

ETHAN ALLEN INTERIORS INC  
Form 10-Q  
April 27, 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 March 31, 2018

**OR**

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

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

Commission File Number: 1-11692

Ethan Allen Interiors Inc

(Exact name of registrant as specified in its charter)

Delaware

06-1275288

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(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

25 Lake Avenue Ext., Danbury, Connecticut 06811-5386  
(Address of principal executive offices) (Zip Code)

(203) 743-8000

(Registrant's telephone number, including area code)

N/A

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T 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.

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 April 17, 2018, there were 27,190,407 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)****ETHAN ALLEN  
INTERIORS  
INC. AND  
SUBSIDIARIES  
Consolidated  
Balance Sheets  
(In thousands)**

	March 31, 2018 (Unaudited)	June 30, 2017
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 44,977	\$57,701
Accounts receivable, less allowance for doubtful accounts of \$1,710 at March 31, 2018 and \$1,667 at June 30, 2017	15,933	12,293
Inventories	163,748	149,483
Prepaid expenses and other current assets	19,356	23,621
Total current assets	244,014	243,098
Property, plant and equipment, net	265,122	270,198
Goodwill and other intangible assets	45,128	45,128
Restricted cash and investments	7,086	7,330
Other assets	3,207	2,468
Total assets	\$ 564,557	\$568,222

**LIABILITIES AND SHAREHOLDERS' EQUITY**

Current liabilities:		
Current maturities of long-term debt	\$ 586	\$2,731
Customer deposits	67,626	62,960
Accounts payable	24,680	16,961
Accrued compensation and benefits	22,089	20,352
Accrued expenses and other current liabilities	22,228	23,441
Total current liabilities	137,209	126,445
Long-term debt	1,119	11,608
Other long-term liabilities	24,830	29,273
Total liabilities	163,158	167,326
Shareholders' equity:		
Common stock	490	490
Additional paid-in-capital	376,911	377,550
Less: Treasury stock (at cost)	(634,532 )	(635,179)
Retained earnings	662,581	661,976
Accumulated other comprehensive income (loss)	(4,202 )	(4,131 )
Total Ethan Allen Interiors Inc. shareholders' equity	401,248	400,706
Noncontrolling interests	151	190
Total shareholders' equity	401,399	400,896
Total liabilities and shareholders' equity	\$ 564,557	\$ 568,222

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 March 31,		Nine months ended March 31,	
	2018	2017	2018	2017
Net sales	\$181,419	\$180,501	\$561,202	\$568,460
Cost of sales	84,711	85,766	256,380	257,134
Gross profit	96,708	94,735	304,822	311,326
Selling, general and administrative expenses	92,835	90,815	271,862	271,975
Operating income	3,873	3,920	32,960	39,351
Interest and other income (expense)	(16 )	(77 )	223	248
Interest and other related financing costs	54	302	272	949
Income before income taxes	3,803	3,541	32,911	38,650
Income tax expense	1,187	1,259	8,018	14,139
Net income	\$2,616	\$2,282	\$24,893	\$24,511
Per share data:				
Basic earnings per common share:				
Net income per basic share	\$0.10	\$0.08	\$0.91	\$0.89
Basic weighted average common shares	27,476	27,691	27,469	27,694
Diluted earnings per common share:				
Net income per diluted share	\$0.09	\$0.08	\$0.90	\$0.88
Diluted weighted average common shares	27,692	27,953	27,725	27,970
Comprehensive income:				
Net income	\$2,616	\$2,282	\$24,893	\$24,511
Other comprehensive income				
Currency translation adjustment	1,451	1,998	(71 )	(213 )
Other	(7 )	3	(39 )	(20 )
Other comprehensive income (loss) net of tax	1,444	2,001	(110 )	(233 )
Comprehensive income	\$4,060	\$4,283	\$24,783	\$24,278

See accompanying notes to consolidated financial statements.





## ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

## Consolidated Statements of Cash Flows (Unaudited)

(In thousands)

	Nine months ended March 31,	
	2018	2017
<b>Operating activities:</b>		
Net income	\$24,893	\$24,511
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	14,955	15,023
Compensation expense related to share-based payment awards	967	2,161
Provision (benefit) for deferred income taxes	(342 )	4,373
(Gain) loss on disposal of property, plant and equipment	191	915
Other	(11 )	(73 )
Change in operating assets and liabilities, net of effects of acquired businesses:		
Accounts receivable	(3,640 )	(977 )
Inventories	(14,265)	8,098
Prepaid and other current assets	278	(1,158 )
Customer deposits	4,666	(431 )
Accounts payable	7,719	180
Accrued expenses and other current liabilities	519	(718 )
Other assets and liabilities	(840 )	1,865
Net cash provided by operating activities	35,090	53,769
<b>Investing activities:</b>		
Proceeds from the disposal of property, plant & equipment	327	1,261
Change in restricted cash and investments	244	503
Capital expenditures	(9,121 )	(15,112)
Other investing activities	154	121
Net cash provided by (used in) investing activities	(8,396 )	(13,227)
<b>Financing activities:</b>		
Payments on long-term debt and capital lease obligations	(14,306)	(12,602)
Purchases and retirements of company stock	(1,100 )	(3,368 )
Payment of cash dividends	(24,283)	(14,745)
Other financing activities	141	1,180
Net cash provided by (used in) financing activities	(39,548)	(29,535)
Effect of exchange rate changes on cash	130	11
Net increase (decrease) in cash & cash equivalents	(12,724)	11,018
Cash & cash equivalents at beginning of period	57,701	52,659
Cash & cash equivalents at end of period	\$44,977	\$63,677

See accompanying notes to consolidated financial statements.

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## ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

## Consolidated Statements of Shareholders' Equity

Nine Months Ended March 31, 2018

(Unaudited)

(In thousands)

	Common Stock	Additional Paid-in Capital	Treasury Stock	Accumulated Other Comprehensive Income (loss)	Retained Earnings	Non- Controlling Interests	Total
Balance at June 30, 2017	\$ 490	\$ 377,550	\$ (635,179)	\$ (4,131)	\$ 661,976	\$ 190	\$ 400,896
Stock issued on share-based awards	-	141	-	-	-	-	141
Compensation expense associated with share-based awards	-	967	-	-	-	-	967
Purchase/retirement of company stock	-	(1,747)	647	-	-	-	(1,100)
Dividends declared on common stock	-	-	-	-	(24,288)	-	(24,288)
Comprehensive income	-	-	-	(71)	24,893	(39)	24,783
Balance at March 31, 2018	\$ 490	\$ 376,911	\$ (634,532)	\$ (4,202)	\$ 662,581	\$ 151	\$ 401,399

See accompanying notes to consolidated financial statements.

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

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

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

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

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

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

In our opinion, all adjustments, consisting only of normal recurring adjustments necessary for fair presentation, have been included in the consolidated financial statements. The results of operations for the *three* and *nine* months ended *March 31, 2018* are *not* necessarily indicative of results that *may* be expected for the entire fiscal year. The interim consolidated financial statements should be read in conjunction with the consolidated financial statements and accompanying notes included in our Annual Report on Form *10-K* for the year ended *June 30, 2017*.

#### **(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 2013 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 31.2% and 24.4% for the *three* and *nine* months ended *March 31, 2018* and 35.6% and 36.6% for the *three* and *nine* months ended *March 31, 2017*. The current period's effective tax rate primarily includes tax expense on the taxable year's net income, re-measurement of deferred tax assets and liabilities, and tax and interest expense on uncertain tax positions, partially offset by the reversal of and recognition of some 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 reversal and recognition of some uncertain tax positions.

Effective *July 1, 2017* the Company adopted ASU 2015-17, Balance Sheet Classification of Deferred Taxes, which requires the Company to present all deferred tax assets and liabilities as noncurrent. The Company has applied the new guidance prospectively and accordingly the prior periods balance sheets were *not* retrospectively adjusted. The adoption did *not* have a material impact on the Company's consolidated results of operations, cash flows or financial position.

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 will compute 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.

## ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

## Notes to Consolidated Financial Statements (Unaudited)

The 28% Federal Tax Rate will apply to earnings reported for the full 2018 fiscal year. Accordingly, *first* quarter income previously subject to tax at the 35% Federal Tax Rate will benefit from the 28% Federal Tax Rate. The Company must re-measure its net deferred tax assets and liabilities using the Federal Tax Rate that will apply when these amounts are expected to reverse. The effect of the re-measurement is reflected entirely in the interim period that includes the enactment date and is allocated directly to income tax expense from continuing operations.

In *December 2017*, the Securities and Exchange Commission staff issued Staff Accounting Bulletin *No. 118*, Income Tax Accounting Implications of the Tax Cuts and Jobs Act” (“SAB 118”) which addresses how a company recognizes provisional amounts when a company does *not* have the necessary information available, prepared or analyzed (including computations) in reasonable detail to complete its accounting for the effect of the changes in the Tax Act. The measurement period ends when a company has obtained, prepared and analyzed the information necessary to finalize its accounting, but cannot extend beyond *one* year.

As of *March 31, 2018*, the Company can determine a reasonable estimate for certain effects of tax reform and is recording that estimate as a provisional amount. The provisional re-measurement of the deferred tax assets and liabilities was adjusted downward from \$2.6 million at *December 31, 2017* to \$2.4 million at *March 31, 2018* by recording a \$200K discrete tax expense which increased the effective tax rate by 5.4% in the quarter. For the fiscal year to date the provisional re-measurement has resulted in a discrete tax benefit of 7.2%. As permitted under SAB 118, we will complete the required analyses and accounting during the year ending *June 30, 2018*. The provisional re-measurement amount is anticipated to change as data becomes available allowing more accurate scheduling of the deferred tax assets and liabilities primarily related to depreciable assets, inventory, employee compensation and commissions. 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		Nine months ended	
	March 31, 2018		March 31, 2018	
Income before income taxes	\$3.8		\$32.9	
Expected income tax expense	\$1.1	28.0%	\$9.2	28.0%
Provisional remeasurement of deferred taxes	0.2	5.4 %	(2.4)	-7.2 %
State income taxes, net of federal income tax	0.0	0.9 %	0.8	2.4 %
Stock Compensation - Cancelations & exercises	0.0	0.3 %	0.6	1.8 %

Section 199 Qualified Production Activities deduction	(0.2)	-4.5 %	(0.5)	-1.4 %
Other, net	0.0	1.2 %	0.3	0.8 %
Total	\$1.2	31.2%	\$8.0	24.4%

We are still in the process of evaluating the income tax effect of the Tax Act on the executive compensation limitations that will be effective for our fiscal year 2019.

#### **(4) Restricted Cash and Investments**

At *March 31, 2018* and *June 30, 2017*, we held \$7.1 million and \$7.3 million respectively, of restricted cash and investments in lieu of providing letters of credit for the benefit of the provider of our workmen’s compensation insurance and other insurance. These funds can be invested in high quality money market mutual funds, U.S. Treasuries and U.S. Government agency fixed income instruments, and cannot be withdrawn without the prior written consent of the secured party. These assets are carried at cost, which approximates market value and are classified as long-term assets because they are *not* expected to be used within *one* year to fund operations. See also Note 11, “Financial Instruments”.

**ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements (Unaudited)****(5) Inventories**

Inventories at *March 31, 2018* and *June 30, 2017* are summarized as follows (in thousands):

	March 31, 2018	June 30, 2017
Finished goods	\$123,856	\$117,388
Work in process	12,819	10,638
Raw materials	28,829	26,269
Valuation allowance	(1,756 )	(4,812 )
Inventories	\$163,748	\$149,483

**(6) Borrowings**

Total debt obligations at *March 31, 2018* and *June 30, 2017* consist of the following (in thousands):

	March 31, 2018	June 30, 2017
Term Loan due 2019	\$-	\$13,833
Capital leases	1,705	1,085
Total debt obligations	1,705	14,918
Unamortized debt issuance costs	-	(579 )
Total debt	1,705	14,339
Less current maturities	586	2,731
Total long-term	\$1,119	\$11,608



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 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. The unamortized portion is being amortized over the remaining life of the Facility.

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.

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 loans are 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.

The Company intends to use the Facility for working capital and general corporate purposes, including dividend payments and share repurchases. At *March 31, 2018* and *June 30, 2017*, there was \$0.2 million and \$0.1 million, respectively, of standby letters of credit outstanding under the Facility. Total availability under the Facility was \$114.8 million at *March 31, 2018* and \$114.9 million at *June 30, 2017*.

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

At both *March 31, 2018* and *June 30, 2017*, we were in compliance with all the covenants under the Facility.

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

Periods ending June 30,	
2018	\$140
2019	571
2020	533
2021	420
2022	41
2023 and thereafter	-
Total scheduled debt payments	\$1,705

**(7) Litigation**

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

Regulations issued under the Clean Air Act Amendments of 1990 required the industry to reformulate certain furniture finishes or institute process changes to reduce emissions of volatile organic compounds. Compliance with many of these requirements has been facilitated through the introduction of high solids coating technology and alternative formulations. In addition, we have instituted a variety of technical and procedural controls, including reformulation of finishing materials to reduce toxicity, implementation of high velocity low pressure spray systems, development of storm water protection plans and controls, and further development of related inspection/audit teams, all of which have served to reduce emissions per unit of production. We remain committed to implementing new waste minimization programs and/or enhancing existing programs with the objective of (i) reducing the total volume of waste, (ii) limiting the liability associated with waste disposal, and (iii) continuously improving environmental and

job safety programs on the factory floor which serve to minimize emissions and safety risks for employees. To reduce the use of hazardous materials in the manufacturing process, we will continue to evaluate the most appropriate, cost-effective control technologies for finishing operations and production methods. We believe that our facilities are in material compliance with all such applicable laws and regulations. Our currently anticipated capital expenditures for environmental control facility matters are *not* material.

On a quarterly basis, we review our litigation activities and determine if an unfavorable outcome to us is considered “remote”, “reasonably possible” or “probable” as defined by 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.

## ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

## Notes to Consolidated Financial Statements (Unaudited)

**(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 *nine* months ended *March 31, 2018* is presented below:

	Shares
Outstanding as of June 30, 2017	836,020
Granted	19,482
Exercised	(5,416 )
Canceled (forfeited/expired)	(275,675)
Outstanding as of March 31, 2018	574,411
Exercisable as of March 31, 2018	444,810

A summary of stock unit activity occurring during the *nine* months ended *March 31, 2018* is presented below.

	Units	Weighted Average Grant Date Fair Value
Non-vested units at June 30, 2017	308,330	\$ 25.92
Granted	81,250	25.42
Vested	(59,211 )	23.96
Canceled (forfeited/expired)	-	-
Non-vested units at March 31, 2018	330,369	\$ 26.15

A summary of restricted stock activity occurring during the *nine* months ended *March 31, 2018* is presented below.

	Units	Weighted Average Grant Date Fair Value
Non-vested shares at June 30, 2017	-	\$ -
Granted	16,234	25.62
Vested	-	-
Canceled (forfeited/expired)	(16,234)	25.62
Non-vested units at March 31, 2018	-	\$ -

At *March 31, 2018*, there were *1,438,473* 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 March 31,		Nine months ended March 31,	
	2018	2017	2018	2017
Weighted average shares of common stock outstanding for basic calculation	27,476	27,691	27,469	27,694
Effect of dilutive stock options and other share-based awards	216	262	256	276
Weighted average shares of common stock outstanding adjusted for dilution calculation	27,692	27,953	27,725	27,970

As of *March 31, 2018* and *2017*, stock options to purchase *302,655* and *467,305* 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 table following sets forth the activity in accumulated other comprehensive income (loss) for the fiscal year-to-date period ended *March 31, 2018* (in thousands).

Balance June 30, 2017	\$(4,131)
Changes before reclassifications	\$(71 )

Amounts reclassified from accumulated other comprehensive income Current period other comprehensive income (loss)	\$-
Balance March 31, 2018	\$(71 ) \$(4,202)

## (11) Financial Instruments

At *March 31, 2018* and *June 30, 2017*, \$7.1 million and \$7.3 million, respectively, of cash equivalents were restricted and classified as a long-term asset. We did *not* hold any available-for-sale securities at *March 31, 2018* or *June 30, 2017*.

### Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

We measure certain assets, including our cost and equity method investments, at fair value on a nonrecurring basis. These assets are recognized at fair value when they are deemed to be other-than-temporarily impaired. During the *nine* month period ended *March 31, 2018*, we did *not* record any other-than-temporary impairments on those assets required to be measured at fair value on a non-recurring basis.

## (12) 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.





## ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

## Notes to Consolidated Financial Statements (Unaudited)

As of *March 31, 2018*, the Company operated *147* design centers (our retail segment) and our independent retailers operated *160* 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 *nine* months ended *March 31, 2018*. Our wholesale segment net sales accounted for *23%*. Information for the *three* and *nine* months ended *March 31, 2018* and *2017* sales by product line for our wholesale segment is provided below:

	Three months ended		Nine months ended	
	March 31, 2018	2017	March 31, 2018	2017
Case Goods	34 %	32 %	32 %	32 %
Upholstered Products	49 %	53 %	51 %	52 %
Home Accents and Other	17 %	15 %	17 %	16 %
	100%	100 %	100%	100 %

The proportion of retail segment sales by these product lines for the *three* and *nine* months ended *March 31, 2018* and *2017* is provided as follows:

	Three months ended		Nine months ended	
	March 31, 2018	2017	March 31, 2018	2017
Case Goods	31 %	30 %	31 %	30 %
Upholstered Products	47 %	48 %	47 %	48 %
Home Accents and Other	22 %	22 %	22 %	22 %
	100%	100 %	100%	100 %

## ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

## Notes to Consolidated Financial Statements (Unaudited)

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

	Three months ended March 31,		Nine months ended March 31,	
	2018	2017	2018	2017
<b>Net sales:</b>				
Wholesale segment	\$118,921	\$110,819	\$348,473	\$339,076
Retail segment	136,903	141,948	431,469	450,495
Elimination of inter-company sales	(74,405)	(72,266)	(218,740)	(221,111)
Consolidated Total	\$181,419	\$180,501	\$561,202	\$568,460
<b>Operating income:</b>				
Wholesale segment	\$7,927	\$9,729	\$36,957	\$40,399
Retail segment	(2,896)	(7,319)	(6,304)	(4,149)
Adjustment of inter-company profit (1)	(1,158)	1,510	2,307	3,101
Consolidated Total	\$3,873	\$3,920	\$32,960	\$39,351
<b>Depreciation &amp; Amortization:</b>				
Wholesale segment	\$2,002	\$1,832	\$5,827	\$5,611
Retail segment	2,913	3,192	9,128	9,412
Consolidated Total	\$4,915	\$5,024	\$14,955	\$15,023
<b>Capital expenditures:</b>				
Wholesale segment	\$1,561	\$2,193	\$3,076	\$7,776
Retail segment	2,579	1,665	6,045	7,336
Acquisitions	-	-	-	-
Consolidated Total	\$4,140	\$3,858	\$9,121	\$15,112

	March 31, 2018	June 30, 2017
<b>Total Assets:</b>		
Wholesale segment	\$276,884	\$279,364
Retail segment	316,175	319,341
Inventory profit elimination (2)	(28,502)	(30,483)

Consolidated Total                      \$564,557    \$568,222

- (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.

**(13) Recently Adopted Accounting Pronouncements**

In *July 2015*, the FASB issued ASU *2015-11*, “Inventory (Topic 330): Simplifying the Measurement of Inventory,” which states that inventory should be measured at the lower of cost and net realizable value. Net realizable value is defined as estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. We adopted the provisions of ASU *2015-11* effective *July 1, 2017*, applied prospectively. We do *not* believe that the adoption will have a material impact on our consolidated financial statements.

## ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements (Unaudited)

In *November 2015*, the FASB issued ASU 2015-17, Balance Sheet Classification of Deferred Taxes, which requires the Company to present all deferred tax assets and liabilities as noncurrent. We adopted the provisions of ASU 2015-17 effective *July 1, 2017*. At *June 30, 2017*, we had net current deferred tax assets of \$3.9 million which would have been classified as noncurrent under the new standard.

In *March 2016*, the FASB issued ASU 2016-09, Improvements to Employee Share-Based Payment Accounting, which amends ASC Topic 718, Stock Compensation. The objective of this amendment is part of the FASB's Simplification Initiative as it applies to several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. We adopted the provisions of ASU 2016-09 effective *July 1, 2017*. For the fiscal year ended *June 30, 2017*, the Company recorded a credit to additional paid in capital of \$0.1 million that under the new standard would have been recognized in income. Excess tax benefits were *not* material in fiscal year 2017.

#### (14) Subsequent Events

Subsequent to *March 31, 2018*, the Company resumed repurchasing shares in the open market under the Company's existing share repurchase program (the "Share Repurchase Program"), and by *April 24, 2018* approximately 500,000 additional shares have been repurchased. On *April 24, 2018*, the Company's Board of Directors authorized an increase in the amount available for share repurchases under the Company's Share Repurchase Program by approximately 2,000,000 shares. After giving effect to the increase in the authorized repurchase amount, as of *April 24, 2018*, approximately 3,000,000 shares *may* yet be purchased by the Company under the Share Repurchase Program. The timing, number and amount of any shares repurchased will be determined by the Company's officers at their discretion, and as permitted by securities laws, covenants under existing bank agreements and other legal requirements, and will be based on a number of factors, including an evaluation of general market and economic conditions and the trading price of the common stock. The Share Repurchase Program *may* be suspended or discontinued at any time without prior notice.

## **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, 2017.

## 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; 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; disruption to our technology infrastructure (including those relating to 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; 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 effects of terrorist attacks or conflicts or wars involving the United States or its allies or trading partners; and those matters discussed in "Item 1A – Risk Factors" of our Annual Report on Form 10-K for the year ended June 30, 2017, 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. There have been no other changes with respect to the Company's critical accounting policies from those disclosed in its 2017 Annual Report on Form 10-K filed with the SEC on August 2, 2017. Also see Note 13, Recently Adopted Accounting Pronouncements.

### **Overview**

We are a leading interior design company and manufacturer and retailer of quality home furnishings. Founded over 80 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 believe our network of professionally trained interior design professionals differentiates 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 have completed a major transformation of our product offerings, which refreshed over 70% of our entire line of products over the past three years. During the spring of 2017 we expanded the reach of our Ethan Allen | Disney home line by selling a selection on shopdisney.com and launching it in the China market, we expanded our government contract business with an award of a blanket purchase agreement for the Department of State "Worldwide Residential Furniture Program", and we entered into an agreement with Amazon to sell products through the Amazon marketplace. During the fall of 2017 we introduced Passport, a focused collection of unique artisan crafted items inspired by designs from around the world. We also announced the planned launch in May of 2018 of our new Uptown collection, which features a modern perspective on classic designs.

During the first quarter of fiscal 2018, we were negatively impacted by adverse weather affecting sales, manufacturing and delivery of our products. Additionally, our net delivered sales and profitability were negatively affected by first run production of floor samples for Passport and first run production of product for the government contract. Additionally, the high order volume from the government contract together with the new product runs further impacted production capacity which resulted in production and shipping delays, the results of which have continued into the third quarter of fiscal 2018. As a result, our retail division and wholesale backlogs for the third quarter were 15.0% and 69.7% higher respectively, compared to the prior year quarter.

**ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES**

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.

**Results of Operations**

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

	Three months ended March 31,				Nine months ended March 31,			
	2018	%	2017	%	2018	%	2017	%
Net sales	\$181.4	100.0%	\$180.5	100.0%	\$561.2	100.0%	\$568.5	100.0%
Gross profit	96.7	53.3 %	94.7	52.5 %	304.8	54.3 %	311.3	54.8 %
Selling, general and administrative expenses	92.8	51.2 %	90.8	50.3 %	271.9	48.4 %	272.0	47.8 %
Operating income	3.9	2.1 %	3.9	2.2 %	33.0	5.9 %	39.4	6.9 %
Net income	2.6	1.4 %	2.3	1.3 %	24.9	4.4 %	24.5	4.3 %
Earnings per diluted share	\$0.09		\$0.08		\$0.90		\$0.88	
Net cash provided by operating activities	\$20.9		\$26.3		\$35.1		\$53.8	

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

	Three months ended March 31,		Nine months ended March 31,	
	2018	2017	2018	2017
<b>Revenue:</b>				
Wholesale segment	\$118.9	\$110.8	\$348.5	\$339.1



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Retail segment	136.9	141.9	431.5	450.5
Elimination of inter-segment sales	(74.4)	(72.2)	(218.8)	(221.1)
Consolidated revenue	\$181.4	\$180.5	\$561.2	\$568.5

**Operating income (loss):**

Wholesale segment	\$7.9	\$9.7	\$37.0	\$40.4
Retail segment	(2.9 )	(7.3 )	(6.3 )	(4.1 )
Adjustment for inter-company profit (1)	(1.1 )	1.5	2.3	3.1
Consolidated operating income	\$3.9	\$3.9	\$33.0	\$39.4

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

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 comprised 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 9.3% in the current year quarter and 10.1% in the prior year quarter. The following tables show selected design center location information.

## ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

	Fiscal 2018			Fiscal 2017		
	Independent-retailers	Company-operated	Total	Independent-retailers	Company-operated	Total
Retail Design Center location activity:						
Balance at beginning of period	155	148	303	153	143	296
New locations	11	2	13	7	5	12
Closures	(6 )	(3 )	(9 )	(5 )	(2 )	(7 )
Transfers	-	-	-	-	-	-
Balance at end of period	160	147	307	155	146	301
Relocations (in new and closures)	-	-	-	1	2	3
Retail Design Center geographic locations:						
United States	47	141	188	49	140	189
Canada	-	6	6	-	6	6
China	88	-	88	82	-	82
Other Asia	12	-	12	11	-	11
Europe	6	-	6	6	-	6
Middle East	7	-	7	7	-	7
Total	160	147	307	155	146	301

*Third Quarter Ended March 31, 2018 Compared to Third Quarter Ended March 31, 2017*

**Consolidated net sales** for the quarter of \$181.4 million compared to \$180.5 million for the same period in the prior year, an increase of 0.5%. Wholesale segment sales increased progressively each month during the March 2018 quarter, as the disruptions diminished in the manufacturing processes related to first production runs and government contract orders. Although shipments from wholesale to fill retail orders increased 3%, they were weighted towards the end of the quarter, which translated into lower sales for the retail segment, given less time to ship the product to retail customers.

**Retail net sales** for the quarter of \$136.9 million compared to \$141.9 million for the prior year period, a decrease of 3.6%. Comparative retail net sales decreased 4.2%, partially offset by an increase in net sales through the internet. There were 147 Company-operated design centers during the quarter, up from 146 in the prior year quarter. The reduction in sales is primarily a reflection of delayed shipments to the retail segment from the wholesale segment due to the timing of wholesale shipments as previously mentioned. Total written business (new orders booked) increased 2.6%, and comparable design center written business in the quarter increased 1.6%, driven primarily by increased marketing efforts.

**Wholesale net sales** for the quarter of \$118.9 million compared to \$110.8 million for the prior year period, an increase of 7.3%. The increase in sales is due to increases to our retail segment, domestic independent retailers and the government contract, partially offset by decreases to our international dealers.

**Gross profit** for the quarter of \$96.7 million compared to \$94.7 million for the prior year period, an increase of 2.1%, with an increase in both our retail and wholesale segments. The prior year included an inventory write-down associated with an inventory donation of \$6.4 million. Gross profit for wholesale was negatively impacted by an increase in raw materials costs of \$1.7 million. Consolidated gross margin for the quarter was 53.3% compared to 52.5%. Retail sales as a percent of total consolidated sales was 75.5% for the quarter compared to 78.6% in the prior year quarter, decreasing our consolidated gross margin due to this reduced percentage.

**Operating expenses** for the quarter of \$92.8 million, or 51.2% of net sales, increased \$2.0 million compared to \$90.8 million, or 50.3% of net sales, for the prior year period. The 2.2% increase to prior year was primarily due to an increase in advertising of \$2.3 million and an increase in insurance retention of \$1.6 million, partially offset by a decrease in performance-based incentive compensation of \$1.6 million.

## ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

**Operating income and profit margin** for the quarter of \$3.9 million, or 2.1% of net sales, compared to \$3.9 million, or 2.2% of net sales, for the prior year period. The prior year included an inventory write-down associated with an inventory donation of \$6.4 million. The primary causes for the 1.2% decrease in operating income were the lower sales in retail, partially offset by the positive effects of the increase in wholesale sales during the current year quarter.

**Retail operating income** for the quarter of a loss of \$2.9 million, or -2.1% of sales, compared to a loss of \$7.3 million, or -5.2% of sales, for the prior year period. The lower operating loss and margin in the current quarter was driven primarily by the inventory write-down in the prior year period.

**Wholesale operating income** for the quarter of \$7.9 million, or 6.7% of sales, compared to \$9.7 million, or 8.8% of sales, for the prior year period. The decrease was largely due to the increase in current period operating expenses, raw material cost increases and manufacturing inefficiencies mentioned previously.

**Income tax expense** for the quarter totaled \$1.2 million compared to \$1.3 million. Our effective tax rate was 31.2% in the quarter compared to 35.6%. The effective tax rate for the quarter was lower due to the Tax Act. The effective tax rate for the third quarter of fiscal 2018 primarily includes tax expense on that quarter's net income, re-measurement of deferred tax assets and liabilities, and tax and interest expense on uncertain tax positions, partially offset by the reversal of and recognition of some uncertain tax positions. The effective tax rate for the third quarter of fiscal 2017 primarily includes tax expense on that quarter's net income, and tax and interest expense on uncertain tax positions, partially offset by the reversal and recognition of some uncertain tax positions. See footnote 3, Income Taxes, for further information.

**Net income** for the quarter of \$2.6 million compared to \$2.3 million for the prior year period increased 14.6%. This resulted in net income per diluted share for the quarter of \$0.09 compared to \$0.08, an increase of 12.5%.

### *Nine Months Ended March 31, 2018 Compared to Nine Months Ended March 31, 2017*

**Consolidated net sales** year-to-date of \$561.2 million compared to \$568.5 million for the same period in the prior year, a decrease of 1.3%. Sales for the retail and wholesale segments were negatively affected mostly in the first quarter of fiscal 2018 by the hurricanes and disruptions in the manufacturing processes due to first production runs of new product lines, as discussed previously. While wholesale net sales increased compared to the prior year period, overall, an increase in wholesale net sales was more than offset by a decrease in retail sales.

**Retail net sales** year-to-date of \$431.5 million compared to \$450.5 million for the prior year period, a decrease of 4.2%. Comparative retail net sales decreased 5.1%, partially offset by an increase in net sales through the internet. There were 147 Company-operated design centers during the period, up from 146 in the prior year. The reduction in sales is primarily a reflection of the disruptions caused by the first production runs of new product lines and production to satisfy government contract orders that delayed shipments to the retail segment from the wholesale segment and caused the retail undelivered order backlog to increase 15.0% from the prior quarter. Total written business (new orders booked) decreased 0.4% and comparable design center written business year-to-date decreased 1.3%. Written business was also negatively affected by lower traffic at our retail design centers.

**Wholesale net sales** year-to-date of \$348.5 million compared to \$339.1 million for the prior year period, an increase of 2.8%. The increase in sales is primarily due to increases to our international and domestic independent dealers.

**Gross profit** year-to-date of \$304.8 million compared to \$311.3 million for the prior year period, a decrease of 2.1%, with a decrease in both our retail segment and wholesale segments. The decrease was primarily due to the lower retail sales of \$19.0 million and increased costs of raw materials of \$4.4 million, partially offset by the prior year inventory write-down associated with an inventory donation of \$6.4 million, and increased wholesale sales of \$9.4 million. Consolidated gross margin year-to-date was 54.3% compared to 54.8%. Retail sales as a percent of total consolidated sales was 76.9% year-to-date compared to 79.2% in the prior year period, decreasing our consolidated gross margin due to mix.

**Operating expenses** year-to-date of \$271.9 million, or 48.4% of net sales, compared to \$272.0 million, or 47.8% of net sales, for the prior year period. The \$0.1 million decrease was primarily due to a reduction in performance-based incentive compensation expense of \$2.5 million, partially offset by higher advertising costs of \$1.7 in the current year.

**Operating income and profit margin** year-to-date of \$33.0 million, or 5.9% of net sales, compared to \$39.4 million, or 6.9% of net sales, for the prior year period. The prior year included an inventory write-down associated with an inventory donation of \$6.4 million. The primary causes for the 16.2% decrease in operating income were lower retail sales in fiscal 2018 caused in part by the negative effects of the first production runs and government contract mentioned previously.

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

**Retail operating income** year-to-date of a loss of \$6.3 million, or -1.5% of sales, compared to a loss of \$4.1 million, or -0.9% of sales, for the prior year period. The higher operating loss and lower margin in the current period was driven primarily by lower sales, partially offset by reduced operating expenses and the inventory write-down in the prior year.

**Wholesale operating income** year-to-date of \$37.0 million, or 10.6% of sales, compared to \$40.4 million, or 11.9% of sales, for the prior year period. The decrease was largely due to increases in raw materials and advertising costs, partially offset by the positive effect of higher sales and a reduction in performance-based incentive compensation.

**Income tax expense** year-to-date totaled \$8.0 million compared to \$14.1 million. Our effective tax rate was 24.4% in the period compared to 36.6%. The effective tax rate for the current year-to-date period was lower due to the Tax Act. The effective tax rate for the current fiscal year primarily includes tax expense on that fiscal year's net income, the tax benefit lost on the cancelation of stock options and tax and interest expense on uncertain tax positions, partially offset by tax benefit from the re-measurement of deferred tax assets and liabilities, the vesting of restricted stock units, and the reversal of and recognition of some uncertain tax positions. The effective tax rate for the prior fiscal year primarily includes tax expense on that fiscal year's net income, and tax and interest expense on uncertain tax positions, partially offset by the reversal and recognition of some uncertain tax positions. See Note 3, Income Taxes, for further information.

**Net income** year-to-date of \$24.9 million compared to \$24.5 million for the prior year period, an increase of 1.6%. This resulted in net income per diluted share year-to-date of \$0.90 compared to \$0.88 in the prior year period, an increase of 2.3%.

### **Liquidity and Capital Resources**

At March 31, 2018, we held unrestricted cash and equivalents of \$45.0 million and restricted cash and investments of \$7.1 million. At June 30, 2017, we held unrestricted cash and cash equivalents of \$57.7 million and restricted cash and investments of \$7.3 million. Our principal sources of liquidity include cash and cash equivalents, cash flow from operations, amounts available under the Facility, and other borrowings.

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.



**ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES**

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

	Nine months ended March 31,	
	2018	2017
<b>Cash provided by (used in) operating activities</b>		
Net income plus depreciation and amortization	\$39.8	\$39.5
Working capital items	(4.7 )	5.0
Other operating activities	-	9.3
Total provided by operating activities	\$35.1	\$53.8
<b>Cash provided by (used in) investing activities</b>		
Capital expenditures and acquisitions	\$(9.1 )	\$(15.1)
Net sales of marketable securities	-	-
Other investing activities	0.7	1.9
Total provided by (used in) investing activities	\$(8.4 )	\$(13.2)
<b>Cash provided by (used in) financing activities</b>		
Payments on long-term debt and capital lease obligations	\$(14.3)	\$(12.6)
Payment of cash dividends	(24.3)	(14.7)
Purchase/retirement of company stock	(1.1 )	(3.4 )
Other financing activities	0.2	1.2
Total provided by (used in) financing activities	\$(39.5)	\$(29.5)

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

Year-to-date, cash of \$35.1 million was provided by operating activities, a decrease of \$18.7 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, \$8.4 million of cash was used in investing activities, a decrease of \$4.8 million. The decrease was primarily due to a decrease in capital expenditures offset by a decrease in proceeds from disposal of property, plant and equipment. 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.

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

Year-to-date, \$39.5 million was used in financing activities, which is \$10.0 million more cash used than the \$29.5 million of cash used during the first nine months of fiscal 2017. During the current fiscal year, a \$13.2 million pre-payment on the term loan was made, while in the prior fiscal year we made a \$10.0 million pre-payment on the revolving credit facility. During the current fiscal year to date period we paid dividends of \$24.3 million compared to \$14.7 million in the prior year to date period, an increase of \$9.6 million, paying \$0.88 per share compared to \$0.53, an increase of 66.0%. In November 2017, we declared a special \$0.31 per share cash dividend payable to our shareholders in January 2018. The Company has continuously paid dividends for every quarter since 1996 and we expect to continue to do so as economic conditions and liquidity permit.

We believe that our cash flow from operations, together with our other available sources of liquidity including the Facility and refinancing alternatives, will be adequate to make all required payments of principal and interest on our debt, to permit anticipated capital expenditures, and to fund working capital and other cash requirements. As of March 31, 2018, we had working capital of \$106.8 million compared to \$116.7 million at June 30, 2017, a decrease of \$9.8 million, or 8.4%. The Company had a current ratio of 1.78 to 1 at March 31, 2018 and 1.92 to 1 at June 30, 2017.

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

In addition to using available cash to fund changes in working capital, capital expenditures, acquisition activity, the repayment of debt, the payment of dividends, and debt repurchases, we have been authorized by our board of directors to repurchase 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. All our common stock repurchases and retirements are recorded as treasury stock and result in a reduction of shareholders' equity. During the nine months ending March 31, 2018 there were no share repurchases.

At March 31, 2018, we had a remaining Board authorization to repurchase 1,400,497 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, 2017 as filed with the SEC on August 2, 2017.

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

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 material program was for our consumer credit program described below, which was in place both at March 31, 2018 and June 30, 2017.

### **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 satisfactorily perform 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 certain covenants. At March 31, 2018 and June 30, 2017, no collateral was required under the Program Agreement.

### **Product Warranties**

Our products, including our case goods, upholstery and home accents, generally carry explicit product warranties that extend from one to ten 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 March 31, 2018 and June 30, 2017 our product warranty liability totaled \$1.3 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. In December 2017, the Tax Act substantially reduced our effective tax rate. We expect our effective tax rate to be approximately 30% for the remainder of fiscal 2018 and 24% to 25% for fiscal 2019.

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.

We therefore remain cautiously optimistic about our performance due to the many strong programs already in place and others we currently plan to introduce in the coming months. Our retail strategy involves (i) a continued focus on 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 May 2014, the Financial Accounting Standards Board (the “FASB”) issued ASU 2014-09, *Revenue from Contracts with Customers*. This ASU provides a framework for revenue recognition that replaces most existing GAAP revenue

recognition guidance when it becomes effective. The core principle of the ASU is that a company will recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The standard also requires expanded disclosures surrounding the recognition of revenue from contracts with customers. We have an option to use either a retrospective approach or a cumulative effect adjustment approach to implement the guidance. We will adopt the new standard effective July 1, 2018. We are currently conducting a comprehensive review of our revenue streams and contracts as they relate to this guidance to identify potential differences that would result from applying the new requirements. While we are still assessing the overall impact this guidance will have on our consolidated financial statements and financial statement disclosures, based on the work performed to date, we do not believe that the adoption will have a material impact on the amount or timing of revenue recognized. We are still assessing the impact of the standard on our financial statement disclosures.

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. We plan on adopting effective July 1, 2019.

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 currently does not include restricted cash as a component of cash and equivalents as presented on the statement of cash flows. The new guidance is effective for the Company on July 1, 2018, with early adoption permitted. The Company is currently evaluating the impact on our consolidated financial statements. We plan on adopting effective July 1, 2018.

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

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

Our website is *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*. You may obtain and copy any document we furnish or file with the SEC at the SEC's public reference room at 100 F Street, NE, Room 1580, Washington, D.C. 20549. You may obtain information on the operation of the SEC's public reference facilities by calling the SEC at 1-800-SEC-0330. You may request copies of these documents, upon payment of a duplicating fee, by writing to the SEC at its principal office at 100 F Street, NE, Room 1580, Washington, D.C. 20549.

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

We are exposed to market risks relating to fluctuations in interest 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 March 31, 2018, we did not have any floating-rate debt obligations outstanding under our Facility. We currently do not engage in any interest rate hedging activity and we have no intention of doing so in the foreseeable future. Based on the average interest rate of the loans under the Facility during the quarter ended March 31, 2018, and to the extent that borrowings were outstanding, a 10% change in the interest rate would not have a material effect on our consolidated results of operations and financial condition. For information regarding the Company's other risk factors, see Item 7A – Quantitative and Qualitative Disclosures About Market Risk in our Annual Report on Form 10-K for the year ended June 30, 2017 as filed with the SEC on August 2, 2017.

#### **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 March 31, 2018, our disclosure controls and procedures were effective in ensuring that material information relating to us (including our consolidated subsidiaries), which is required to be disclosed by us in our periodic reports filed with or submitted to the SEC is (i) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and (ii) accumulated and communicated to management, including the CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure.

##### **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 March 31, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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

### **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, 2017 as filed with the SEC on August 2, 2017. See Note 7 of the Notes to Consolidated Financial Statements contained in Part I, Item 1 of this Quarterly Report on Form 10-Q for a description of our legal proceedings.

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

There have been no material changes to the matters discussed in “Item 1A – Risk Factors” in our Annual Report on Form 10-K for the year ended June 30, 2017 as filed with the SEC on August 2, 2017.

#### **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 March 31, 2018 on a trade date basis is provided below:

On November 21, 2002, our Board of Directors approved a share repurchase program authorizing us to repurchase up to 2,000,000 shares of our common stock, from time to time, either directly or through agents, in the open market at prices and on terms satisfactory to us. The Board of Directors subsequently increased the aggregate authorization under the repurchase program on several occasions, the last of which was on April 13, 2015 when the aggregate authorization was increased 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. There were no repurchases effected by the Company during the quarter ended March 31, 2018. The maximum number of shares that may yet be purchased under our publicly announced repurchase program is 1,400,497 shares.

**Item 3. Defaults Upon Senior Securities**

Not applicable.

**Item 4. Mine Safety Disclosures**

Not applicable.

**Item 5. Other Information**

Not applicable.

**ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES**

**Item 6. Exhibits**

Exhibit Number	Description
31.1	<u>Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>
31.2	<u>Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>
32.1	<u>Certification of Principal Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 *</u>
32.2	<u>Certification of Principal Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 *</u>
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema
101.CAL	XBRL Taxonomy Extension Calculation Linkbase
101.DEF	XBRL Taxonomy Extension Definition Linkbase
101.LAB	XBRL Taxonomy Extension Label Linkbase
101.PRE	XBRL Taxonomy Extension Presentation Linkbase

\* - Furnished herewith.

**ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES**

**SIGNATURE**

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: April 26, 2018 BY: /s/ M. Farooq Kathwari  
M. Farooq Kathwari  
Chairman, President and Chief Executive Officer  
(Principal Executive Officer)

Date: April 26, 2018 BY: /s/ Corey Whitely  
Corey Whitely  
Executive Vice President Administration  
  
Chief Financial Officer and Treasurer  
(Principal Financial Officer)