

ETHAN ALLEN INTERIORS INC  
Form 10-Q  
October 24, 2018

**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 September 30, 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.)

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25 Lake Avenue Ext., Danbury, Connecticut  
(Address of principal executive offices)

06811-5386  
(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 and post 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. ☐

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

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

At October 16, 2018, there were 26,569,294 shares of Common Stock, par value \$.01, outstanding.

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## PART I - FINANCIAL INFORMATION

### Item 1. Financial Statements

#### ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

##### Consolidated Balance Sheets

(In thousands)

|                                                | September<br>30, 2018<br>(Unaudited) | June 30,<br>2018 |
|------------------------------------------------|--------------------------------------|------------------|
| <b>ASSETS</b>                                  |                                      |                  |
| Current assets:                                |                                      |                  |
| Cash and cash equivalents                      | \$ 39,590                            | \$ 22,363        |
| Accounts receivable, net                       | 12,772                               | 12,364           |
| Inventories, net                               | 165,719                              | 163,012          |
| Prepaid expenses and other current assets      | 18,211                               | 16,686           |
| Total current assets                           | 236,292                              | 214,425          |
| Property, plant and equipment, net             | 266,650                              | 267,903          |
| Goodwill and other intangible assets           | 45,128                               | 45,128           |
| Other assets                                   | 2,884                                | 2,977            |
| Total assets                                   | \$ 550,954                           | \$ 530,433       |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>    |                                      |                  |
| Current liabilities:                           |                                      |                  |
| Current maturities of long-term debt           | \$ 552                               | \$ 584           |
| Customer deposits                              | 67,576                               | 61,248           |
| Accounts payable                               | 18,807                               | 18,768           |
| Accrued compensation and benefits              | 23,518                               | 18,926           |
| Accrued expenses and other current liabilities | 25,672                               | 21,734           |
| Total current liabilities                      | 136,125                              | 121,260          |
| Long-term debt                                 | 927                                  | 1,096            |
| Other long-term liabilities                    | 23,915                               | 24,207           |
| Total liabilities                              | 160,967                              | 146,563          |
| Shareholders' equity:                          |                                      |                  |
| Common stock                                   | 490                                  | 490              |

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|                                                       |            |            |
|-------------------------------------------------------|------------|------------|
| Additional paid-in-capital                            | 378,078    | 376,950    |
| Less: Treasury stock (at cost)                        | (656,551 ) | (656,551 ) |
| Retained earnings                                     | 672,781    | 669,013    |
| Accumulated other comprehensive income (loss)         | (4,924 )   | (6,171 )   |
| Total Ethan Allen Interiors Inc. shareholders' equity | 389,874    | 383,731    |
| Noncontrolling interests                              | 113        | 139        |
| Total shareholders' equity                            | 389,987    | 383,870    |
| Total liabilities and shareholders' equity            | \$ 550,954 | \$ 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<br>September 30, |           |
|----------------------------------------------|-------------------------------------|-----------|
|                                              | 2018                                | 2017      |
| Net sales                                    | \$187,785                           | \$181,302 |
| Cost of sales                                | 86,335                              | 80,979    |
| Gross profit                                 | 101,450                             | 100,323   |
| Selling, general and administrative expenses | 89,651                              | 88,774    |
| Operating income                             | 11,799                              | 11,549    |
| Interest and other income (expense)          | 26                                  | 56        |
| Interest and other related financing costs   | 53                                  | 185       |
| Income before income taxes                   | 11,772                              | 11,420    |
| Income tax expense                           | 2,932                               | 4,005     |
| Net income                                   | \$8,840                             | \$7,415   |
| Per share data:                              |                                     |           |
| Basic earnings per common share:             |                                     |           |
| Net income per basic share                   | \$0.33                              | \$0.27    |
| Basic weighted average common shares         | 26,539                              | 27,459    |
| Diluted earnings per common share:           |                                     |           |
| Net income per diluted share                 | \$0.33                              | \$0.27    |
| Diluted weighted average common shares       | 26,940                              | 27,756    |
| Comprehensive income:                        |                                     |           |
| Net income                                   | \$8,840                             | \$7,415   |
| Other comprehensive income                   |                                     |           |
| Currency translation adjustment              | 1,247                               | (130 )    |
| Other                                        | (26 )                               | (14 )     |
| Other comprehensive income (loss) net of tax | 1,221                               | (144 )    |
| Comprehensive income                         | \$10,061                            | \$7,271   |

See accompanying notes to consolidated financial statements.

**ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES****Consolidated Statements of Cash Flows (Unaudited)****(In thousands)**

|                                                                                    | Three months<br>ended<br>September 30, |          |
|------------------------------------------------------------------------------------|----------------------------------------|----------|
|                                                                                    | 2018                                   | 2017     |
| <b>Operating activities:</b>                                                       |                                        |          |
| Net income                                                                         | \$8,840                                | \$7,415  |
| Adjustments to reconcile net income to net cash provided by operating activities:  |                                        |          |
| Depreciation and amortization                                                      | 5,000                                  | 5,086    |
| Compensation expense related to share-based payment awards                         | 491                                    | 444      |
| Provision (benefit) for deferred income taxes                                      | 99                                     | 821      |
| (Gain) loss on disposal of property, plant and equipment                           | 12                                     | 346      |
| Other                                                                              | 104                                    | 44       |
| Change in operating assets and liabilities, net of effects of acquired businesses: |                                        |          |
| Accounts receivable                                                                | (408 )                                 | 2,205    |
| Inventories                                                                        | (2,707 )                               | (8,022 ) |
| Prepaid and other current assets                                                   | (1,538 )                               | (2,105 ) |
| Customer deposits                                                                  | 6,328                                  | 6,205    |
| Accounts payable                                                                   | 39                                     | 270      |
| Accrued expenses and other current liabilities                                     | 8,523                                  | 5,182    |
| Other assets and liabilities                                                       | (343 )                                 | (259 )   |
| Net cash provided by operating activities                                          | 24,440                                 | 17,632   |
| <b>Investing activities:</b>                                                       |                                        |          |
| Proceeds from the disposal of property, plant & equipment                          | -                                      | 4        |
| Capital expenditures                                                               | (2,777 )                               | (2,653 ) |
| Other investing activities                                                         | 32                                     | 47       |
| Net cash provided by (used in) investing activities                                | (2,745 )                               | (2,602 ) |
| <b>Financing activities:</b>                                                       |                                        |          |
| Payments on long-term debt and capital lease obligations                           | (165 )                                 | (14,059) |
| Purchases and retirements of company stock                                         | -                                      | (1,100 ) |
| Payment of cash dividends                                                          | (5,065 )                               | (5,239 ) |
| Other financing activities                                                         | 637                                    | 4        |
| Net cash provided by (used in) financing activities                                | (4,593 )                               | (20,394) |
| Effect of exchange rate changes on cash                                            | 125                                    | 107      |
| Net increase (decrease) in cash, cash equivalents, and restricted cash             | 17,227                                 | (5,257 ) |
| Cash, cash equivalents, and restricted cash at beginning of period                 | 22,363                                 | 65,031   |

|                                                              |          |          |
|--------------------------------------------------------------|----------|----------|
| Cash, cash equivalents, and restricted cash at end of period | \$39,590 | \$59,774 |
|--------------------------------------------------------------|----------|----------|

See accompanying notes to consolidated financial statements.

**ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES**

**Consolidated Statements of Shareholders' Equity**

**Three Months Ended September 30, 2018**

**(Unaudited)**

**(In thousands)**

|                                                         | Common<br>Stock | Additional<br>Paid-in<br>Capital | Treasury<br>Stock | Accumulated<br>Other<br>Comprehensive<br>Income<br>(loss) | Retained<br>Earnings | Non-<br>Controlling<br>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                      | -               | 637                              | -                 | -                                                         | -                    | -                                | 637       |
| Compensation expense associated with share-based awards | -               | 491                              | -                 | -                                                         | -                    | -                                | 491       |
| Dividends declared on common stock                      | -               | -                                | -                 | -                                                         | (5,072 )             | -                                | (5,072 )  |
| Comprehensive income                                    | -               | -                                | -                 | 1,247                                                     | 8,840                | (26 )                            | 10,061    |
| Balance at September 30, 2018                           | \$ 490          | \$378,078                        | \$(656,551)       | \$ (4,924 )                                               | \$672,781            | \$ 113                           | \$389,987 |

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 months ended September 30, 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's consolidated effective tax rate was 24.9% for the three months ended September 30, 2018 and 35.1% for the three months ended September 30, 2017. The current period's effective tax rate primarily includes tax expense on the taxable year's net income, tax expense on the cancelation of stock options, and tax and interest expense on uncertain tax positions. The prior period's effective tax rate primarily includes tax expense on the taxable year's net income, and tax and interest expense on uncertain tax positions partially offset by the tax benefit on the vesting of restricted stock units.

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

On December 22, 2017 H.R. 1, originally known as the Tax Cuts and Jobs Act, (the “Tax Act”) was enacted. Among the significant changes to the U.S. Internal Revenue Code, the Tax Act lowers the U.S. federal corporate income tax rate (“Federal Tax Rate”) from 35% to 21% effective January 1, 2018, introduces a limitation on the deduction of certain interest expenses, introduces a deduction for certain business capital expenditures and introduces a system of taxing foreign-sourced income from multinational corporations. The Company computed its income tax expense for the June 30, 2018 fiscal year using a blended Federal Tax Rate of 28%. The 21% Federal Tax Rate will apply to fiscal years ending June 30, 2019 and each year thereafter. Following is a reconciliation of income tax expense (benefit) computed by applying the federal statutory income tax rate to income before taxes to actual tax expense (benefit):

|                                                | Three months ended |        |
|------------------------------------------------|--------------------|--------|
|                                                | September 30, 2018 |        |
| Income before income taxes                     | \$11.8             |        |
| Expected income tax expense                    | \$2.5              | 21.0%  |
| State income taxes, net of federal income tax  | 0.4                | 3.1 %  |
| Stock Compensation - Cancellations & exercises | 0.1                | 1.2 %  |
| Other, net                                     | (0.0 )             | -0.4 % |
| Total                                          | \$2.9              | 24.9%  |

**(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.

|                           | September 30, 2018 | June 30, 2018 | September 30, 2017 | June 30, 2017 |
|---------------------------|--------------------|---------------|--------------------|---------------|
| Cash and cash equivalents | \$ 39,590          | \$22,363      | \$ 52,728          | \$57,701      |
| Restricted cash           | -                  | -             | 7,046              | 7,330         |

Total cash, cash equivalents, and restricted cash    \$ 39,590    \$22,363    \$ 59,774    \$65,031

## (5) Inventories

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

|                     | September<br>30,<br>2018 | June 30,<br>2018 |
|---------------------|--------------------------|------------------|
| Finished goods      | \$ 127,724               | \$ 124,640       |
| Work in process     | 12,224                   | 12,057           |
| Raw materials       | 27,098                   | 27,947           |
| Valuation allowance | (1,327 )                 | (1,632 )         |
| Inventories         | \$ 165,719               | \$ 163,012       |

## (6) Borrowings

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

|                         | September<br>30,<br>2018 | June<br>30,<br>2018 |
|-------------------------|--------------------------|---------------------|
| Capital leases          | \$ 1,479                 | \$ 1,680            |
| Total debt              | 1,479                    | 1,680               |
| Less current maturities | 552                      | 584                 |
| Total long-term         | \$ 927                   | \$ 1,096            |

The Company entered into a five year, \$150 million senior secured revolving credit and term loan facility on October 21, 2014, as amended (the “Facility”). The Company intends to use the Facility for working capital and general corporate purposes, including dividend payments and share repurchases. The Facility, which expires on October 21, 2019, provided a single-draw term loan of \$35 million and a revolving credit line of up to \$115 million, subject to borrowing base availability. We incurred financing costs of \$1.5 million under the Facility, which are being amortized by the interest method, over the remaining life of the Facility.

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

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

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 1.75%, or (b) the higher of (i) the prime rate, (ii) the federal funds effective rate plus 0.50%, or (iii) LIBOR plus 1.0% plus in each case 0.5% to 0.75%.

The Company pays a commitment fee of 0.15% to 0.25% per annum on the unused portion of the Facility, and fees on issued letters of credit at an annual rate of 1.5% to 1.75% based on the average availability. Certain payments are restricted if the availability under the revolving credit line falls below 20% of the total revolving credit line, and the Company is subject to pro forma compliance with the fixed charge coverage ratio if applicable.

In fiscal 2018 the Company repaid the remaining balance of \$13.8 million on the term loan with excess operating cash.

The Facility is secured by all property owned, leased or operated by the Company in the United States and includes certain real property owned by the Company and contains customary covenants which may limit the Company's ability to incur debt; engage in mergers and consolidations; make restricted payments (including dividends and share repurchases); sell certain assets; and make investments.

The Facility includes a covenant that requires the Company to maintain a minimum fixed charge coverage ratio of 1.1 to 1.0 at all times unless the outstanding term loan is less than \$17.5 million and the fixed charge coverage ratio equals or exceeds 1.25 to 1.0, in which case the fixed charge coverage ratio ceases to apply and thereafter is only triggered if average monthly availability is less than 15% of the amount of the revolving credit line. The Company has met the exemption conditions and is currently exempt from the fixed charge coverage ratio covenant.

At both September 30, 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 \$108.8 million at both September 30, 2018 and June 30, 2018.

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

The following table summarizes, as of September 30, 2018, the timing of cash payments related to our outstanding long-term debt obligations for the remaining nine 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                          | \$413   |
| 2020                          | 550     |
| 2021                          | 437     |
| 2022                          | 59      |
| 2023                          | 20      |
| 2024 and thereafter           | -       |
| Total scheduled debt payments | \$1,479 |

## **(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.

## ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements (Unaudited)

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 U.S. GAAP. 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.

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 three months ended September 30, 2018 is presented below:

|                                      | Shares    |
|--------------------------------------|-----------|
| Outstanding as of June 30, 2018      | 561,595   |
| Granted                              | 25,590    |
| Exercised                            | (40,000 ) |
| Canceled (forfeited/expired)         | (91,066 ) |
| Outstanding as of September 30, 2018 | 456,119   |
| Exercisable as of September 30, 2018 | 339,687   |

A summary of non-vested stock unit award activity occurring during the three months ended September 30, 2018 is presented below.

|                                        | Units     | Weighted<br>Average<br>Grant<br>Date<br>Fair<br>Value |
|----------------------------------------|-----------|-------------------------------------------------------|
| Non-vested units at June 30, 2018      | 330,369   | \$ 26.15                                              |
| Granted                                | 107,204   | 18.60                                                 |
| Vested                                 | -         | -                                                     |
| Canceled (forfeited/expired)           | (22,758 ) | 24.06                                                 |
| Non-vested units at September 30, 2018 | 414,815   | \$ 24.31                                              |

At September 30, 2018, there were 1,428,669 shares of common stock available for future issuance pursuant to the Stock Incentive Plan.

# ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

## Notes to Consolidated Financial Statements (Unaudited)

### (9) Earnings Per Share

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

|                                                                                       | Three months ended September 30, |        |
|---------------------------------------------------------------------------------------|----------------------------------|--------|
|                                                                                       | 2018                             | 2017   |
| Weighted average shares of common stock outstanding for basic calculation             | 26,539                           | 27,459 |
| Effect of dilutive stock options and other share-based awards                         | 401                              | 297    |
| Weighted average shares of common stock outstanding adjusted for dilution calculation | 26,940                           | 27,756 |

As of September 30, 2018 and 2017, stock options to purchase 279 and 338 common shares, respectively, were excluded from the respective diluted earnings per share calculations because their impact was anti-dilutive.

### (10) Accumulated Other Comprehensive Income

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 September 30, 2018 (in thousands).

|                                  |           |
|----------------------------------|-----------|
| Balance June 30, 2018            | \$(6,171) |
| Changes before reclassifications | \$1,247   |
| Amounts reclassified from        | \$-       |

|                |           |
|----------------|-----------|
| accumulated    |           |
| other          |           |
| comprehensive  |           |
| income         |           |
| Current period |           |
| other          | \$ 1,247  |
| comprehensive  |           |
| income (loss)  |           |
| Balance        |           |
| September 30,  | \$(4,924) |
| 2018           |           |

### (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 September 30, 2018, the Company operated 147 design centers (our retail segment) and our independent retailers operated 153 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 77% of our consolidated net sales in the three months ended September 30, 2018. Our wholesale segment net sales accounted for 23%.

# ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

## Notes to Consolidated Financial Statements (Unaudited)

Segment information for the three months ended September 30, 2018 and 2017 is provided below (in thousands):

|                                    | Three months ended<br>September 30, |            |
|------------------------------------|-------------------------------------|------------|
|                                    | 2018                                | 2017       |
| <b>Net sales:</b>                  |                                     |            |
| Wholesale segment                  | \$ 118,072                          | \$ 111,587 |
| Retail segment                     | 145,214                             | 141,575    |
| Elimination of inter-company sales | (75,501 )                           | (71,860 )  |
| Consolidated Total                 | \$ 187,785                          | \$ 181,302 |

|                                        |           |           |
|----------------------------------------|-----------|-----------|
| <b>Operating income:</b>               |           |           |
| Wholesale segment                      | \$ 14,315 | \$ 13,462 |
| Retail segment                         | (1,559 )  | (2,773 )  |
| Adjustment of inter-company profit (1) | (957 )    | 860       |
| Consolidated Total                     | \$ 11,799 | \$ 11,549 |

|                                         |          |          |
|-----------------------------------------|----------|----------|
| <b>Depreciation &amp; Amortization:</b> |          |          |
| Wholesale segment                       | \$ 1,961 | \$ 1,987 |
| Retail segment                          | 3,039    | 3,099    |
| Consolidated Total                      | \$ 5,000 | \$ 5,086 |

|                              |          |          |
|------------------------------|----------|----------|
| <b>Capital expenditures:</b> |          |          |
| Wholesale segment            | \$ 850   | \$ 751   |
| Retail segment               | 1,927    | 1,902    |
| Consolidated Total           | \$ 2,777 | \$ 2,653 |

|                                  | September<br>30,<br>2018 | June 30,<br>2018 |
|----------------------------------|--------------------------|------------------|
| <b>Total Assets:</b>             |                          |                  |
| Wholesale segment                | \$ 259,199               | \$ 241,616       |
| Retail segment                   | 321,106                  | 317,590          |
| Inventory profit elimination (2) | (29,351 )                | (28,773 )        |
| Consolidated Total               | \$ 550,954               | \$ 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 September 30, 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 as within current liabilities on our Consolidated Balance Sheet. At the beginning of fiscal 2019, we had \$61.2 million of Customer Deposits. During the quarter ended September 30, 2018, we recognized revenue of \$46.7 million related to our Customer Deposits.

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 quarter September 30, 2018:

| <b>(Unaudited, amounts in thousands)</b> | <b>Wholesale</b> | <b>Retail</b> | <b>Total</b> |
|------------------------------------------|------------------|---------------|--------------|
| Upholstery furniture                     | \$ 58,792        | \$64,147      | \$122,939    |
| Case goods furniture                     | 39,993           | 42,476        | 82,469       |
| Accents                                  | 20,426           | 33,455        | 53,881       |
| Other                                    | (1,139 )         | 5,136         | 3,997        |
| Total                                    | \$ 118,072       | \$145,214     | 263,286      |
| Eliminations                             |                  |               | (75,501 )    |
| Consolidated Net Sales                   |                  |               | \$187,785    |

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

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

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 negation of 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.

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.

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

### **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. Our GSA business 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. In the spring and summer of 2018, we launched our new Uptown collection, featuring a modern perspective on classic designs.

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. Consequently, our first quarter fiscal 2018 advertising expense increased by 12.8% over the same prior year period.

While we implement major product introductions, such as the introductions described above, our wholesale segment experiences some disruptions in manufacturing as we change tooling and manufacturing methods, build prototypes and then ramp up production. In our retail segment, some disruption also occurs in our design centers as we update floor displays, and sell the remainder of our older products on clearance to make space for the new product. These disruptions may affect sales and expenses.

Sales increases of 5.8% for wholesale and 2.6% for retail combined to increase gross profit by \$1.1 million. Gross margin was below the prior year, primarily due to increased raw material costs, which reduced gross profit by \$0.8 million and the retail sales mix in relation to total sales, which was 77.3% in the current quarter compared to 78.1% in the comparable prior year period. Operating expenses increased in total due to increases in advertising and distribution expenses, and decreased as a percentage of sales. Income taxes were reduced due to the changes resulting from the U.S. Tax Cuts and Jobs Act enacted in December 2017, with an effective tax rate of 24.9% in the current quarter compared to 35.1% in the prior year. The net result was an increase in earnings per diluted share of \$0.06.



**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 month period ended September 30, 2018 to the comparable prior year fiscal three month period (\$ in millions except per share amounts).

|                                              | Three months ended September 30, |        |  |         |        |  |
|----------------------------------------------|----------------------------------|--------|--|---------|--------|--|
|                                              | 2018                             | %      |  | 2017    | %      |  |
| Net sales                                    | \$187.8                          | 100.0% |  | \$181.3 | 100.0% |  |
| Gross profit                                 | 101.5                            | 54.0 % |  | 100.3   | 55.3 % |  |
| Selling, general and administrative expenses | 89.7                             | 47.7 % |  | 88.8    | 49.0 % |  |
| Operating income                             | 11.8                             | 6.3 %  |  | 11.5    | 6.4 %  |  |
| Net income                                   | 8.8                              | 4.7 %  |  | 7.4     | 4.1 %  |  |
| Earnings per diluted share                   | \$0.33                           |        |  | \$0.27  |        |  |
| Net cash provided by operating activities    | \$24.4                           |        |  | \$17.6  |        |  |

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

|                                           | Three months ended September 30, |          |
|-------------------------------------------|----------------------------------|----------|
|                                           | 2018                             | 2017     |
| Net sales                                 | 3.6 %                            | (6.2 %)  |
| Operating income                          | 2.2 %                            | (37.0 %) |
| Net income                                | 19.2 %                           | (35.7 %) |
| Earnings per diluted share                | 22.2 %                           | (34.1 %) |
| Net cash provided by operating activities | 38.6 %                           | (35.9 %) |

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

|                                         | Three months<br>ended<br>September 30, |         |
|-----------------------------------------|----------------------------------------|---------|
|                                         | 2018                                   | 2017    |
| <b>Revenue:</b>                         |                                        |         |
| Wholesale segment                       | \$118.1                                | \$111.6 |
| Retail segment                          | 145.2                                  | 141.6   |
| Elimination of inter-segment sales      | (75.5 )                                | (71.9 ) |
| Consolidated revenue                    | \$187.8                                | \$181.3 |
| <b>Operating income (loss):</b>         |                                        |         |
| Wholesale segment                       | \$14.3                                 | \$13.5  |
| Retail segment                          | (1.6 )                                 | (2.8 )  |
| Adjustment for inter-company profit (1) | (0.9 )                                 | 0.8     |
| Consolidated operating income           | \$11.8                                 | \$11.5  |

(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<br>ended<br>September 30,<br>2018 |    |       |    | 2017 |
|--------------------------|------------------------------------------------|----|-------|----|------|
| <b>Wholesale segment</b> |                                                |    |       |    |      |
| Revenue                  | 5.8                                            | %  | (2.6  | %) |      |
| Operating Income         | 6.3                                            | %  | (18.4 | %) |      |
| Backlog                  | (21.6                                          | %) | 50.7  | %  |      |

|                                         | Three months<br>ended<br>September 30,<br>2018 |    |        |    | 2017 |
|-----------------------------------------|------------------------------------------------|----|--------|----|------|
| <b>Retail segment</b>                   |                                                |    |        |    |      |
| Revenue                                 | 2.6                                            | %  | (7.0   | %) |      |
| Comparable design center revenue        | 0.8                                            | %  | (8.8   | %) |      |
| Total written orders                    | (0.2                                           | %) | 1.7    | %  |      |
| Comparable design center written orders | (2.1                                           | %) | 0.5    | %  |      |
| Operating Income                        | 43.8                                           | %  | (371.1 | %) |      |
| Backlog                                 | (4.7                                           | %) | 10.4   | %  |      |

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. International net sales as a percent of our consolidated net sales were 7.9% in the current year quarter and 11.0% in the prior year quarter. The following tables show selected design center location information.

|                                            | Fiscal 2019              |                      |       | Fiscal 2018              |                      |       |
|--------------------------------------------|--------------------------|----------------------|-------|--------------------------|----------------------|-------|
|                                            | Independent<br>retailers | Company-<br>operated | Total | Independent<br>retailers | Company-<br>operated | Total |
| Retail Design Center location activity:    |                          |                      |       |                          |                      |       |
| Balance at beginning of period             | 148                      | 148                  | 296   | 155                      | 148                  | 303   |
| New locations                              | 6                        | -                    | 6     | 3                        | 2                    | 5     |
| Closures                                   | (1 )                     | (1 )                 | (2 )  | (2 )                     | -                    | (2 )  |
| Transfers                                  | -                        | -                    | -     | -                        | -                    | -     |
| Balance at end of period                   | 153                      | 147                  | 300   | 156                      | 150                  | 306   |
| Relocations (in new and closures)          | -                        | -                    | -     | -                        | -                    | -     |
| Retail Design Center geographic locations: |                          |                      |       |                          |                      |       |
| United States                              | 43                       | 141                  | 184   | 48                       | 144                  | 192   |
| Canada                                     | -                        | 6                    | 6     | -                        | 6                    | 6     |
| China                                      | 92                       | -                    | 92    | 83                       | -                    | 83    |
| Other Asia                                 | 10                       | -                    | 10    | 12                       | -                    | 12    |
| Europe                                     | 1                        | -                    | 1     | 6                        | -                    | 6     |
| Middle East                                | 7                        | -                    | 7     | 7                        | -                    | 7     |
| Total                                      | 153                      | 147                  | 300   | 156                      | 150                  | 306   |

## ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

### *First Quarter Ended September 30, 2018 Compared to First Quarter Ended September 30, 2017*

**Consolidated net sales** for the quarter of \$187.8 million compared to \$181.3 million for the same period in the prior year, an increase of 3.6%. Wholesale segment sales increased largely due to increased GSA contract orders. Manufacturing production levels were strong during the quarter, without the previous year disruptions from first production runs that had caused shipping delays, which helped drive stronger shipments to the retail segment and contributed to increased retail segment sales.

**Retail net sales** for the quarter of \$145.2 million compared to \$141.6 million for the prior year period, an increase of 2.6%. Comparative retail net sales increased 0.8%. There were 147 Company-operated design centers during the quarter, down from 150 in the prior year quarter. There was a 4.1% increase in sales in the U.S., while sales from the Canadian design centers decreased 28.0%. We believe this decrease in Canadian design center sales is related to the economic uncertainty surrounding current international trade disputes. Total written business (new orders booked) decreased 0.2%, with a decrease in Canada partly offset by an increase in the U.S. written business. Comparable design center written business in the quarter decreased 2.1% in total, primarily attributable to a decrease in Canada.

**Wholesale net sales** for the quarter of \$118.1 million compared to \$111.6 million for the prior year period, an increase of 5.8%. The increase in sales is due to increases to our GSA contract business, partially offset by decreases to our international retailers.

**Gross profit** for the quarter of \$101.5 million compared to \$100.3 million for the prior year period, an increase of 1.1%, with an increase in both our retail and wholesale segments. Gross profit for wholesale increased due to higher sales volume, partly offset by an increase in raw materials costs of \$0.8 million. Consolidated gross margin for the quarter was 54.0% compared to 55.3%. Retail sales as a percent of total consolidated sales was 77.3% for the quarter compared to 78.1% in the prior year quarter, decreasing our consolidated gross margin due to this reduced percentage.

**Operating expenses** for the quarter of \$89.7 million, or 47.7% of net sales, increased \$0.9 million compared to \$88.8 million, or 49.0% of net sales, for the prior year period. The 1.0% increase to prior year was primarily due to increased freight, distribution and warehouse costs of \$1.5 million due to increased sales, and an increase in advertising of \$0.9 million, partly offset by prior year organizational changes and other exit costs of \$0.8 that did not recur this year.

**Operating income and profit margin** for the quarter of \$11.8 million, or 6.3% of net sales, compared to \$11.5 million, or 6.4% of net sales, for the prior year period. The primary causes for the 2.2% increase in operating income were the increased sales in wholesale and retail and prior year organizational changes that did not recur, partly offset by increased variable costs of freight, distribution and warehouse costs associated with increased sales, and increased raw material costs, as discussed previously.

**Retail operating income** for the quarter of a loss of \$1.6 million, or -1.1% of sales, compared to a loss of \$2.8 million, or -2.0% of sales, for the prior year period. The lower operating loss and improved margin in the current quarter was driven primarily by the improved sales in the current year period.

**Wholesale operating income** for the quarter of \$14.3 million, or 12.1% of sales, compared to \$13.5 million, or 12.1% of sales, for the prior year period. The increase was largely due to the increase in current period net sales, partly offset by raw material cost increases as discussed above.

**Income tax expense** for the quarter totaled \$2.9 million compared to \$4.0 million. Our effective tax rate was 24.9% in the quarter compared to 35.1%. The effective tax rate for the quarter was lower due to the changes introduced by the U.S. Tax Cuts and Jobs Act enacted in December 2017. The effective tax rate for the first quarter of fiscal 2019 primarily includes tax expense on that quarter's net income, tax expense on cancellation of stock options, and tax and interest expense on uncertain tax positions. The effective tax rate for the first quarter of fiscal 2018 primarily includes tax expense on that quarter's net income, and tax and interest expense on uncertain tax positions, partially offset by the tax benefit on the vesting of restricted stock units. See Note 3, Income Taxes, for further information.

**Net income** for the quarter of \$8.8 million compared to \$7.4 million for the prior year period an increase of 19.2%. This resulted in net income per diluted share for the quarter of \$0.33 compared to \$0.27, an increase of 22.2%.

## **Liquidity and Capital Resources**

At September 30, 2018, we held cash and cash equivalents of \$39.6 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.

## ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

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 three months ended September 30, 2018 and 2017 is provided below (in millions):

|                                                          | Three months<br>ended<br>September 30,<br>2018 2017 |           |
|----------------------------------------------------------|-----------------------------------------------------|-----------|
| <b>Cash provided by (used in) operating activities</b>   |                                                     |           |
| Net income plus depreciation and amortization            | \$13.8                                              | \$12.5    |
| Working capital items                                    | 10.2                                                | 3.7       |
| Other operating activities                               | 0.4                                                 | 1.4       |
| Total provided by operating activities                   | \$24.4                                              | \$17.6    |
| <b>Cash provided by (used in) investing activities</b>   |                                                     |           |
| Capital expenditures and acquisitions                    | \$(2.8 )                                            | \$(2.7 )  |
| Other investing activities                               | 0.1                                                 | 0.1       |
| Total provided by (used in) investing activities         | \$(2.7 )                                            | \$(2.6 )  |
| <b>Cash provided by (used in) financing activities</b>   |                                                     |           |
| Payments on long-term debt and capital lease obligations | \$(0.2 )                                            | \$(14.1 ) |
| Payment of cash dividends                                | (5.1 )                                              | (5.2 )    |
| Purchase/retirement of company stock                     | -                                                   | (1.1 )    |
| Other financing activities                               | 0.7                                                 | -         |
| Total provided by (used in) financing activities         | \$(4.6 )                                            | \$(20.4 ) |

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

Year-to-date, cash of \$24.4 million was provided by operating activities, an increase of \$6.8 million. This was largely due to changes in the ordinary course of business for working capital items, primarily an inventory increase 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).

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

Year-to-date, \$2.7 million of cash was used in investing activities, an increase of \$0.1 million. Capital expenditures remained consistent with the prior year. Current year capital expenditures 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, \$4.6 million was used in financing activities, which is \$15.8 million less cash used than the \$20.4 million of cash used during the first three 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 \$5.1 million compared to \$5.2 million in the prior year to date period, paying \$0.19 per share in both periods. 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.

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

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 payments of principal and interest on our debt, to permit anticipated capital expenditures, and to fund working capital and other cash requirements. As of September 30, 2018, we had working capital of \$100.2 million compared to \$93.2 million at June 30, 2018, an increase of \$7.0 million, or 7.5%. The Company had a current ratio of 1.74 to 1 at September 30, 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 three months ending September 30, 2018 there were no share repurchases.

At September 30, 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**

There has been no 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 September 30, 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, but includes a provision for automatic one-year renewals unless either party gives notice of 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 September 30, 2018 and June 30, 2018, we were in compliance with such covenant.

### **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 September 30, 2018 and June 30, 2018 the Company's product warranty liability totaled \$1.5 million.

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

### **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](http://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 shorter lead times and is the most effective approach to ensuring that acceptable levels of quality, service and value are attained.

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.

### **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, the ASU 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.

### **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).

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

### **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 September 30, 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 September 30, 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 September 30, 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.

## **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 September 30, 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.

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

### **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 September 30, 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.

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**ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES**

**Item 6. Exhibits**

| Exhibit<br>Number | Description                                                                                                                                                    |
|-------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 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.

## 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: October 24, 2018 BY: /s/ M. Farooq Kathwari  
M. Farooq Kathwari  
Chairman, President and Chief Executive Officer  
(Principal Executive Officer)

Date: October 24, 2018 BY: /s/ Corey Whitely  
Corey Whitely  
Executive Vice President Administration  
  
Chief Financial Officer and Treasurer  
(Principal Financial Officer)