q and our SEC filings. Accordingly, actual circumstances and results could differ materially from those contemplated by the forward-looking statements.



## **ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES**

Given the risks and uncertainties surrounding forward-looking statements, you should not place undue reliance on these statements. Many of these factors are beyond our ability to control or predict. Our forward-looking statements speak only as of the date of this Quarterly Report on Form 10-Q. Other than as required by law, we undertake no obligation to update or revise forward-looking statements, whether as a result of new information, future events, or otherwise.

### **Critical Accounting Policies**

The Company's consolidated financial statements are based on the accounting policies used. Certain accounting policies require that estimates and assumptions be made by management for use in the preparation of the financial statements. Critical accounting policies are those that are central to the presentation of the Company's financial condition and results and that require subjective or complex estimates by management. We implemented Accounting Standard Update No. 2014-09, Revenue from Contracts with Customers (Accounting Standards Codification Topic 606, "ASC 606"), in the first quarter of fiscal 2019. There have been no other changes with respect to the Company's critical accounting policies from those disclosed in its 2018 Annual Report on Form 10-K filed with the SEC on August 2, 2018. Also see Note 12, Recently Adopted Accounting Pronouncements, and Note 13, Revenue Recognition.

### **Overview**

We are a leading interior design company and manufacturer and retailer of quality home furnishings. Founded over 85 years ago, today we are a leading international home fashion brand doing business in North America, Europe, Asia and the Middle East. We are vertically integrated from design through delivery, affording our clientele a value proposition of style, quality and price. We offer complementary interior design service to our clients and sell a full range of furniture products and decorative accents through ethanallen.com and a network of approximately 300 design centers in the United States and abroad. The design centers represent a mix of independent licensees and our own Company operated retail segment. We own and operate nine manufacturing facilities including six manufacturing plants and one sawmill in the United States and one manufacturing plant each in Mexico and Honduras.

Our business model is to maintain continued focus on (i) communicating our messages with strong advertising and marketing campaigns, (ii) capitalizing on the strength of our interior design professionals and management in our retail design centers, (iii) utilizing ethanallen.com as a key marketing tool to drive traffic to a network of 200 North

American design centers located near our demographic base, (iv) investing in new technologies across key aspects of our vertically integrated business, and (v) leveraging the benefits of our vertical integration by maintaining our manufacturing capacity in North America where we manufacture approximately 75% of our products.

Our competitive advantages arise from:

providing fashionable high quality products of the finest craftsmanship;

offering complimentary design service through an estimated 2,000 motivated interior design professionals network-wide, which we believe makes us the world's leading interior design network;

offering a wide array of custom products across our upholstery, case goods, and accent product categories;

enhancing our technology in all aspects of the business; and

leveraging our vertically integrated structure.

We have completed a major transformation of our product offerings, having refreshed over 70% of our entire product line over the past three years. In the spring and summer of 2018, we further strengthened our offerings with new products featuring a modern perspective on classic designs. Our contract business, including GSA, hospitality and commercial sales, continues to grow and the GSA is now one of our ten largest customers. Our internet sales, while still a minor portion of our sales, are growing at a rate that continues to out-pace our brick and mortar design centers.

We measure the performance of our design centers based on net sales and written orders booked on a comparable period basis. Comparable design centers are those which have been operating for at least 15 months, including relocated design centers provided the original and relocated design center location had been operating for at least 15 months on a combined basis. During the first three months of operations of newly opened design centers, written orders are booked but minimal net sales are achieved through the delivery of products. Design centers we acquire from independent retailers are included in comparable design center sales in their 13th full month of Ethan Allen-owned operations. The frequency of our promotional events as well as the timing of the end of those events can also affect the comparability of orders booked during a given period. Our international net sales are composed of our wholesale segment sales to independent retailers and our retail segment sales to consumers through the Company operated international design centers.

**ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES****Results of Operations**

A summary of our consolidated operations is presented in the following tables. In this Item 2 of this quarterly report, unless otherwise noted, all comparisons in the discussion following are from the three or six month period ended December 31, 2018 to the comparable prior year fiscal three or six month period (\$ in millions except per share amounts).

	Three months ended December 31,				Six months ended December 31,			
	2018	%	2017	%	2018	%	2017	%
Net sales	\$197.2	100.0%	\$198.5	100.0%	\$384.9	100.0%	\$379.8	100.0%
Gross profit	108.9	55.2 %	107.8	54.3 %	210.3	54.6 %	208.1	54.8 %
Selling, general and administrative expenses	92.7	47.0 %	90.3	45.5 %	182.4	47.4 %	179.0	47.1 %
Operating income	16.1	8.2 %	17.5	8.8 %	27.9	7.3 %	29.1	7.7 %
Net income	12.2	6.2 %	14.9	7.5 %	21.1	5.5 %	22.3	5.9 %
Earnings per diluted share	\$0.45		\$0.54		\$0.78		\$0.80	
Net cash provided by (used in) operating activities	\$7.0		\$(3.5 )		\$31.5		\$14.2	

A summary of changes from the preceding fiscal year are presented in the following table.

	Three months ended December 31,		Six months ended December 31,	
	2018	2017	2018	2017
Net sales	(0.7 %)	2.0 %	1.4 %	(2.1 %)
Operating income	(8.0 %)	2.6 %	(4.0 %)	(17.9 %)
Net income	(18.0 %)	38.9 %	(5.6 %)	0.2 %
Earnings per diluted share	(16.7 %)	42.1 %	(2.5 %)	1.3 %
Net cash provided by (used in) operating activities	302.3 %	(8,380.5 %)	122.4 %	(48.5 %)

Edgar Filing: ETHAN ALLEN INTERIORS INC - Form 10-Q

The components of consolidated revenues and operating income (loss) by business segment are as follows (in millions):

	Three months ended December 31,		Six months ended December 31,	
	2018	2017	2018	2017
<b>Revenue:</b>				
Wholesale segment	\$107.7	\$118.0	\$225.7	\$229.5
Retail segment	158.5	153.0	303.7	294.6
Elimination of inter-segment sales	(69.0)	(72.5)	(144.5)	(144.3)
Consolidated revenue	\$197.2	\$198.5	\$384.9	\$379.8
<b>Operating income (loss):</b>				
Wholesale segment	\$8.8	\$15.5	\$23.1	\$29.0
Retail segment	3.3	(0.6)	1.8	(3.4)
Adjustment for inter-company profit (1)	4.0	2.6	3.0	3.5
Consolidated operating income	\$16.1	\$17.5	\$27.9	\$29.1

(1) Represents the change in wholesale profit contained in Ethan Allen operated design center inventory existing at the end of the period.

**ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES**

A summary by business segment of annual percentage changes from the preceding fiscal year are presented in the following tables:

	Three months ended December 31,		Six months ended December 31,	
	2018	2017	2018	2017
<b>Wholesale segment</b>				
Revenue	(8.7 %)	3.8 %	(1.7 %)	0.6 %
Operating Income	(43.3 %)	9.8 %	(20.3 %)	(5.3 %)
Backlog	(26.4 %)	56.8 %	(26.4 %)	56.8 %
<b>Retail segment</b>				
Revenue	3.6 %	(2.1 %)	3.1 %	(4.5 %)
Comparable design center revenue	2.7 %	(2.2 %)	1.8 %	(5.5 %)
Total written orders	(3.4 %)	(5.8 %)	(1.7 %)	(1.9 %)
Comparable design center written orders	(4.2 %)	(6.2 %)	(3.1 %)	(2.7 %)
Operating Income	621.4%	(129.6%)	151.4%	(207.5%)
Backlog	(14.2 %)	7.0 %	(14.2 %)	7.0 %

We are in the midst of a major brand-building marketing program utilizing multiple mediums including direct mail, television, print, digital and social marketing. This program targets a broad demographic base beyond our core customer. We expect that as we continue to market to this broader base, our brand awareness will increase and ultimately drive increased revenues over time. We accelerated our advertising expense in our first quarter of fiscal 2019, increasing by 12.8% over the same prior year period. During this second quarter of fiscal 2019, we moderated our advertising, which decreased 12.4% over the same prior year period. On a year-to-date basis our advertising expense is 0.8% less than the prior year.

A sales decrease for the second quarter of 8.7% for wholesale was partly offset by a 3.6% increase for retail. The increase in retail sales contributed in reducing inventory resulting in a release of intercompany profit previously held in inventory. These factors combined to increase gross profit by \$1.1 million. International net sales decreased 29.4% primarily due to China and Canada, and as a percent of our consolidated net sales were 7.1% in the current year quarter and 10.0% in the prior year quarter. Gross margin was above the prior year, primarily due to improved retail gross margin, and the retail sales mix in relation to total sales, which was 80.4% in the current quarter compared to 77.1% in the comparable prior year period, and in an increase of intercompany profit in inventory. Operating expenses



increased in total due to increases in logistics expenses and increased retail expenses due to the change in retail sales mix mentioned previously, partially offset by reduced advertising expenses. Income taxes were affected by the changes resulting from the Tax Act enacted in December 2017, with an effective tax rate of 25.1% in the current quarter compared to 16.0% in the prior year. The net result was a decrease in earnings per diluted share of \$0.09.

**ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES**

The following tables show selected design center location information.

	Fiscal 2019			Fiscal 2018		
	Independent-retailers	Company-operated	Total	Independent-retailers	Company-operated	Total
<b>Retail Design Center location activity:</b>						
Balance at beginning of period	148	148	296	155	148	303
New locations	13	1	14	6	2	8
Closures	(1 )	(4 )	(5 )	(4 )	(2 )	(6 )
Transfers	(1 )	1	-	-	-	-
Balance at end of period	159	146	305	157	148	305
Relocations (in new and closures)	-	1	1	-	-	-
<b>Retail Design Center geographic locations:</b>						
United States	42	140	182	47	142	189
Canada	-	6	6	-	6	6
China	98	-	98	85	-	85
Other Asia	11	-	11	12	-	12
Europe	1	-	1	6	-	6
Middle East	7	-	7	7	-	7
Total	159	146	305	157	148	305

***Second Quarter Ended December 31, 2018 Compared to Second Quarter Ended December 31, 2017***

**Consolidated net sales** for the quarter of \$197.2 million compared to \$198.5 million for the same period in the prior year, a decrease of 0.7%. Sales decreased for our wholesale segment, which were partly offset by an increase in our retail segment. There was a decrease in international sales in our retail and wholesale segments. We believe this decrease is related to the economic uncertainty surrounding current international trade disputes.

**Retail net sales** for the quarter of \$158.5 million compared to \$153.0 million for the prior year period, an increase of 3.6%. Comparative retail net sales increased 2.7%. There were 146 Company-operated design centers during the quarter, down from 148 in the prior year quarter. There was a 4.7% increase in sales in the U.S., while sales from the Canadian design centers decreased 20.2%. Total written business (new orders booked) decreased 3.4%, with decreases

in both the U.S. and Canada. Comparable design center written business in the quarter decreased 4.2% in total.

**Wholesale net sales** for the quarter of \$107.7 million compared to \$118.0 million for the prior year period, a decrease of 8.7%. During the previous year, wholesale segment sales were at elevated levels as the shipping delays and the high backlogs from the first quarter were mostly caught up in the second quarter. This year the wholesale segment backlog levels in the first quarter were at normal levels as our manufacturing is running more efficiently this year with no shipping delays. Lower international sales, especially to China, partially offset by increased contract sales, also contributed to the sales decrease.

**Gross profit** for the quarter of \$108.9 million compared to \$107.8 million for the prior year period, an increase of 1.0%, with an increase in our retail segment and a decrease in our wholesale segment primarily related to lower sales volume. Consolidated gross margin for the quarter was 55.2% compared to 54.3%. Retail sales as a percent of total consolidated sales was 80.4% for the quarter compared to 77.1% in the prior year quarter, increasing our consolidated gross margin due to this increased percentage.

**Operating expenses** for the quarter of \$92.7 million, or 47.0% of net sales, increased \$2.5 million compared to \$90.3 million, or 45.5% of net sales, for the prior year period. The 2.7% increase to prior year was primarily due to increased wholesale distribution costs of \$1.0 million and higher variable costs in retail due to higher retail sales, partly offset by a decrease in advertising of \$1.1 million.

**Operating income and profit margin** for the quarter of \$16.1 million, or 8.2% of net sales, compared to \$17.5 million, or 8.8% of net sales, for the prior year period. The primary causes for the 8.0% decrease in operating income were the decreased sales in wholesale partly offset by retail sales increases, increased variable costs of logistics partly associated with increased sales, as discussed previously.

## ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

**Retail operating income** for the quarter of \$3.1 million, or 2.1% of sales, compared to a loss of \$0.6 million, or -0.4% of sales, for the prior year period. The higher operating income and improved margin in the current quarter was driven primarily by the improved sales and gross margin in the current year period.

**Wholesale operating income** for the quarter of \$8.8 million, or 8.2% of sales, compared to \$15.5 million, or 13.2% of sales, for the prior year period. The decrease was largely due to the decrease in current period net sales, as discussed above.

**Income tax expense** for the quarter totaled \$4.1 million compared to \$2.8 million. Our effective tax rate was 25.1% in the quarter compared to 16.0%. The effective tax rate for the second quarter of fiscal 2019 primarily includes tax expense on that quarter's net income, tax and interest expense on uncertain tax positions and tax expense on cancellation and exercise of stock options. The prior period's effective tax rate primarily includes tax expense on the taxable year's net income, the tax benefit lost on the cancellation of stock options, and also includes tax and interest expense on uncertain tax positions partially offset by the tax benefit from the re-measurement of deferred tax assets and liabilities and the vesting of restricted stock units.

**Net income** for the quarter of \$12.2 million compared to \$14.9 million for the prior year period a decrease of 18.0%. This resulted in net income per diluted share for the quarter of \$0.45 compared to \$0.54, a decrease of 16.7%.

### *Six Months Ended December 31, 2018 Compared to Six Months Ended December 31, 2017*

**Consolidated net sales** year-to-date of \$384.9 million compared to \$379.8 million for the same period in the prior year, an increase of 1.4%. Domestic sales increased for both wholesale and retail, and international sales decreased in both segments. We believe this decrease in international sales is related to the economic uncertainty surrounding current international trade disputes.

**Retail net sales** year-to-date of \$303.7 million compared to \$294.6 million for the prior year period, an increase of 3.1%. Comparative retail net sales increased 1.8%. There were 146 Company-operated design centers during the period, down from 148 in the prior year. There was a 4.4% increase in sales in the U.S., while sales from the Canadian design centers decreased 24.2%. Total written business (new orders booked) decreased 1.7%, with a decrease in both

Canada and the U.S. Comparable design center written business year-to-date decreased 3.1% in total.

**Wholesale net sales** year-to-date of \$225.7 million compared to \$229.6 million for the prior year period, a decrease of 1.7%. During the previous year, wholesale segment sales were at elevated levels as the shipping delays and the high backlogs from the first quarter were mostly caught up in the second quarter. This year the wholesale segment backlog levels in the first quarter were at normal levels as our manufacturing is running more efficiently this year with no shipping delays. Lower international sales, especially to China, partially offset by increased contract sales, also contributed to the sales decrease.

**Gross profit** year-to-date of \$210.3 million compared to \$208.1 million for the prior year period, an increase of 1.1%, with an increase in our retail segment and a decrease in our wholesale segment. Gross profit for wholesale decreased due to lower sales volume. Consolidated gross margin year-to-date was 54.6% compared to 54.8%. Retail sales as a percent of total consolidated sales was 78.9% year-to-date compared to 77.6% in the prior year period, increasing our consolidated gross margin due to this increased percentage.

**Operating expenses** year-to-date of \$182.4 million, or 47.4% of net sales, increased \$3.4 million compared to \$179.0 million, or 47.1% of net sales, for the prior year period. The 1.9% increase to prior year was primarily due to increased logistics costs of \$2.2 million.

**Operating income and profit margin** year-to-date of \$27.9 million, or 7.3% of net sales, compared to \$29.1 million, or 7.7% of net sales, for the prior year period. The primary causes for the 4.0% decrease in operating income were the reduced sales in wholesale and increased variable costs of freight, distribution and warehouse costs, partly offset by increased domestic retail sales as discussed previously.

**Retail operating income** year-to-date of \$1.8 million, or 0.6% of sales, compared to a loss of \$3.4 million, or -1.2% of sales, for the prior year period. The improved operating income in the current period was driven primarily by the improved domestic sales in the current year period.

**Wholesale operating income** year-to-date of \$23.1 million, or 10.2% of sales, compared to \$29.0 million, or 12.6% of sales, for the prior year period. The decrease was largely due to the decrease in second quarter net sales coupled with an increase in distribution costs.

## ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

**Income tax expense** year-to-date totaled \$7.0 million compared to \$6.8 million. Our effective tax rate was 25.0% in the period compared to 23.5%. The effective tax rate for the current year-to-date period of fiscal 2019 primarily includes tax expense on that fiscal year's net income, tax and interest expense on uncertain tax positions and tax expense on cancellation and exercises of stock options. The prior period's effective tax rate primarily includes tax expense on the taxable year's net income, the tax benefit lost on the cancellation of stock options, and also includes tax and interest expense on uncertain tax positions partially offset by the tax benefit from the re-measurement of deferred tax assets and liabilities and the vesting of restricted stock units.

**Net income** year-to-date of \$21.0 million compared to \$22.3 million for the prior year period a decrease of 5.6%. This resulted in net income per diluted share year-to-date of \$0.78 compared to \$0.80, a decrease of 2.5%.

### Liquidity and Capital Resources

At December 31, 2018, we held cash and cash equivalents of \$38.8 million. At June 30, 2018, we held cash and cash equivalents of \$22.4 million. Our principal sources of liquidity include cash and cash equivalents, cash flow from operations, amounts available under the Facility, and other borrowings.

During the quarter ended December 31, 2018 the Company entered into a five-year, \$165 million senior secured revolving credit facility, which amended and restated the previously existing facility. For a detailed discussion of our debt obligations and timing of our related cash payments see Note 6 to the Consolidated Financial Statements included under Item 1 of this Quarterly Report.

A summary of net cash provided by (used in) operating, investing, and financing activities for the six months ended December 31, 2018 and 2017 is provided below (in millions):

	Six months ended December 31,	
	2018	2017
<b>Cash provided by (used in) operating activities</b>		

Edgar Filing: ETHAN ALLEN INTERIORS INC - Form 10-Q

Net income plus depreciation and amortization	\$31.0	\$32.3
Working capital items	-	(18.8)
Other operating activities	0.5	0.7
Total provided by operating activities	\$31.5	\$14.2

**Cash provided by (used in) investing activities**

Capital expenditures	\$(5.0 )	\$(5.0 )
Other investing activities	0.1	0.4
Total provided by (used in) investing activities	\$(4.9 )	\$(4.6 )

**Cash provided by (used in) financing activities**

Payments on long-term debt and capital lease obligations	\$(0.3 )	\$(14.2)
Payment of cash dividends	(10.1)	(10.5)
Purchase/retirement of company stock	-	(1.1 )
Other financing activities	0.2	0.2
Total provided by (used in) financing activities	\$(10.2)	\$(25.6)

**Cash Provided by (Used in) Operating Activities**

Year-to-date, cash of \$31.5 million was provided by operating activities, an increase of \$17.3 million. This was largely due to changes in the ordinary course of business for working capital items, primarily an inventory increase during fiscal 2018 to support the order backlog. Working capital items consist of current assets (accounts receivable, inventories, prepaid and other current assets) less current liabilities (customer deposits, payables, and accrued expenses and other current liabilities).

## **ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES**

### **Cash Provided by (Used in) Investing Activities**

Year-to-date, \$4.9 million of cash was used in investing activities, an increase of \$0.3 million. Capital expenditures remained consistent with the prior year and primarily related to retail design center improvements. We anticipate that cash from operations will be sufficient to fund future capital expenditures. Effective July 1, 2018, the company considers restricted cash as a component of cash and cash equivalents as presented on the statement of cash flows. Previously the net change in restricted cash was considered an investing activity. Prior periods have been reclassified to conform to current year presentation. See also notes 4 and 12.

### **Cash Provided by (Used in) Financing Activities**

Year-to-date, \$10.2 million was used in financing activities, which is \$15.4 million less cash used than the \$25.6 million of cash used during the first six months of fiscal 2018. This was primarily due to a \$13.2 million pre-payment on the term loan in the prior fiscal year. During the current fiscal year to date period we paid dividends of \$10.1 million compared to \$10.5 million in the prior year to date period, paying \$0.38 per share in both year to date periods. In November 2018, we declared a \$1.00 per share special cash dividend, payable to our shareholders in January 2019, and a regular quarterly dividend of \$0.19 per share, also payable to our shareholders in January 2019. The Company has continuously paid dividends for every quarter since 1996 and we expect to continue to do so as economic conditions and liquidity permit.

We believe that our cash flow from operations, together with our other available sources of liquidity including the Facility and refinancing alternatives, will be adequate to make all required debt payments, to permit anticipated capital expenditures, and to fund working capital and other cash requirements. As of December 31, 2018, we had working capital of \$82.9 million compared to \$93.2 million at June 30, 2018, a decrease of \$10.3 million, or 11.1%. The Company had a current ratio of 1.59 to 1 at December 31, 2018 and 1.77 to 1 at June 30, 2018.

In addition to using available cash to fund changes in working capital, necessary capital expenditures, acquisition activity, the repayment of debt and the payment of dividends, the Company has been authorized by our board of directors to repurchase our common stock from time to time, either directly or through agents, in the open market at prices and on terms satisfactory to us. During the six months ending December 31, 2018 there were no share repurchases.



At December 31, 2018, we had a remaining Board authorization to repurchase 2,518,046 shares of our common stock pursuant to our previously announced share repurchase program.

### **Contractual Obligations**

We amended our credit facility in December 2018, as more fully described in this form 10-Q in Part I, Financial Statements, under Note 6, Borrowings. There has been no other material change to the amount or timing of cash payments related to our outstanding contractual obligations as set forth in Part II, Item 7 – Management’s Discussion and Analysis of Financial Condition and Results of Operations of our Annual Report on Form 10-K for the year ended June 30, 2018 as filed with the SEC on August 2, 2018.

### **Off-Balance Sheet Arrangements and Other Commitments, Contingencies and Contractual Obligations**

Except as indicated below, we do not utilize or employ any off-balance sheet arrangements, including special-purpose entities, in operating our business. As such, we do not maintain any (i) retained or contingent interests, (ii) derivative instruments (other than as specified below), or (iii) variable interests which could serve as a source of potential risk to our future liquidity, capital resources and results of operations.

We may, from time to time in the ordinary course of business, provide guarantees on behalf of selected affiliated entities or become contractually obligated to perform in accordance with the terms and conditions of certain business agreements. The nature and extent of these guarantees and obligations may vary based on our underlying relationship with the benefiting party and the business purpose for which the guarantee or obligation is being provided. The only such program in place at both December 31, 2018 and June 30, 2018 was for our consumer credit program described below.

#### **Ethan Allen Consumer Credit Program**

The terms and conditions of our consumer credit program, which is financed and administered by a third-party financial institution on a non-recourse basis to Ethan Allen, are set forth in an agreement between the Company and that financial service provider (the “Program Agreement”) which was last amended effective January 2014. Any independent retailer choosing to participate in the consumer credit program is required to enter into a separate agreement with that same third-party financial institution which sets forth the terms and conditions under which the retailer is to perform in connection with its offering of consumer credit to its customers (the “Retailer Agreement”). We have obligated ourselves on behalf of any independent retailer choosing to participate in our consumer credit program by agreeing, in the event of default, breach, or failure of the independent retailer to perform under such Retailer

Agreement, to take on certain responsibilities of the independent retailer, including, but not limited to, delivery of goods and reimbursement of customer deposits. Customer receivables originated by independent retailers remain non-recourse to Ethan Allen. The Program Agreement will terminate on July 31, 2019, and the Company will utilize a substitute program upon termination. While the maximum potential amount of future payments (undiscounted) that we could be required to make under this obligation is indeterminable, recourse provisions exist that would enable us to recover, from the independent retailer, any amount paid or incurred by us related to our performance. Based on the underlying creditworthiness of our independent retailers, including their historical ability to perform satisfactorily in connection with the terms of our consumer credit program, we believe this obligation will expire without requiring funding by us. To ensure funding for delivery of products sold, the terms of the Program Agreement also contain a right for the financial services provider to demand from the Company collateral at a variable rate based on the volume of program sales if the Company does not meet a covenant regarding minimum working capital or tangible net worth. At both December 31, 2018 and June 30, 2018, we were in compliance with such covenant.

## **ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES**

### **Product Warranties**

Our products, including our case goods, upholstery and home accents, generally carry explicit product warranties that extend up to twelve years and are provided based on terms that are generally accepted in the industry. All our domestic independent retailers are required to enter into and perform in accordance with the terms and conditions of a warranty service agreement. We record provisions for estimated warranty and other related costs at time of sale based on historical warranty loss experience and make periodic adjustments to those provisions to reflect actual experience. On rare occasions, certain warranty and other related claims involve matters of dispute that ultimately are resolved by negotiation, arbitration or litigation. In certain cases, a material warranty issue may arise which is beyond the scope of our historical experience. We provide for such warranty issues as they become known and are deemed both probable and estimable. It is reasonably possible that, from time to time, additional warranty and other related claims could arise from disputes or other matters beyond the scope of our historical experience. At both December 31, 2018 and June 30, 2018 the Company's product warranty liability totaled \$1.5 million.

### **Business Outlook**

We continue to strengthen our vertically integrated structure from concept of idea, to engineering, to manufacturing, to retail and logistics. We intend to maintain strong manufacturing capabilities in North America, which we believe is a long-term competitive advantage that will allow us to advance our objectives of maintaining fast order delivery, exceptional quality and improving capacity to ship stocked and custom made-to-order items more quickly, which in turn will allow us to grow our business. Having refreshed over 70% of our products in the last three years, our current product offerings are fresh and relevant.

Our marketing programs continue to be strengthened with messaging focused on our stylish products, quality and service offerings. We expect to continue to expand our advertising during fiscal 2019 as we broaden the reach of our messaging to drive more traffic to our design centers and to ethanallen.com.

Our network of professionally trained interior design professionals differentiate us significantly from our competitors. We continue to strengthen the level of service, professionalism, and interior design competence, as well as to improve the efficiency of our retail operations. We believe that over time, we will continue to benefit from (i) continuous repositioning of our retail network, (ii) frequent new product introductions, (iii) new and innovative marketing promotions and effective use of targeted advertising media, and (iv) continued use of the latest technology combined

with personal service from our interior design professionals.

We expect the home furnishings industry to remain extremely competitive with respect to both the sourcing of products and the wholesale and retail sale of those products for the foreseeable future. Domestic manufacturers continue to face pricing pressures because of the lower manufacturing costs on imports, particularly from Asia. While we also utilize overseas sourcing for approximately one quarter of our products, we choose to differentiate ourselves by maintaining a substantial North American manufacturing base, the majority of which is located in the United States. This structure enables us to leverage our vertically integrated structure to our advantage. We continue to believe that a balanced approach to product sourcing, which includes our own North American manufacturing of about 75% of our product offerings coupled with the import of other selected products, provides the greatest degree of flexibility and short lead times and is the most effective approach to ensuring that acceptable levels of quality and service are maintained.

With our vertical enterprise well positioned, we maintain a cautiously optimistic outlook. Our retail strategy will continue with its focus on (i) providing relevant product offerings, a wide array of product solutions, and superior interior design solutions through our large staff of interior design professionals, (ii) continuing strong advertising and marketing campaigns to get our message across and to continue broadening our customer base, (iii) the opening of new or relocated design centers in more prominent locations, and encouraging independent retailers to do the same, (iv) leveraging the use of technology and personal service within our retail network and online through [www.ethanallen.com](http://www.ethanallen.com), and (v) further expansion internationally. We believe this strategy provides an opportunity to grow our business.

## **ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES**

### **Recent Accounting Pronouncements**

In February 2016, the FASB issued ASU 2016-02, *Leases*, which is intended to improve financial reporting about leasing transactions. The ASU will require lessees that lease assets with lease terms of more than twelve months to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases. Lessors will remain largely unchanged from current GAAP. In addition, ASU 2016-02 will require disclosures to help investors and other financial statement users better understand the amount, timing and uncertainty of cash flows arising from leases. This pronouncement is effective for the Company on July 1, 2019, and early adoption is permitted. The Company is currently evaluating the impact on our consolidated financial statements, but expects that it will have a material impact on our consolidated balance sheet to recognize the right of use assets and related liabilities.

### **Where You Can Find Other Information**

Our website is [www.ethanallen.com](http://www.ethanallen.com). Information contained on our website is not part of this Quarterly Report on Form 10-Q. Information that we furnish or file with the SEC, including our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and any amendments to, or exhibits included in, these reports are available for download, free of charge, on our website soon after such reports are filed with or furnished to the SEC. Our SEC filings, including exhibits filed therewith, are also available on the SEC's website at [www.sec.gov](http://www.sec.gov).

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

We are exposed to market risks relating to fluctuations in interest rates and foreign currency exchange rates.

Interest rate risk exists primarily through our borrowing activities. We utilize United States dollar denominated borrowings to fund substantially all our working capital and investment needs. Short-term debt, if required, is used to meet working capital requirements and long-term debt is generally used to finance long-term investments. There is inherent rollover risk for borrowings as they mature and are renewed at current market rates. The extent of this risk is not quantifiable or predictable because of the variability of future interest rates and our future financing requirements.

For floating-rate obligations, interest rate changes do not affect the fair value of the underlying financial instrument but would impact future earnings and cash flows, assuming other factors are held constant. Conversely, for fixed-rate obligations, interest rate changes affect the fair value of the underlying financial instrument but would not impact earnings or cash flows. At December 31, 2018, we did not have any floating-rate debt obligations outstanding under our Facility. We currently do not engage in any interest rate hedging activity and we have no intention of doing so in the foreseeable future. Based on the average interest rate of the loans under the Facility during the quarter ended December 31, 2018, and to the extent that borrowings were outstanding, a 10% change in the interest rate would not have a material effect on our consolidated results of operations and financial condition. For information regarding the Company's other risk factors, see Item 7A – Quantitative and Qualitative Disclosures About Market Risk in our Annual Report on Form 10-K for the year ended June 30, 2018 as filed with the SEC on August 2, 2018.

Foreign currency exchange risk is primarily limited to our operation of Ethan Allen operated retail design centers located in Canada and our plants in Mexico and Honduras, as substantially all purchases of imported parts and finished goods are denominated in United States dollars. As such, gains or losses resulting from market changes in the value of foreign currencies have not had, nor are they expected to have, a material effect on our consolidated results of operations. A decrease in the value of foreign currencies relative to the United States dollar may affect the profitability of our international vendors and independent international retailers, but as we employ a balanced sourcing strategy, we believe any impact would be moderate.

#### **Item 4. Controls and Procedures**

##### **Disclosure Controls and Procedures**

We carried out an evaluation, under the supervision and with the participation of our management, including the Chairman of the Board and Chief Executive Officer ("CEO") and the Executive Vice President Administration and Chief Financial Officer ("CFO"), of the effectiveness of the design and operation of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this report. Based on such evaluation, the CEO and CFO have concluded that, as of December 31, 2018, our disclosure controls and procedures were effective in ensuring that material information relating to us (including our consolidated subsidiaries), which is required to be disclosed by us in our periodic reports filed with or submitted to the SEC is (i) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and (ii) accumulated and communicated to management, including the CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure.

## **ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES**

### **Changes in Internal Control over Financial Reporting**

There have been no changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal quarter ended December 31, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## **PART II - OTHER INFORMATION**

### **Item 1. Legal Proceedings**

There have been no material changes to the matters discussed in Part I, Item 3 - Legal Proceedings in our Annual Report on Form 10-K for the year ended June 30, 2018 as filed with the SEC on August 2, 2018. See Note 7 of the Notes to Consolidated Financial Statements contained in Part I, Item 1 of this Quarterly Report on Form 10-Q for a description of our legal proceedings.

### **Item 1A. Risk Factors**

There have been no material changes to the matters discussed in “Item 1A – Risk Factors” in our Annual Report on Form 10-K for the year ended June 30, 2018 as filed with the SEC on August 2, 2018.

### **Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

#### ***Issuer Purchases of Equity Securities***

Certain information regarding purchases made by or on behalf of us or any affiliated purchaser (as defined in Rule 10b-18(a)(3) under the Exchange Act) of our common stock during the three months ended December 31, 2018 on a trade date basis is provided below:

On November 21, 2002, our Board of Directors approved a share repurchase program authorizing us to repurchase up to 2,000,000 shares of our common stock, from time to time, either directly or through agents, in the open market at prices and on terms satisfactory to us. Subsequent to that date, the Board of Directors increased the aggregate authorization under the repurchase program on several separate occasions, the last of which was on April 24, 2018 when the Board of Directors increased the aggregate authorization to approximately 3,000,000 shares. There is no expiration date on the repurchase authorization and the amount and timing of future share repurchases, if any, will be determined as market and business conditions warrant. The maximum number of shares that may yet be purchased under our publicly announced repurchase program is 2,518,046 shares.

**Item 3. Defaults Upon Senior Securities**

Not applicable.

**Item 4. Mine Safety Disclosures**

Not applicable.

**Item 5. Other Information**

Not applicable.



**ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES**

**Item 6. Exhibits**

Exhibit Number	Description
10.1	<u>Second Amended and Restated Credit Agreement among Ethan Allen Interiors, Inc., most of its domestic subsidiaries, J.P.Morgan Chase Bank, N.A., as Administrative Agent and Syndication Agent, and Capital One, National Association, as Documentation Agent, dated as of December 21, 2018 (incorporated by reference to Exhibit 10.1 to the Registrant’s Current Report on Form 8-K filed on December 21, 2018).</u>
31.1	<u>Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>
31.2	<u>Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>
32.1	<u>Certification of Principal Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 *</u>
32.2	<u>Certification of Principal Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 *</u>
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema
101.CAL	XBRL Taxonomy Extension Calculation Linkbase
101.DEF	XBRL Taxonomy Extension Definition Linkbase
101.LAB	XBRL Taxonomy Extension Label Linkbase
101.PRE	XBRL Taxonomy Extension Presentation Linkbase

\* - Furnished herewith.



**ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES**

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ETHAN ALLEN INTERIORS INC.  
(Registrant)

Date: January 28, 2019 BY: /s/ M. Farooq Kathwari  
M. Farooq Kathwari  
Chairman, President and Chief Executive Officer  
(Principal Executive Officer)

Date: January 28, 2019 BY: /s/ Corey Whitely  
Corey Whitely  
Executive Vice President Administration  
Chief Financial Officer and Treasurer  
(Principal Financial Officer)