Lumber Liquidators Holdings, Inc.
Form 10-Q
April 30, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2014

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: 001-33767

Lumber Liquidators Holdings, Inc.

(Exact name of registrant as specified in its charter)

Delaware **(State or other jurisdiction of** **incorporation or organization)**	**27-1310817** **(I.R.S. Employer** **Identification No.)**
3000 John Deere Road **Toano, Virginia** **(Address of Principal Executive Offices)**	**23168** **(Zip Code)**

(757) 259-4280
(Registrant's telephone number, including area code)

Not Applicable

(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 of 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. x Yes ¨ No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). x Yes ¨ No

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

x Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company
(Do not check if a smaller reporting company)

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

As of April 28, 2014, there 27,428,476 shares of the registrant’s common stock, par value of $0.001 per share, outstanding.

LUMBER LIQUIDATORS HOLDINGS, INC.

Quarterly Report on Form 10-Q

For the quarter ended March 31, 2014

TABLE OF CONTENTS

PART I

FINANCIAL INFORMATION

Item 1. Financial Statements.

Lumber Liquidators Holdings, Inc.

Condensed Consolidated Balance Sheets

(in thousands, except share data)

	March 31, 2014 (unaudited)	December 31, 2013
Assets		
Current Assets:		
Cash and Cash Equivalents	$ 76,065	$ 80,634
Merchandise Inventories	247,370	252,428
Prepaid Expenses	7,926	6,229
Other Current Assets	11,880	12,916
Total Current Assets	343,241	352,207
Property and Equipment, net	78,409	65,947
Goodwill	9,693	9,693
Other Assets	1,698	1,712
Total Assets	$ 433,041	$ 429,559
Liabilities and Stockholders' Equity		
Current Liabilities:		
Accounts Payable	$ 41,496	$ 56,327
Customer Deposits and Store Credits	33,510	22,377
Accrued Compensation	4,813	11,709
Sales and Income Tax Liabilities	8,046	4,878
Other Current Liabilities	18,330	11,709
Total Current Liabilities	106,195	107,000
Deferred Rent	4,862	4,169
Deferred Tax Liability	9,636	9,061
Stockholders' Equity:		
Common Stock ($0.001 par value; 35,000,000 authorized; 27,505,476 and 27,557,570 outstanding, respectively)	30	30
Treasury Stock, at cost (2,311,285 and 2,133,307 shares, respectively)	(103,046)	(85,382)

Additional Capital	171,419	164,581
Retained Earnings	244,356	230,662
Accumulated Other Comprehensive Loss	(411)	(562)
Total Stockholders’ Equity	312,348	309,329
Total Liabilities and Stockholders’ Equity	$ 433,041	$ 429,559

See accompanying notes to condensed consolidated financial statements

Lumber Liquidators Holdings, Inc.

Condensed Consolidated Statements of Income

(in thousands, except share data and per share amounts)

(unaudited)

	Three Months Ended March 31, 2014	2013
Net Sales	$246,291	$230,419
Cost of Sales	145,004	137,422
Gross Profit	101,287	92,997
Selling, General and Administrative Expenses	78,866	67,589
Operating Income	22,421	25,408
Other (Income) Expense	94	(210)
Income Before Income Taxes	22,327	25,618
Provision for Income Taxes	8,633	9,837
Net Income	$13,694	$15,781
Net Income per Common Share—Basic	$0.50	$0.58
Net Income per Common Share—Diluted	$0.49	$0.57
Weighted Average Common Shares Outstanding:		
Basic	27,521,443	27,211,506
Diluted	27,832,110	27,783,611

See accompanying notes to condensed consolidated financial statements

Lumber Liquidators Holdings, Inc.

Condensed Consolidated Statements of Other Comprehensive Income

(in thousands)

(unaudited)

	Three Months Ended March 31,	
	2014	2013
Net Income	$ 13,694	$ 15,781
Foreign Currency Translation Adjustments	151	(321)
Comprehensive Income	$ 13,845	$ 15,460

See accompanying notes to condensed consolidated financial statements

Lumber Liquidators Holdings, Inc.

Condensed Consolidated Statements of Cash Flows

(in thousands)

(unaudited)

	Three Months Ended March 31, 2014	2013
Cash Flows from Operating Activities:		
Net Income	$ 13,694	$ 15,781
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Depreciation and Amortization	3,437	2,716
Stock-Based Compensation Expense	1,514	1,107
Changes in Operating Assets and Liabilities:		
Merchandise Inventories	4,897	(3,522)
Accounts Payable	(16,305)	(15,966)
Customer Deposits and Store Credits	11,170	2,874
Prepaid Expenses and Other Current Assets	(533)	1,952
Other Assets and Liabilities	4,421	6,122
Net Cash Provided by Operating Activities	22,295	11,064
Cash Flows from Investing Activities:		
Purchases of Property and Equipment	(14,384)	(2,589)
Net Cash Used in Investing Activities	(14,384)	(2,589)
Cash Flows from Financing Activities:		
Payments for Stock Repurchases	(17,664)	(4,276)
Proceeds from the Exercise of Stock Options	2,089	1,278
Excess Tax Benefit from Stock-Based Compensation	3,224	3,367
Net Cash (Used in) Provided by Financing Activities	(12,351)	369
Effect of Exchange Rates on Cash and Cash Equivalents	(129)	(283)
Net (Decrease) Increase in Cash and Cash Equivalents	(4,569)	8,561
Cash and Cash Equivalents, Beginning of Period	80,634	64,167
Cash and Cash Equivalents, End of Period	$ 76,065	$ 72,728

See accompanying notes to condensed consolidated financial statements

6

Lumber Liquidators Holdings, Inc.

Notes to Condensed Consolidated Financial Statements

(amounts in thousands, except share data and per share amounts)

(unaudited)

Note 1. Basis of Presentation

Lumber Liquidators Holdings, Inc. and its direct and indirect subsidiaries (collectively and, where applicable, individually, the “Company”) engage in business as a multi-channel specialty retailer of hardwood flooring, and hardwood flooring enhancements and accessories, operating as a single business segment. The Company offers an extensive assortment of exotic and domestic hardwood species, engineered hardwood, laminate and vinyl plank flooring direct to the consumer. The Company also features the renewable flooring products, bamboo and cork, and provides a wide selection of flooring enhancements and accessories, including moldings, noise-reducing underlay, adhesives and flooring tools. These products are primarily sold under the Company’s private label brands, including the premium Bellawood brand floors. The Company sells primarily to homeowners or to contractors on behalf of homeowners through a network of 322 store locations in primary or secondary metropolitan areas in 46 states and nine store locations in Canada at March 31, 2014. In addition to the store locations, the Company’s products may be ordered, and customer questions/concerns addressed, through both its call center in Toano, Virginia, and its website, www.lumberliquidators.com. The Company finishes the majority of the Bellawood products on its finishing line in Toano, Virginia, which along with the call center, corporate offices, and a distribution center, represent the “Corporate Headquarters.”

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q for interim financial reporting pursuant to the rules and regulations of the Securities and Exchange Commission. While these statements reflect all normal recurring adjustments which are, in the opinion of management, necessary for a fair presentation of the results of the interim period, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. Therefore, the interim condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes included in the Company’s annual report filed on Form 10-K for the year ended December 31, 2013.

The consolidated financial statements of the Company include the accounts of its wholly owned subsidiaries. All significant intercompany transactions have been eliminated in consolidation.

Results of operations for the three months ended March 31, 2014 are not necessarily indicative of the results to be expected for the full year.

Note 2. Fair Value of Financial Instruments

The carrying amounts of financial instruments such as cash and cash equivalents, accounts payable and other liabilities approximate fair value because of the short-term nature of these items. Of these financial instruments, the cash equivalents are classified as Level 1 as defined in the Financial Accounting Standards Board ASC 820 fair value hierarchy. The Company had cash equivalents of $170 at both March 31, 2014 and December 31, 2013.

Note 3. Stockholders' Equity

Net Income per Common Share

The following table sets forth the computation of basic and diluted net income per common share:

	Three Months Ended March 31,	
	2014	**2013**
Net Income	$ 13,694	$ 15,781
Weighted Average Common Shares Outstanding—Basic	27,521,443	27,211,506
Effect of Dilutive Securities:		
Common Stock Equivalents	310,667	572,105
Weighted Average Common Shares Outstanding—Diluted	27,832,110	27,783,611
Net Income per Common Share—Basic	$ 0.50	$ 0.58
Net Income per Common Share—Diluted	$ 0.49	$ 0.57

The following have been excluded from the computation of Weighted Average Common Shares Outstanding—Diluted because the effect would be anti-dilutive:

7

	Three Months Ended March 31,	
	2014	2013
Stock Options	35,366	210,747
Restricted Stock Awards	6,534	—

Stock Repurchase Program

In January 2014, the Company's board of directors authorized the repurchase of up to an additional $50,000 of the Company's common stock, bringing the total authorization to $150,000. At March 31, 2014, the Company had $50,168 remaining under this authorization. Purchases under this program were as follows:

	Three Months Ended March 31,	
	2014	**2013**
Shares Repurchased	168,000	70,600
Average Price per Share	$ 99.39	$ 54.34
Total Aggregate Costs	$ 16,698	$ 3,836

Note 4. Stock-Based Compensation

The following table summarizes share activity related to stock options and restricted stock awards ("RSAs"):

	Stock Options	Restricted Stock Awards
Options Outstanding/Nonvested RSAs, December 31, 2013	749,490	178,335
Granted	65,949	18,995
Options Exercised/RSAs Released	(90,879)	(35,005)
Forfeited	(6,308)	(4,014)
Options Outstanding/Nonvested RSAs, March 31, 2014	718,252	158,311

Note 5. Related Party Transactions

As of March 31, 2014, the Company leased 28 of its locations and the Corporate Headquarters, which includes a store location, representing 8.8% of the total number of store leases in operation, from entities controlled by the Company's founder and current chairman of the board ("Controlled Companies"). As of March 31, 2013, the Company leased 29 of its locations and the Corporate Headquarters, representing 9.9% of store leases in operation at that time, from Controlled Companies. Rental expense related to Controlled Companies was as follows:

	Three Months Ended March 31,	
	2014	2013
Rental expense related to Controlled Companies	$ 760	$ 707

Note 6. Commitments and Contingencies

On August 30, 2012, Jaroslaw Prusak, a purported customer ("Prusak"), filed a putative class action lawsuit, which was subsequently amended, against the Company in the United States District Court for the Northern District of Illinois. Prusak alleges that the Company willfully violated the Fair and Accurate Credit Transactions Act amendments to the Fair Credit Reporting Act in connection with electronically printed credit card receipts provided to certain of its customers. Prusak, for himself and the putative class, seeks statutory damages of no less than one hundred dollars and no more than one thousand dollars per violation, punitive damages, attorney's fees and costs, and other relief. Prusak has filed a motion seeking certification of the putative class and the parties have each filed motions seeking summary judgment with regard to matters at issue in the case. Those motions are currently pending before the Court. Although the Company believes it has defenses to the claims asserted and has opposed the motion to certify the class, the Company's estimate of the reasonably possible loss that may result from this action is a range between zero and $2,300, with no amount within that range a better estimate than any other amount.

On or about November 26, 2013, Gregg Kiken ("Kiken") filed a securities class action lawsuit, which was subsequently amended, in the Federal District Court for the Eastern District of Virginia against the Company, its founder, Chief Executive Officer and President, and Chief Financial Officer (collectively, the "Defendants"). In the complaint, Kiken alleges that the Defendants made material false and/or misleading statements and failed to disclose material adverse facts about the Company's business, operations and prospects. In particular, Kiken alleges that the Defendants made material misstatements or omissions related to the Company's compliance with the federal Lacey Act and the chemical content of its wood products. In addition to attorney's fees and costs, Kiken seeks to recover damages on behalf of himself and other persons who purchased or otherwise acquired the Company's stock during the putative class period at allegedly inflated prices and purportedly suffered financial harm as a result. The Company disputes Kiken's claims and intends to defend the matter vigorously. Given the uncertainty of litigation, the preliminary stage of the case, insurance coverage issues and the legal standards that must be met for, among other things, class certification and success on the merits, the Company cannot reasonably estimate the possible loss or range of loss that may result from this action.

On or about January 14, 2014, the case of Lambert et al. v. Lumber Liquidators Holdings, Inc. was filed in the United States District Court for the Eastern District of Virginia by four plaintiffs (the "Original Plaintiffs") on behalf of themselves and a class of persons in Virginia, Alabama and New York who purchased and installed wood flooring from the Company that was sourced, processed or manufactured in China. The Original Plaintiffs claimed that the Company made certain misrepresentations regarding the chemical emission levels of the Chinese flooring products that it sells. On February 11, 2014, an amended complaint was filed in which a number of additional plaintiffs and purported classes were added (collectively with the Original Plaintiffs, the "Plaintiffs") and the originally named defendant was replaced with a new one, Lumber Liquidators, Inc. The amended complaint, which is captioned Williamson et al. v. Lumber Liquidators, Inc., also states additional claims concerning alleged noncompliance with the federal Lacey Act, namely the importation and sale of wood products that were originally harvested in Russia without valid authority. The Company disputes the Plaintiffs' contentions and has vigorously litigated the matter. After the Company filed several motions, the Plaintiffs' agreed to dismiss all claims on behalf of all named plaintiffs for the total amount of $16, inclusive of all costs, fees and expenses. Although the Company firmly believes that the claims lacked merit and that the Company would have prevailed in the litigation, in its estimation, the favorable financial terms warranted agreeing to this settlement.

Two putative class action cases have recently been filed against the Company in the United States District Court for the Northern District of Illinois alleging that Lumber Liquidators unlawfully sent unsolicited facsimile advertisements. On or about March 5, 2014, Richard Wade Architects, P.C. ("RWA") filed a lawsuit, which was subsequently amended, alleging that Lumber Liquidators violated the Telephone Consumer Protection Act ("TCPA"), the Illinois Consumer Fraud Act and the common law by sending an unsolicited facsimile advertisement to RWA. RWA seeks recourse on its own behalf as well as other similarly situated parties that received unsolicited facsimile advertisements from the Company. Similarly, on or about April 29, 2014, Stonecrafters, Inc. ("Stonecrafters") filed suit on its own behalf and on behalf of other similarly situated parties alleging that Lumber Liquidators violated the TCPA by sending unsolicited facsimiles to Stonecrafters and others. The TCPA provides for recovery of actual damages or five hundred dollars for each violation, whichever is greater. If it is determined that a defendant acted willfully or knowingly in violating the TCPA, the amount of the award may be increased by up to three times the amount provided above. Given the uncertainty of litigation, the preliminary stage of these cases and the legal standards that must be met for, among other things, class certification, the Company cannot reasonably estimate the possible loss or range of loss that may result from this action.

The Company is also, from time to time, subject to claims and disputes arising in the normal course of business. In the opinion of management, while the outcome of any such claims and disputes cannot be predicted with certainty, the Company’s ultimate liability in connection with these matters is not expected to have a material adverse effect on the results of operations, financial position or cash flows.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations.

Cautionary Note Regarding Forward-Looking Statements

This report includes statements of our expectations, intentions, plans and beliefs that constitute “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 and are intended to come within the safe harbor protection provided by those sections. These statements, which involve risks and uncertainties, relate to matters such as sales growth, comparable store net sales, impact of cannibalization, price changes, earnings performance, stock-based compensation expense, margins, return on invested capital, strategic direction, the demand for our products, and store openings. We have used words such as “may,” “will,” “should,” “expects,” “intends,” “plans,” “anticipates,” “believes,” “thinks,” “estimates,” “seeks,” “predicts,” “co “potential” and other similar terms and phrases, including references to assumptions, in this report to identify forward-looking statements. These forward-looking statements are made based on expectations and beliefs concerning future events affecting us and are subject to uncertainties, risks and factors relating to our operations and business environments, all of which are difficult to predict and many of which are beyond our control, that could cause our actual results to differ materially from those matters expressed or implied by these forward-looking statements. These risks and other factors include those listed in this report and in our other reports filed with the Securities and Exchange Commission (“SEC”) including the Item 1A, “Risk Factors,” section of the Form 10-K for the year ended December 31, 2013.

When considering these forward-looking statements, you should keep in mind the cautionary statements in this report and the other documents we file with the SEC. New risks and uncertainties arise from time to time, and we cannot predict those events or how they may affect us. There may also be other factors that we cannot anticipate or that are not described in this report that could cause results to differ materially from our expectations. Forward-looking statements speak only as of the date they are made and we assume no obligation to update them after the date of this report as a result of new information, future events or subsequent developments, except as required by the federal securities laws.

This management discussion should be read in conjunction with the financial statements and notes included in Part I, Item 1. “Financial Statements” of this quarterly report and the audited financial statements and notes and management discussion included in our annual report filed on Form 10-K for the year ended December 31, 2013.

Overview and Trends

Lumber Liquidators is the largest specialty retailer of hardwood flooring in North America. We believe we have achieved a reputation for offering great value, superior service and a broad selection of high-quality hardwood flooring products. We offer an extensive selection of premium hardwood flooring products under multiple proprietary brands at low prices designed to appeal to a diverse customer base. We believe our value proposition to the customer is the most complete and the strongest within a highly-fragmented hardwood flooring market. Sourcing directly from the mill provides the foundation for this value proposition, strengthened by our unique store model and the industry expertise of our people. At March 31, 2014, we sold our products through 331 Lumber Liquidators stores in 46 states in the United States ("U.S.") and in Canada, a call center, websites and catalogs.

Since 2011, we have focused on three strategic initiatives:

- Expanding the base of customers recognizing our value proposition.
- Expanding gross margin through sourcing initiatives, operational efficiencies and supply chain optimization.
- Developing the best people to serve our customers and deliver continuous improvement in our operations.

In 2014, we expect our infrastructure investment to be the largest in our history, as we open key facilities in our supply chain, expand our finishing capacity, explore vertical integration and continue our store base expansion. We expect this investment, combined with an aggressive marketing strategy and certain significant legal and professional fees, to increase selling, general and administrative ("SG&A") expenses more than our 2014 net sales growth. However, we continue to expect full year operating margin expansion due to higher product margins and lower net transportation costs as a percentage of net sales.

Our Customer Demand in Unusually Severe Weather

We sell our products and services principally to existing homeowners, or a contractor on behalf of a homeowner. A flooring purchase is generally a large-ticket, discretionary purchase that most residential homeowners make infrequently. Our research indicates that our customers will often choose to replace their flooring after they have lived in their home for a certain number of years, when a life event occurs such as a change in household members, and/or prior to or shortly after moving into a new home. We believe that due to the average size of the sale and the general infrequency of a hardwood flooring purchase, many of our customers conduct extensive research using multiple channels before making a purchase decision. Further, our research indicates that the average length for a hardwood flooring purchase, from initial interest to sale, is approximately 100 days. We have an integrated multi-channel sales model that enables our stores, call center, website and catalogs to work together in a coordinated manner. Though our customers utilize a range of these services in the decision process, the final sale is most often completed in the store, working with our flooring expert.

In the first quarter of 2014, the winter weather in the U.S. and Canada was unusual in severity, geographic scale and duration. We believe the long purchase cycle for many of our customers was either interrupted or completely suspended during this period in as many as 135 of our 331 store locations in operation at March 31, 2014. A number of consumers may be reprioritizing a range of discretionary purchases, including residential repair and maintenance and lawn/garden. We continue to believe our customer demand over the full year 2014 will not be materially impacted as we recover that which was delayed or suspended. That recovery may last through the end of the third quarter.

In the chart below, we segregate our total first quarter net sales and the percentage change in comparison to the first quarter of 2013 into those stores we believe were significantly impacted by the unusually severe weather from all other stores.