

ETHAN ALLEN INTERIORS INC
Form 10-K
August 22, 2008
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended June 30, 2008 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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Ethan Allen Drive, Danbury, CT
(Address of principal executive offices)

06811
(Zip Code)

Registrant's telephone number, including area code (203) 743-8000

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange On Which Registered
Common Stock, \$.01 par value	New York Stock Exchange, Inc.

Securities registered pursuant to Section 12(g) of the Act:

None

(Title of Class)

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>

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

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The aggregate market value of the Registrant's common stock, par value \$.01 per share, held by non-affiliates (based upon the closing sale price on the New York Stock Exchange) on December 31, 2007, (the last day of the Registrant's most recently completed second fiscal quarter) was approximately \$827,128,995. As of July 31, 2008, there were 28,708,959 shares of the Registrant's common stock, par value \$.01 per share, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE: The Registrant's definitive Proxy Statement for the 2008 Annual Meeting of stockholders, which will be filed with the Securities and Exchange Commission pursuant to Regulation 14A of the Securities Exchange Act of 1934, is incorporated by reference into Part III hereof.

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PART I

Item 1. Business

Background

Incorporated in Delaware in 1989, Ethan Allen Interiors Inc., through its wholly-owned subsidiary, Ethan Allen Global, Inc., and Ethan Allen Global, Inc.'s subsidiaries (collectively, We, Us, Our, Ethan Allen or the Company), is a leading manufacturer and retailer of quality home furnishings and accessories, offering a full complement of home decorating and design solutions through one of the country's largest home furnishing retail networks. In recent years, we have made, and continue to make, considerable investment in our business in order to expand and improve our interior design capabilities. In order to better reflect these expanded capabilities, we have changed the designation of our Ethan Allen retail outlets from stores to design centers. The Company was founded in 1932 and has sold products under the Ethan Allen brand name since 1937.

Mission Statement

Our primary business objective is to provide our customers with a convenient, full-service, one-stop shopping solution for their home decorating needs by offering stylish, high-quality products at good value. In order to meet our stated objective, we have developed and adhere to a focused and comprehensive business strategy. The elements of this strategy, each of which is integral to our solutions-based philosophy, include (i) our vertically integrated operating structure, (ii) our products and related marketing initiatives, (iii) our retail design center network, (iv) our people, and (v) our numerous customer service offerings.

Operating Segments

Our operations are classified into two operating segments: wholesale and retail. These operating segments represent strategic business areas which, although they operate separately and provide their own distinctive services, enable us to more effectively offer our complete line of home furnishings and accessories. For certain financial information regarding our operating segments, see Note 16 to the Consolidated Financial Statements included under Item 8 of this Annual Report and incorporated herein by reference.

The wholesale segment is principally involved in the development of the Ethan Allen brand, which encompasses the design, manufacture, domestic and off-shore sourcing, sale and distribution of a full range of home furnishings and accessories to a network of independently owned and Ethan Allen-owned design centers as well as related marketing and brand awareness efforts. Wholesale revenue is generated upon the wholesale sale and shipment of our product to all retail design centers, including those owned by Ethan Allen. Wholesale profitability includes (i) the wholesale gross margin, which represents the difference between the wholesale sales price and the cost associated with manufacturing and/or sourcing the related product, and (ii) other operating costs associated with wholesale segment activities.

The retail segment sells home furnishings and accessories to consumers through a network of Company owned design centers. Retail revenue is generated upon the retail sale and delivery of our product to our customers. Retail profitability includes (i) the retail gross margin, which represents the difference between the retail sales price and the cost of goods purchased from the wholesale segment, and (ii) other operating costs associated with retail segment activities.

While the manner in which our home furnishings and accessories are marketed and sold is consistent, the nature of the underlying recorded sales (i.e. wholesale versus retail) and the specific services that each operating segment provides (i.e. wholesale manufacturing, sourcing, and distribution versus retail selling) are different. Within the wholesale segment, we maintain revenue information according to each respective

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product line (i.e. case goods, upholstery, or home accessories and other). Sales of case good items include, but are not limited to, beds, dressers, armoires, tables, chairs, buffets, entertainment units, home office furniture, bathroom vanities, and

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wood accents. Sales of upholstery home furnishing items include sleepers, recliners, chairs, sofas, loveseats, cut fabrics and leather. Skilled craftsmen cut, sew and upholster custom-designed upholstery items which are available in a variety of frame and fabric options. Home accessory and other items include window treatments, wall decor, lighting, clocks, bedspreads, decorative accessories, area rugs, bedding, and home and garden furnishings.

Revenue information by product line is not as easily determined within the retail segment. However, because wholesale production and sales are matched, for the most part, to incoming orders, we believe that the allocation of retail sales by product line would be similar to that of the wholesale segment.

We evaluate performance of the respective segments based upon revenues and operating income. Inter-segment eliminations result, primarily, from the wholesale sale of inventory to the retail segment, including the related profit margin.

In fiscal 2008, wholesale sales to independent retailers and retail sales of Company owned design centers accounted for approximately 26% and 74%, respectively, of our total net sales.

Wholesale Segment Overview:

Wholesale net sales for each of the last three fiscal years are summarized below (in millions):

	Fiscal Year Ended June 30,		
	2008	2007	2006
Wholesale net sales	\$ 616.2	\$ 656.0	\$ 736.1

Wholesale net sales for each of the last three fiscal years, allocated by product line, were as follows:

	Fiscal Year Ended June 30,		
	2008	2007	2006
Case Goods	43%	44%	48%
Upholstered Products	40	38	37
Home Accessories and Other	17	18	15
	100%	100%	100%

We operate ten manufacturing facilities, including four case good plants (two of which include separate sawmill operations), five upholstery plants and one home accessory plant, located within the United States and one in Mexico. We also source selected case good, upholstery, and home accessory items from third-party suppliers located both domestically and outside the United States.

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As of June 30, 2008, we maintained a wholesale backlog of \$33.0 million (as compared to \$43.1 million as of June 30, 2007) which is anticipated to be serviced in the first quarter of fiscal 2009. Backlog at a point in time is a result, primarily, of net orders booked in prior periods, manufacturing schedules, timing associated with the receipt of sourced product, and the timing and volume of wholesale shipments. Because orders may be rescheduled and/or canceled, the measure of backlog at a point in time may not necessarily be indicative of future sales performance.

For the twelve months ended June 30, 2008, net orders booked at the wholesale level, which includes orders generated by independently owned and Company owned design centers, totaled \$617.1 million as compared to \$670.6 million for the twelve months ended June 30, 2007. In any given period, net orders booked may be impacted by the timing of floor sample orders received in connection with new product introductions. New product offerings may be made available to the retail network at any time during the year, including in connection with our periodic retailer conferences.

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Retail net sales for each of the last three fiscal years are summarized below (in millions):

	Fiscal Year Ended June 30,		
	2008	2007	2006
Retail net sales	\$ 724.6	\$ 698.6	\$ 691.0

We sell our products through a dedicated network of 295 retail design centers. As of June 30, 2008, we owned and operated 159 design centers and independent retailers owned and operated 136 design centers (as compared to 158 and 155, respectively, at the end of the prior fiscal year). The ten largest independent retailers own a total of 55 design centers, which, based on net orders booked, accounted for approximately 10% of total net sales in fiscal 2008.

During fiscal 2008 we acquired five design centers from, and opened one previously owned by independent retailers, and opened eighteen new design centers (of which eleven were relocations). In addition, during the past year, independent retailers opened five new design centers (of which one was a relocation), and closed seventeen design centers. In the past five years, we and our independent retailers have, on a combined basis, opened 98 new design centers, 43 of which were relocations. The geographic distribution of all retail design center locations is included under Item 2 of Part I of this Annual Report.

We pursue further expansion of the Company owned retail business by opening new design centers, relocating existing design centers and, when appropriate, acquiring design centers from independent retailers. In addition, we continue to promote the growth of our independent retailers through ongoing support in the areas of market analysis, site selection, and business development. All retailers are required to enter into license agreements with us which (i) authorize the use of certain Ethan Allen service marks and (ii) require adherence to certain standards of operation, including a requirement to fulfill related warranty service agreements. We are not subject to any territorial or exclusive retailer agreements in the United States.

Products

Our strategy has been to position Ethan Allen as a preferred brand with superior quality and value while, at the same time, providing consumers with a comprehensive, one-stop shopping solution for their home furnishing needs. In carrying out our strategy, we continue to expand our reach to a broader consumer base through a diverse selection of attractively priced products, many of which have been designed to complement one another, reflecting the recent trend toward more eclectic home decorating. Recent product introductions, as well as increased styles and fabric selections within our custom upholstery line, new finishes for, and redesigns of, previous product introductions, and expanded product offerings to accommodate today's home decorating trends, are serving to redefine Ethan Allen, positioning us as a leader in style.

In an effort to more effectively position ourselves as a provider of interior design solutions, we introduced a merchandising strategy which involves the grouping of our product offerings, previously categorized by collection, into seven distinct product lifestyles, each reflecting the diversity and eclecticism that we believe represents the best in American design. In accordance with this merchandising strategy, new products

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are designed and developed to reflect unique elements applicable to one or more of the following lifestyles: Country House; Estate; Glamour; Global; Loft; Metro; and Villa.

All of our case goods, coordinated upholstered products, and home accessories are styled with distinct design characteristics. Home accessories play an important role in our marketing strategy as they enable us to offer the consumer the convenience of one-stop shopping by creating a comprehensive home furnishing solution. The interior of our design centers is designed to facilitate display of our product offerings in complete room settings in order to project the category lifestyle.

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We continuously monitor changes in home design trends through attendance at international industry events and fashion shows, internal market research, and regular communication with our retailers and design center design consultants who provide valuable input on consumer tendencies. Observations and input gathered as a result of our efforts enable us to incorporate appropriate style details into our products thereby allowing us, we believe, to react quickly to changing consumer tastes. For example, since 2004, approximately 63% of our current complement of product offerings is new. The balance has been refined and enhanced through product redesign, additions, deletions, and/or finish changes. Such undertakings are indicative of our ability to adapt to the current consumer trend toward more casual and eclectic lifestyles while, at the same time, maintaining a classic appeal.

In fiscal 2005, we also introduced an innovative pricing program, eliminating periodic sale events in lieu of an everyday best price on all of our product offerings. We believe that this initiative demonstrates our commitment to differentiating ourselves through strategies focused on customer credibility and excellence in service. In addition, everyday best pricing provided us the opportunity to critically examine all facets of our business, making substantive changes, where necessary, in order to more effectively carry out our solutions-based approach to home decorating.

Product Sourcing Activities

We are one of the largest manufacturers of home furnishings in the United States, currently manufacturing and/or assembling approximately 60% of our products within ten manufacturing facilities, two of which include separate sawmill operations. The balance of our production is outsourced, according to our own internally-developed design specifications, through third-party suppliers, most of which are located outside the United States. Our case good facilities are located in the Northeast and Southeast regions of the country where they are close to sources of raw materials and skilled craftsmen. Upholstery facilities are located across the country in order to reduce shipping costs to retail design centers and are situated where skilled craftsmen are available. Our U.S. plants are supported by a cut and sew operation in Mexico. We believe that continued investment in our manufacturing facilities, combined with an appropriate level of outsourcing through both foreign and domestic suppliers, will accommodate future sales growth and allow us to maintain an appropriate degree of control over cost, quality and service to our customers.

Raw Materials and Other Suppliers

The most important raw materials we use in furniture manufacturing are lumber, veneers, plywood, hardware, glue, finishing materials, glass, mirrored glass, laminates, fabrics, foam, and filling material. The various types of wood used in our products include cherry, ash, oak, maple, prima vera, mahogany, birch and pine, substantially all of which are purchased domestically.

Fabrics and other raw materials are purchased both domestically and outside the United States. We have no significant long-term supply contracts, and have experienced no significant problems in supplying our operations. We maintain a number of sources for our raw materials which, we believe, contributes to our ability to obtain competitive pricing. Lumber prices fluctuate over time based on factors such as weather and demand, which, in turn, impact availability. Upward trends in prices could have an adverse effect on margins.

Appropriate amounts of lumber and fabric inventory are typically stocked so as to maintain adequate production levels. We believe that our sources of supply for these materials are sufficient and that we are not dependent on any one supplier.

We enter into standard purchase agreements with certain foreign and domestic suppliers to source selected case good, upholstery, and home accessory items. The terms of these arrangements are customary for the industry and do not contain any long-term contractual obligations on our behalf. We believe we maintain good relationships with our suppliers.

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Distribution and Logistics

Within the wholesale segment, we warehouse and distribute our products primarily through a national network of five distribution centers (four of which are owned) strategically located throughout the United States. These distribution centers hold finished product received from our manufacturing facilities and our third-party suppliers, for shipment to retail design centers and retail service centers. From time to time, we may also rent temporary warehouse space and/or utilize third-party logistics service providers to accommodate our additional storage needs. We stock selected case goods, upholstery and accessories to provide for quick delivery of in-stock items and to allow for more efficient production runs.

Wholesale shipments are made utilizing our own fleet of trucks and trailers or through subcontracting agreements with independent carriers. Approximately 46% of our fleet (trucks and trailers) is leased under operating lease agreements with terms ranging from 24 to 72 months.

Our policy is to sell our products at the same delivered cost to all Company owned and independently owned design centers nationwide, regardless of their shipping point. The adoption of this policy has created pricing credibility with our customers and provided our retail network the opportunity to achieve more consistent margins as fluctuations attributable to the cost of shipping have been eliminated. Further, this policy has eliminated the need for our independent retailers to carry significant amounts of inventory in their own warehouses. As a result, we obtain more accurate information regarding product demand in order to better plan production runs and manage inventory levels.

Marketing Programs

We believe that our ability to create high-quality marketing programs and coordinate advertising efforts for Ethan Allen design centers, including, from time to time, coordination of local market advertising, provides a competitive advantage over other home furnishing manufacturers and retailers. With a dedicated network of about 300 retail design centers taking advantage of such internally-developed marketing efforts, we believe we are better positioned to fulfill our brand promise on a more consistent basis.

The objectives of our marketing campaign are to (i) communicate our position as both a leader in style and a full-service provider of home decorating and design solutions, and (ii) drive traffic into the retail design center network. In support of these objectives, several forms of media are utilized, including television (both national and local), direct mail, newspapers, magazines, radio, and our internet website. We also conduct a national email marketing campaign which serves to distribute electronic newsletters containing inspirational interior design ideas to a growing database of consumers.

Our national television advertising campaign is designed to capitalize on our existing brand equity and maintain top-of-mind awareness of the breadth of our product and service offerings. With this in mind, our in-house team of advertising specialists has developed what we believe is the most cohesive national advertising campaign in the home furnishings industry. Coordinated local television, to the extent the medium is utilized, serves to support our national television program.

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The Ethan Allen direct mail magazine, which brands our product lifestyles and communicates the breadth of our services, is one of our most important marketing tools. We publish and sell the magazines to both Company owned and independently owned design centers, who, with demographic information collected through independent market research, are able to target potential customers. Given the importance of this advertising medium, direct mail marketing lists continue to be refined in order to target those consumers that are most likely to purchase, with the objective of improving our return on direct mail expenditures. Approximately 23 million copies of our direct mail magazine were distributed to consumers during fiscal 2008.

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Our television advertising and direct mail efforts are supported by strong print and radio campaigns in various markets. During fiscal 2008, we also updated our 220-page Ethan Allen Style book. This publication, which includes a catalogue of our home furnishings and accessories, projects our seven product lifestyles to our clients and helps customers identify their own personal style using our product offerings. We believe this publication represents one of the most comprehensive and effective home decorating resources in the home furnishings industry.

We are located on the worldwide web at www.ethanallen.com. The primary goal of our website is to drive additional business into the retail design center network through lead generation and information sourcing. With this in mind, customers may access our website to review our home furnishing offerings or to purchase selected home accessories. The Company has been developing a new state-of-the-art website which we expect to launch later in calendar 2008. We believe this new website will enable us to add the newest technology of the web to the personal service of our design consultants, giving us a unique competitive advantage. The new website will also enable our clients to place orders for Ethan Allen's product offering which will be serviced through our retail network.

We have also developed an extranet website which links the retail design centers with consumer information captured on-line, such as customer requests for design assistance and copies of our direct mail magazine. This medium has become the primary source of communications within our retail network providing a variety of information, including a Company-wide daily news flash, downloads of current advertising materials, prototype design center display floor plans and detailed product information.

Retail Design Center Network

Ethan Allen design centers are typically located in busy urban settings as freestanding destinations or as part of suburban strip malls, depending upon the real estate opportunities in a particular market. At the present time, our design centers average approximately 16,000 square feet in size. While the footprint for most of our retail network is similar, our design centers currently range in size from approximately 6,000 square feet to 35,000 square feet.

We maximize uniformity of presentation throughout the retail design center network through a comprehensive set of standards. These standards assist each design center in presenting a high quality image and offer retail customers consistent levels of product selection and service. A uniform design center image is conveyed through our ongoing program to model all retail design centers with similar and consistent exterior facades and interior layouts. This program is carried out at all design centers, including those that are independently owned and operated.

We provide display planning assistance to all Company owned design centers and independent retailers to support them in updating the interior projection and to maintain a consistent image. We have developed a standard interior design format for our retail network which, through the use of focused lifestyle settings to display our products and information displays to educate consumers, has positioned Ethan Allen as a leader in home furnishings retailing.

People

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At June 30, 2008, we had approximately 5,800 employees, approximately 5% of whom are represented by unions under collective bargaining agreements. Most of these collective bargaining agreements expire at various times throughout the next three years. We expect no significant changes in our relations with these unions and believe we maintain good relationships with our employees.

The retail network, which includes both Company owned and independently owned design centers, is staffed with a sales force of design consultants and service professionals who provide customers with an effective home decorating solution at no additional charge. Our employees receive appropriate training with respect to the distinctive design and quality features inherent in each of our products and programs, allowing them to more effectively communicate the elements of style and value that serve to differentiate us from the competition. As

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such, we believe our design consultants, and the complimentary service they provide, create a distinct competitive advantage over other home furnishing retailers.

We have strengthened the retail division with many initiatives, including rationalization of our structure, with 23 newer locations added during the year including relocations. We converted 8% of the network to design studios. Twelve locations in underperforming markets closed. We consolidated 16 retail service centers into larger service centers, and most importantly, implemented the team concept, with the development of interior design teams.

We have made considerable investment within the retail network to strengthen the level of service, professionalism, interior design competence, efficiency, and effectiveness of retail design center personnel. The implementation of the team concept is the latest phase of that progression, which resulted in the development of over 280 interior design teams. We believe that with this structure, along with the emphasis in our messaging to clients that we can help as little or as much as you like, as well as offering the benefit of making appointments with our design professionals, we continue to improve the customer service experience.

We recognize the importance of our retail design center network to our long-term success. Accordingly, we believe we (i) have established strong management teams within Company owned design centers and (ii) continue to work closely with our independent retailers in order to assist them in strengthening their teams. With this in mind, we make our services available to every design center, whether independently owned or Company owned, in support of their marketing efforts, including coordinated advertising, merchandising and display programs, and extensive training seminars and educational materials. We believe that the development of design teams, design consultants, service and delivery personnel, and retailers is important for the growth of our business. As a result, we have committed to make available a comprehensive retail training program which is intended to increase the customer service capabilities of each individual.

Customer Service Offerings

We offer numerous customer service programs, each of which has been developed and introduced to consumers in an effort to make their shopping experience easier and more enjoyable.

Gift Card

This program allows customers to purchase, through our website or at any participating retail design center, gift cards which can be redeemed for any of our products or services.

On-Line Room Planning

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We offer, via our website, an interactive on-line room planning resource which serves to further assist consumers with their home decorating needs. Through the use of this web-based tool, customers can determine which of our product offerings best fit their particular needs based on their own individual home floor plan.

Ethan Allen Consumer Credit Programs

The Ethan Allen Finance Plus program offers consumers (clients) a menu of three custom financing options through the use of just one account. Consumers (clients) can choose between (1) Term Choice which offers fixed monthly payments the customer chooses from 12 to 60 months at an interest rate from 3.99% to 9.99% per annum, (2) No Payment / Deferred Interest which offers clients a way to borrow interest free for three or six months with no monthly payments. If the purchase is not paid by the due date, interest is charged from the date of purchase at a fixed interest rate of 23.99% per annum, and (3) Ethan Allen Prime which offers the lowest minimum monthly payment plan including no payments the first three months; interest is accrued at a rate that matches the current prime rate. All plans provide credit lines from \$1,000 to \$30,000, or greater, if the customer qualifies. Financing offered is administered by a third-party financial institution and is granted to us on a non-recourse basis. Consumers (clients) may apply for an Ethan Allen Finance Plus card at any participating design center.

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Competition

In recent years, the home furnishings industry has faced numerous challenges, not the least of which is an influx of low-priced competition from overseas and some resultant measure of price deflation. As a result, we believe a trend toward product commoditization has developed. In that time, we have, instead, attempted to further differentiate ourselves as a preferred brand by adhering to a business strategy focused on providing (i) high-quality, well designed products at good value, including the marketing of our products at an everyday best price, (ii) a comprehensive complement of home furnishing design solutions, including our complimentary design service, and (iii) excellence in customer service. We consider our vertical integration a significant competitive advantage in the current environment as it allows us to design, manufacture, source, distribute, market, and sell our products through one of the industry's largest single-source retail networks.

Industry globalization has provided us an opportunity to adhere to a blended sourcing strategy, establishing relationships with certain manufacturers, both domestically and outside the United States, to source selected case goods, upholstery, and home accessory items. We intend to continue to balance our domestic production with opportunities to source from foreign and domestic manufacturers, as appropriate, in order to maintain our competitive advantage.

We believe the home furnishings industry competes primarily on the basis of product styling and quality, personal service, prompt delivery, product availability and price. We further believe that we effectively compete on the basis of each of these factors and that, more specifically, our retail format and complimentary design service create a distinct competitive advantage, further supporting our mission of providing consumers with a complete home decorating and design solution. Our objective is to continue to develop and strengthen our retail network by (i) expanding the Company owned retail business through the relocation of existing design centers, opening of new design centers, and, when appropriate, acquiring design centers from, or selling design centers to, independent retailers, and (ii) obtaining and retaining independent retailers, encouraging such retailers to expand their business through the opening or relocation of new design centers with the objective of increasing the volume of their sales.

Trademarks

We currently hold, or have registration applications pending for, numerous trademarks, service marks and design patents for the Ethan Allen name, logos and designs in a broad range of classes for both products and services in the United States and in many foreign countries. In addition, we have registered, or have applications pending for, many of our major collection names as well as certain of our slogans utilized in connection with promoting brand awareness, retail sales and other services. We view such trade and service marks as valuable assets and have an ongoing program to diligently monitor and defend, through appropriate action, against their unauthorized use.

Available Information

We make available, free of charge via our website, all Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and other information filed with, or furnished to, the Securities and Exchange Commission (the SEC or the Commission), including amendments to such reports. This information is available at www.ethanallen.com/investors as soon as reasonably practicable after it is electronically filed with, or furnished to, the SEC. In addition, the SEC maintains a website that contains reports, proxy and information statements, and other information regarding companies that file electronically with the Commission. This information is available at

www.sec.gov.

In addition, charters of all committees of our Board of Directors, as well as our Corporate Governance guidelines, are available on our website at www.ethanallen.com/governance or, upon written request, in printed hardcopy

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form. Written requests should be sent to Office of the Secretary, Ethan Allen Interiors Inc., Ethan Allen Drive, Danbury, Connecticut 06811.

Item 1A. Risk Factors

The following information describes certain significant risks and uncertainties inherent in our business that should be carefully considered, along with other information contained elsewhere in this report and in other filings, when making an investment decision with respect to us. If one or more of these risks actually occurs, the impact on our business, including our financial condition, results of operations, and cash flows could be adverse.

We face changes in global and local economic conditions that may adversely affect consumer demand and spending, our manufacturing operations or sources of merchandise.

Historically, the home furnishings industry has been subject to cyclical variations in the general economy and to uncertainty regarding future economic prospects. Such uncertainty, as well as other variations in global economic conditions such as rising fuel costs and increasing interest rates, may continue to cause inconsistent and unpredictable consumer spending habits, while increasing our own fuel, utility, transportation or security costs. These risks, as well as industrial accidents or work stoppages, could also severely disrupt our manufacturing operations, which could have a material adverse effect on our financial performance.

We import a portion of our merchandise from foreign countries. As a result, our costs may be increased by events affecting international commerce and businesses located outside the United States, including changes in international trade, central bank actions, changes in the relationship of the U.S. dollar versus other currencies, and other governmental policies of the U.S. and the countries from which we import a portion of our merchandise. The inability to import products from certain foreign countries or the imposition of significant tariffs could have a material adverse effect on our results of operations.

Competition from overseas manufacturers continues to increase and may adversely affect our business, operating results or financial condition.

Our wholesale business segment is involved in the development of our brand, which encompasses the design, manufacture, sourcing, sales and distribution of our home furnishings products, and competes with other U.S. and foreign manufacturers. Our retail business segment sells home furnishings to consumers through a network of Company owned design centers, and competes against a diverse group of retailers ranging from specialty stores to traditional furniture and department stores, any of which may operate locally, regionally and nationally. We also compete with these and other retailers for appropriate retail locations as well as for qualified design consultants and management personnel. Such competition could adversely affect our future financial performance.

Industry globalization has led to increased competitive pressures brought about by the increasing volume of imported finished goods and components, particularly for case good products, and the development of manufacturing capabilities in other countries, specifically within Asia. The increase in overseas production capacity in recent years has created over-capacity for many U.S. manufacturers, including us, which has led to industry-wide plant consolidation. In addition, because many foreign manufacturers are able to maintain substantially lower production costs, including the cost of labor and overhead, imported product may be capable of being sold at a lower price to consumers, which, in turn, could lead to some measure of further industry-wide price deflation.

We cannot provide assurance that we will be able to establish or maintain relationships with certain manufacturers, whether foreign or domestic, to supply us with selected case goods, upholstery and home accessory items to enable us to maintain our competitive advantage. In addition, the recent emergence of foreign manufacturers has served to broaden the competitive landscape. Some of these competitors produce furniture

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types not manufactured by us and may have greater financial and other resources available to them. This competition could adversely affect our future financial performance.

Failure to successfully anticipate or respond to changes in consumer tastes and trends in a timely manner could adversely impact our business, operating results and financial condition.

Sales of our products are dependent upon consumer acceptance of our product designs, styles, quality and price. We continuously monitor changes in home design trends through attendance at international industry events and fashion shows, internal marketing research, and regular communication with our retailers and design center design consultants who provide valuable input on consumer tendencies. However, as with all retailers, our business is susceptible to changes in consumer tastes and trends. Such tastes and trends can change rapidly and any delay or failure to anticipate or respond to changing consumer tastes and trends in a timely manner could adversely impact our business, operating results and financial condition.

Fluctuations in the price, availability and quality of raw materials could result in increased costs or cause production delays which might result in a decline in sales, either of which could adversely impact our earnings.

We use various types of wood, foam, fibers, fabrics, leathers, and other raw materials in manufacturing our furniture. Certain of our raw materials, including fabrics, are purchased both outside the United States and domestically. Fluctuations in the price, availability and quality of raw materials could result in increased costs or a delay in manufacturing our products, which in turn could result in a delay in delivering products to our customers. For example, lumber prices fluctuate over time based on factors such as weather and demand, which in turn, impact availability. Production delays or upward trends in raw material prices could result in lower sales or margins, thereby adversely impacting our earnings.

In addition, certain suppliers may require extensive advance notice of our requirements in order to produce products in the quantities we desire. This long lead time may require us to place orders far in advance of the time when certain products will be offered for sale, thereby exposing us to risks relating to shifts in consumer demand and trends, and any downturn in the U.S. economy.

Our business is sensitive to increasing labor costs, competitive labor markets, our continued ability to retain high-quality personnel and risks of work stoppages.

The market for qualified employees and personnel in the retail and manufacturing industries is highly competitive. Our success depends upon our ability to attract, retain and motivate qualified craftsmen, management, marketing and sales personnel and upon the continued contributions of these individuals. We cannot provide assurance that we will be successful in attracting and retaining qualified personnel. A shortage of qualified personnel may require us to enhance our wage and benefits package in order to compete effectively in the hiring and retention of qualified employees. Our labor costs may continue to increase and such increases may not be recovered. In addition, some of our employees are covered by collective bargaining agreements with local labor unions. Although we do not anticipate any difficulty renegotiating these contracts as they expire, a labor-related stoppage by these unionized employees could adversely affect our business and results of operations. The loss of the services of key personnel or our failure to attract additional qualified personnel could have a material adverse effect on our business, operating results and financial condition.

Our success depends upon our brand, marketing and advertising efforts and pricing strategies, and if we are not able to maintain and enhance our brand, or if we are not successful in these other efforts, our business and operating results could be adversely affected.

Maintaining and enhancing our brand is critical to our ability to expand our base of customers and may require us to make substantial investments. Our advertising campaign utilizes television, direct mail, newspapers, magazines and radio to maintain and enhance our existing brand equity. We cannot provide assurance that our

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marketing, advertising and other efforts to promote and maintain awareness of our brand will not require us to incur substantial costs. If these efforts are unsuccessful or we incur substantial costs in connection with these efforts, our business, operating results and financial condition could be adversely affected.

We may not be able to maintain our current design center locations at current costs. We may also fail to successfully select and secure design center locations.

Our design centers are typically located in busy urban settings as freestanding destinations or as part of suburban strip malls, depending upon the real estate opportunities in a particular market. Our business competes with other retailers and as a result, our success may be affected by our ability to renew current design center leases and to select and secure appropriate retail locations for existing and future design centers.

We depend on key personnel and could be affected by the loss of their services.

The success of our business depends upon the services of certain senior executives, and in particular, the services of M. Farooq Kathwari, Chairman of the Board, President and Chief Executive Officer, who is the only one of our senior executives who operates under a written employment agreement. The loss of any such person or other key personnel could have a material adverse effect on our business and results of operations.

As we expand and grow our business, we may rely on external funding sources to finance our operations and growth.

Historically, we have relied upon our cash from operations to fund our operations and growth. As we expand our business, we may rely on external funding sources, including the proceeds from the issuance of debt or the \$200 million revolving bank line of credit available under our existing credit facility. Any unexpected reduction in cash flow from operations could increase our external funding requirements to levels above those currently available. There can be no assurance that we will not experience unexpected cash flow shortfalls in the future or that any increase in external funding required by such shortfalls will be available.

Our results of operations for any quarter are not necessarily indicative of our results of operations for a full year.

Sales of furniture and other home furnishing products fluctuate from quarter to quarter due to such factors as changes in global and regional economic conditions, changes in competitive conditions, changes in production schedules in response to seasonal changes in energy costs and weather conditions, and changes in consumer order patterns. From time to time, we have experienced, and may continue to experience, volatility with respect to demand for our home furnishing products. Accordingly, results of operations for any quarter are not necessarily indicative of the results of operations for a full year.

Our current and former manufacturing and retail operations are subject to increasingly stringent environmental, health and safety requirements.

We use and generate hazardous substances in our manufacturing and retail operations. In addition, both the manufacturing properties on which we currently operate and those on which we have ceased operations are and have been used for industrial purposes. Our manufacturing operations and, to a lesser extent, our retail operations involve risk of personal injury or death. We are subject to increasingly stringent environmental, health and safety laws and regulations relating to our current and former properties and our current operations. These laws and regulations provide for substantial fines and criminal sanctions for violations and sometimes require the installation of costly pollution control or safety equipment or costly changes in operations to limit pollution or decrease the likelihood of injuries. In addition, we may become subject to potentially material liabilities for the investigation and cleanup of contaminated properties and to claims alleging personal injury or property damage resulting from exposure to or releases of hazardous substances or personal injury as a result of an unsafe workplace.

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We have been identified as a potentially responsible party in connection with three sites that are currently listed, or proposed for inclusion, on the National Priorities List under the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended, or its state counterpart, and have received notification that we may be named a PRP in a separate, unrelated matter with respect to a fourth site. In addition, noncompliance with, or stricter enforcement of, existing laws and regulations, adoption of more stringent new laws and regulations, discovery of previously unknown contamination or imposition of new or increased requirements could require us to incur costs or become the basis of new or increased liabilities that could be material.

Failure to protect our intellectual property could adversely affect us.

We believe that our patents, trademarks, service marks, trade secrets, copyrights and all of our other intellectual property are important to our success. We rely on patent, trademark, copyright and trade secret laws, and confidentiality and restricted use agreements, to protect our intellectual property and may seek licenses to intellectual property of others. Some of our intellectual property is not covered by any patent, trademark, or copyright or any applications for the same. We cannot provide assurance that agreements designed to protect our intellectual property will not be breached, that we will have adequate remedies for any such breach, or that the efforts we take to protect our proprietary rights will be sufficient or effective. Any significant impairment of our intellectual property rights or failure to obtain licenses of intellectual property from third parties could harm our business or our ability to compete. Moreover, we cannot provide assurance that the use of our technology or proprietary know-how or information does not infringe the intellectual property rights of others. If we have to litigate to protect or defend any of our rights, such litigation could result in significant expense.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

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Our corporate headquarters, located in Danbury, Connecticut, consists of one building containing 144,000 square feet, situated on approximately 18.0 acres of land, all of which is owned by us. Located adjacent to the corporate headquarters, and situated on approximately 5.4 acres, is the Ethan Allen Hotel and Conference Center, containing 195 guestrooms. This hotel, owned by a wholly-owned subsidiary of Ethan Allen, is used in connection with Ethan Allen functions and training programs, as well as for functions and accommodations for the general public.

We operate ten manufacturing facilities located in six states and Mexico. All of these facilities are owned, with the exception of a leased upholstery plant in California, totaling 145,636 square feet. Our ten facilities consist of four case good manufacturing plants (two of which include separate sawmill operations), totaling 1,964,897 square feet; five upholstery furniture plants (including the leased facility in California), totaling 1,137,732 square feet; and one plant involved in the manufacture and assembly of our home accessory products, totaling 295,000 square feet.

In addition, we operate five distribution centers, totaling 1,347,739 square feet. All of these facilities are owned, with the exception of one leased distribution facility in California, totaling 80,000 square feet. We utilize 6,490 square feet within one of our manufacturing facilities as a garage operation for our fleet of trucks and trailers. Our U.S. manufacturing and distribution facilities are located in North Carolina, Vermont, Pennsylvania, Virginia, Oklahoma, California, New Jersey, Indiana and Maine, and our Mexico plant is located in Guanajuato.

We own three and lease 30 retail service centers, totaling 1,296,902 square feet. Our retail service centers are located throughout the United States and serve to support our various retail sales districts.

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The geographic distribution of our retail design center network as of June 30, 2008 is as follows:

	Retail Design Center Category	
	Company Owned	Independently Owned
United States	154	95
North America-Other (1)	5	2
Asia		38
Middle East		1
Total	159	136

-
- (1) We own and operate five retail design centers located in Canada.

Of the 159 retail design centers owned and operated by us, 74 of the properties are owned and 85 of the properties are leased from independent third parties. Of the 74 design center locations owned by us, 17 are subject to land leases. We own three additional retail properties, two of which are leased to independent Ethan Allen retailers, and one of which is leased to an unaffiliated third party. See Note 8 to the Consolidated Financial Statements included under Item 8 of this Annual Report for more information with respect to our operating lease obligations.

Our Ethan Allen Hotel and Conference Center located in Danbury, Connecticut, was financed, in part, with industrial revenue bonds. The bonds bear interest at a fixed rate of 7.50% and have a remaining balance at June 30, 2008 of \$3.9 million which matures in three years. The Beecher Falls, Vermont manufacturing facility was financed, in part, by the State of Vermont Economic Development Authority (VEDA) and the Town of Canaan, Vermont. The VEDA debt matured in June 2006 and was repaid in full at that time. The Town of Canaan debt bears interest at a fixed rate of 3.00% and has remaining balance at June 30, 2008 of \$0.3 million, with maturities of three to 18 years. We believe that all of our properties are well maintained and in good condition.

We estimate that our manufacturing division is currently operating at approximately 75% to 80% of capacity. We believe we have additional capacity at selected facilities, which we could utilize with minimal additional capital expenditures.

Item 3. Legal Proceedings

We are a party to various legal actions with customers, employees and others arising in the normal course of our business. We maintain liability insurance, which is deemed to be adequate for our needs and commensurate with other companies in the home furnishings industry. We believe that the final resolution of pending actions (including any potential liability not fully covered by insurance) will not have a material adverse effect on our financial condition, results of operations, or cash flows.

Environmental Matters

We and our subsidiaries are subject to various environmental laws and regulations. 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.

As of June 30, 2008, we and/or our subsidiaries have been named as a potentially responsible party (PRP) with respect to the remediation of three active sites currently listed, or proposed for inclusion, on the National Priorities List (NPL) under the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended (CERCLA). The sites are located in Southington, Connecticut; High Point, North Carolina; and Atlanta, Georgia.

In addition, during the fiscal year ended June 30, 2007, our liability with respect to a fourth site located in Lyndonville, Vermont was resolved. We had previously received a certificate of construction completion for this

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location, subject to certain limited conditions which were the obligation of another PRP. In July 2007, we obtained the final certificate of construction completion advising us that all conditions had been met.

We do not anticipate incurring significant costs with respect to the Southington, Connecticut, High Point, North Carolina, or Atlanta, Georgia sites as we believe that we are not a major contributor based on the very small volume of waste generated by us in relation to total volume at those sites. Specifically, with respect to the Southington site, our volumetric share is less than 1% of over 51 million gallons disposed of at the site and there are more than 1,000 PRPs. With respect to the High Point site, our volumetric share is less than 1% of over 18 million gallons disposed of at the site and there are more than 2,000 PRPs, including more than 1,000 de-minimis parties (of which we are one). With respect to the Atlanta site, a former solvent recycling/reclamation facility, our volumetric share is less than 1% of over 20 million gallons disposed of at the site by more than 1,700 PRPs. In all three cases, the other PRPs consist of local, regional, national and multi-national companies.

Liability under CERCLA may be joint and several. As such, to the extent certain named PRPs are unable, or unwilling, to accept responsibility and pay their apportioned costs, we could be required to pay in excess of our pro rata share of incurred remediation costs. Our understanding of the financial strength of other PRPs has been considered, where appropriate, in the determination of our estimated liability.

In addition, in July 2000, we were notified by the State of New York (the State) that we may be named a PRP in a separate, unrelated matter with respect to a site located in Carroll, New York. To date, no further notice has been received from the State and the State has not yet conducted an initial environmental study at this site.

As of June 30, 2008, we believe that established reserves related to these environmental contingencies are adequate to cover probable and reasonably estimable costs associated with the remediation and restoration of these sites. We believe our currently anticipated capital expenditures for environmental control facility matters are not material.

We are subject to other 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. We believe that our facilities are in material compliance with all such applicable laws and regulations.

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. We will continue to evaluate the most appropriate, cost effective, control technologies for finishing operations and design production methods to reduce the use of hazardous materials in the manufacturing process.

Item 4. Submission of Matters to a Vote of Security Holders

No matters were submitted for vote by our security holders during the fourth quarter of fiscal 2008.

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PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

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Our common stock is traded on the New York Stock Exchange under ticker symbol ETH . The following table sets forth, for each of the past two fiscal years, (i) the high and low stock prices as reported on the New York Stock Exchange and (ii) the dividend per share paid by us:

	High	Market Price Low	Close	Dividend Per Share
<u>Fiscal 2008</u>				
First Quarter	\$ 36.55	\$ 31.57	\$ 32.69	\$ 0.22
Second Quarter	35.41	25.87	28.50	0.22
Third Quarter	31.98	22.67	28.43	0.22
Fourth Quarter	31.37	24.48	24.60	0.22
<u>Fiscal 2007</u>				
First Quarter	\$ 39.77	\$ 33.54	\$ 34.66	\$ 0.20
Second Quarter	38.63	34.17	36.11	0.20
Third Quarter	39.56	34.75	35.34	0.20
Fourth Quarter	37.85	34.19	34.25	0.20

As of August 13, 2008, there were 348 shareholders of record of our common stock. Management estimates there are over eleven thousand beneficial shareholders of the Company's common stock. On July 22, 2008, we declared a dividend of \$0.25 per common share, payable on October 27, 2008 to shareholders of record as of October 10, 2008. We expect to continue to declare quarterly dividends for the foreseeable future.

Comparative Company Performance

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The following line graph compares cumulative total stockholder return for the Company with a performance indicator of the overall stock market, the Standard & Poor's 500 Index, and an industry index, the Peer Issuer Group Index, assuming \$100 was invested on June 30, 2003.

COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN*

Among Ethan Allen Interiors Inc., The S&P 500 Index

And A Peer group

*\$100 invested on 6/30/03 in stock & Index-Including reinvestment of dividends. (Fiscal year ending June 30.)

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Note - Peer Issuer Group Includes Bassett Furniture Industries, Inc., Chromcraft Revington, Inc., Flexsteel Industries Inc., Furniture Brands International, Inc., Haverty Furniture Companies, Inc., La-Z Boy Inc., Legett & Platt, Inc., and Pier 1 Imports Inc. The returns of each company have been weighted according to each company's market capitalization.

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Equity Compensation Plan Information

The information required by this Item 5 with respect to Equity Compensation Plan Information is set forth in Item 12 Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters, contained in this Annual Report and incorporated herein by reference.

Issuer Purchases of Equity Securities

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 remaining authorization as follows: from 904,755 shares to 2,500,000 shares on April 27, 2004; from 753,600 shares to 2,000,000 shares on November 16, 2004; from 691,100 shares to 2,000,000 shares on April 26, 2005; from 393,100 shares to 2,500,000 shares on November 15, 2005; from 1,110,400 shares to 2,500,000 shares on July 25, 2006; from 707,300 to 2,500,000 shares on July 24, 2007, and from 1,368,000 to 2,000,000 shares on November 13, 2007. As of June 30, 2008 we had a remaining Board authorization to repurchase 1,567,669 shares.

There were no share repurchases during the quarter ended June 30, 2008. Since the Company began repurchasing shares in 1995, approximately 17.7 million shares have been repurchased (adjusted for splits).

On June 20, 2008, options to purchase 19,600 shares of our common stock were granted to employees of the Company. These options were issued at an exercise price of \$25.71 (the price of a share of our common stock on the New York Stock Exchange as of such date), vest ratably over a 4-year period and have a contractual term of 10 years.

Stockholder Rights Plan

We have a Stockholder Rights Plan, a description of which is set forth in Note 9 to the Consolidated Financial Statements included under Item 8 of this Annual Report and incorporated herein by reference. Such description contains all of the required information with respect thereto.

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Item 6. Selected Financial Data

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The following table presents selected financial data for the fiscal years ended June 30, 2008, 2007, 2006, 2005 and 2004 which has been derived from our consolidated financial statements. The information set forth below should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations included under Item 7 of this Annual Report and our Consolidated Financial Statements (including the notes thereto) included under Item 8 of this Annual Report.

	Fiscal Year Ended June 30,					
	2008	2007	2006	2005	2004	
<u>Statement of Operations Data:</u>						
Net sales	\$ 980,045	\$ 1,005,312	\$ 1,066,390	\$ 949,012	\$ 955,107	
Cost of sales	453,980	478,729	525,408	487,958	494,072	
Selling, general and administrative expenses	423,229	402,022	394,069	332,295	322,111	
Restructuring and impairment charge, net (1)	6,836	13,442	4,241	(219)	12,520	
Operating income	96,000	111,119	142,672	128,978	126,404	
Interest and other expense (income), net	3,822	1,393	4,567	(442)	(2,691)	
Income before income tax expense	92,178	109,726	138,105	129,420	129,095	
Income tax expense	34,106	40,499	52,423	50,082	49,617	
Net income	\$ 58,072	\$ 69,227	\$ 85,682	\$ 79,338	\$ 79,478	
<u>Per Share Data:</u>						
Net income per basic share	\$ 1.98	\$ 2.19	\$ 2.58	\$ 2.24	\$ 2.14	
Basic weighted average shares outstanding	29,267	31,566	33,210	35,400	37,179	
Net income per diluted share	\$ 1.97	\$ 2.15	\$ 2.51	\$ 2.19	\$ 2.08	
Diluted weighted average shares outstanding	29,470	32,261	34,086	36,193	38,295	
Cash dividends per share (2)	\$ 0.88	\$ 0.80	\$ 0.72	\$ 0.60	\$ 3.40	
<u>Other Information:</u>						
Depreciation and amortization	\$ 24,670	\$ 23,013	\$ 21,599	\$ 21,338	\$ 21,854	
Capital expenditures and acquisitions	\$ 67,815	\$ 74,370	\$ 49,296	\$ 34,381	\$ 24,976	
Working capital	\$ 174,676	\$ 234,990	\$ 278,038	\$ 130,423	\$ 161,772	
Current ratio	2.29 to 1	2.59 to 1	2.88 to 1	1.97 to 1	2.18 to 1	
Effective tax rate	37.0%	36.9%	38.0%	38.7%	38.4%	
<u>Balance Sheet Data (at end of period):</u>						
Total assets	\$ 761,973	\$ 802,598	\$ 814,100	\$ 628,386	\$ 658,367	
Total debt, including capital lease obligations	203,029	202,908	202,787	12,510	9,221	
Shareholders' equity	\$ 375,773	\$ 409,642	\$ 417,442	\$ 434,068	\$ 456,140	
Debt as a percentage of equity	54.0%	49.5%	48.6%	2.9%	2.0%	
Debt as a percentage of capital	35.1%	33.1%	32.7%	2.8%	2.0%	

See footnotes on following page.

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(1) On January 10, 2008, we announced a plan to consolidate the operations of certain company owned retail design centers and retail service centers. In connection with this initiative, we have permanently ceased operations at ten design centers and six retail service centers which, for the most part, were consolidated into other existing operations. We also implemented our design team concept across the Retail division at the end of the fiscal year. These decisions resulted in a reduction in headcount of approximately 400 employees, with the reduction in headcount occurring during the third and fourth quarters of fiscal 2008. Additionally, other actions taken during fiscal 2008 were not included in the restructuring plan. Altogether, there were more than 500 fewer associates in our Retail business by the end of the fiscal year. We recorded a pre-tax restructuring and impairment charge of \$4.0 million during the third quarter of fiscal 2008 and \$2.8 million in the fourth quarter. Of the \$6.8 million for the fiscal year, \$3.3 million is for lease cancellation and other costs which will be paid out over periods ranging from less than one to seven years; \$2.7 million, which was non-cash in nature, related to fixed asset impairment charges, primarily for real property and leasehold improvements; and \$0.9 million was related to employee severance and benefits. Within the next six months, the Company expects to record a net gain of approximately \$2.5 to \$3.5 million on the sale of real estate held for sale, net of restructuring for remaining charges of lease termination and other costs, after which time the consolidation plan should be complete. The cumulative net pre-tax cost of implementing the 2008 restructuring is estimated to be between \$3.3 million and \$4.3 million (\$2.1 million and \$2.7 million after tax).

On September 6, 2006, we announced a plan to close our Spruce Pine, North Carolina case goods manufacturing facility and convert our Atoka, Oklahoma upholstery manufacturing facility into a regional distribution center. In connection with this initiative, we permanently ceased production at both locations, allocating production among our remaining domestic manufacturing locations and selected offshore suppliers. The decision impacted approximately 465 employees with the reduction in headcount occurring during the second and third quarters of fiscal 2007. We recorded a pre-tax restructuring and impairment charge of \$14.1 million during the quarter ended September 30, 2006, of which \$4.0 million was related to employee severance and benefits and other plant exit costs, and \$10.1 million, which was non-cash in nature, was related to fixed asset impairment charges, primarily for real property and machinery and equipment, stemming from the decision to cease production activities. During the first six months of fiscal 2007, adjustments totaling \$0.4 million were recorded to reverse remaining previously established accruals which were no longer deemed necessary.

In the first quarter of fiscal 2006, we announced a plan to convert one of our existing manufacturing facilities into a regional distribution center. The facility, formerly involved in the production of wood case goods furniture, is located in Dublin, Virginia. In connection with this initiative, we permanently ceased production at the Dublin location, allocating production among our remaining domestic manufacturing locations and selected offshore suppliers, and consolidated the distribution operations of our existing Old Fort, North Carolina location into this larger facility. The decision impacted approximately 325 employees, of which approximately 75 have been employed in new positions. We recorded a pre-tax restructuring and impairment charge of \$4.2 million during the quarter ended September 30, 2005, of which \$1.3 million was related to employee severance and benefits and other plant exit costs, and \$2.9 million, which was non-cash in nature, was related to fixed asset impairment charges, primarily for machinery and equipment, stemming from the decision to cease production activities. During the first six months of fiscal 2007, adjustments totaling \$0.2 million were recorded to reverse remaining previously established accruals which were no longer deemed necessary.

In the fourth quarter of fiscal 2004, we announced a plan to close and consolidate two of our manufacturing facilities. The plants, both involved in the production of case goods, were located in Boonville, New York and Bridgewater, Virginia. The plant closures resulted in a headcount reduction totaling approximately 460 employees: 270 employees effective June 25, 2004, and 190 employees throughout the first quarter of fiscal 2005. A pre-tax restructuring and impairment charge of \$12.8 million was recorded for costs associated with these plant closings, of which \$4.5 million related to employee severance and benefits and other plant exit costs, and \$8.3 million related to fixed asset impairment charges, primarily for real property and machinery and equipment associated with the closed facilities. During the first six months of fiscal 2005, adjustments totaling \$0.2 million were recorded to reverse the remaining previously established accruals which were no longer deemed

necessary.

(2) On April 27, 2004, we declared a special, one-time cash dividend of \$3.00 per common share, payable on May 27, 2004 to shareholders of record as of May 10, 2004.

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Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation

The following discussion of financial condition and results of operations is based upon, and should be read in conjunction with, our Consolidated Financial Statements (including the notes thereto) included under Item 8 of this Annual Report.

Forward-Looking Statements

Management's discussion and analysis of financial condition and results of operations and other sections of this Annual Report contain forward-looking statements relating to our future results. Such forward-looking statements are identified by use of forward-looking words such as anticipates, believes, plans, estimates, expects, and intends or words or phrases of similar expression. These forward-looking statements are subject to management decisions and various assumptions, risks and uncertainties, including, but not limited to: the effects of terrorist attacks or conflicts or wars involving the United States or its allies or trading partners; the effects of labor strikes; weather conditions that may affect sales; volatility in fuel, utility, transportation and security costs; changes in global or regional political or economic conditions, including changes in governmental and central bank policies; changes in business conditions in the furniture industry, including changes in consumer spending patterns and demand for home furnishings; effects of our brand awareness and marketing programs, including changes in demand for our existing and new products; 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; competitive factors, including changes in products or marketing efforts of others; pricing pressures; fluctuations in interest rates and the cost, availability and quality of raw materials; those matters discussed in Items 1A and 7A of this Annual Report and in our SEC filings; and our future decisions. Accordingly, actual circumstances and results could differ materially from those contemplated by the forward-looking statements.

Critical Accounting Policies

Our consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles which require, in some cases, that certain estimates and assumptions be made that affect the amounts and disclosures reported in those financial statements and the related accompanying notes. Estimates are based on currently known facts and circumstances, prior experience and other assumptions believed to be reasonable. We use our best judgment in valuing these estimates and may, as warranted, solicit external advice. Actual results could differ from these estimates, assumptions and judgments, and these differences could be material. The following critical accounting policies, some of which are impacted significantly by estimates, assumptions and judgments, affect our consolidated financial statements.

Inventories Inventories (finished goods, work in process and raw materials) are stated at the lower of cost, determined on a first-in, first-out basis, or market. Cost is determined based solely on those charges incurred in the acquisition and production of the related inventory (i.e. material, labor and manufacturing overhead costs). We estimate an inventory valuation allowance for excess quantities and obsolete items based on specific identification and historical write-downs, taking into account future demand and market conditions. If actual demand or market conditions in the future are less favorable than those estimated, additional inventory write-downs may be required.

Revenue Recognition Revenue is recognized when all of the following have occurred: persuasive evidence of a sales arrangement exists (e.g. a wholesale purchase order or retail sales invoice); the sales arrangement specifies a fixed or determinable sales price; product is shipped or services are provided to the customer; and collectibility is reasonably assured. As such, revenue recognition occurs upon the shipment of goods to independent retailers or, in the case of Ethan Allen-owned retail design centers, upon delivery to the customer. Recorded sales provide for estimated returns and allowances. We permit our customers to return defective products and incorrect shipments, and terms we offer are standard for the industry.

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Allowance for Doubtful Accounts We maintain an allowance for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. The allowance for doubtful accounts is based on a review of specifically identified accounts in addition to an overall aging analysis. Judgments are made with respect to the collectibility of accounts receivable based on historical experience and current economic trends. Actual losses could differ from those estimates.

Retail Design Center Acquisitions - We account for the acquisition of retail design centers and related assets in accordance with Statement of Financial Accounting Standards (SFAS) No. 141, *Business Combinations*, which requires application of the purchase method for all business combinations initiated after June 30, 2001. Accounting for these transactions as purchase business combinations requires the allocation of purchase price paid to the assets acquired and liabilities assumed based on their fair values as of the date of the acquisition. The amount paid in excess of the fair value of net assets acquired is accounted for as goodwill.

Impairment of Long-Lived Assets and Goodwill We periodically evaluate whether events or circumstances have occurred that indicate that long-lived assets may not be recoverable or that the remaining useful life may warrant revision. When such events or circumstances are present, we assess the recoverability of long-lived assets by determining whether the carrying value will be recovered through the expected undiscounted future cash flows resulting from the use of the asset. In the event the sum of the expected undiscounted future cash flows is less than the carrying value of the asset, an impairment loss equal to the excess of the asset's carrying value over its fair value is recorded. The long-term nature of these assets requires the estimation of cash inflows and outflows several years into the future and only takes into consideration technological advances known at the time of the impairment test.

In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*, goodwill and other indefinite-lived intangible assets are evaluated for impairment on an annual basis and between annual tests whenever events or circumstances indicate that the carrying value of the goodwill or other intangible asset may exceed its fair value. We conduct our required annual impairment test during the fourth quarter of each fiscal year and use a discounted cash flow model to estimate fair value. This model requires the use of long-term planning forecasts and assumptions regarding industry-specific economic conditions that are outside our control.

Business Insurance Reserves We have insurance programs in place to cover workers' compensation and property/casualty claims. The insurance programs, which are funded through self-insured retention, are subject to various stop-loss limitations. We accrue estimated losses using actuarial models and assumptions based on historical loss experience. Although we believe that the insurance reserves are adequate, the reserve estimates are based on historical experience, which may not be indicative of current and future losses. In addition, the actuarial calculations used to estimate insurance reserves are based on numerous assumptions, some of which are subjective. We adjust insurance reserves, as needed, in the event that future loss experience differs from historical loss patterns.

Other Loss Reserves We have a number of other potential loss exposures incurred in the ordinary course of business such as environmental claims, product liability, litigation, tax liabilities, restructuring charges, and the recoverability of deferred income tax benefits. Establishing loss reserves for these matters requires the use of estimates and judgment with regard to maximum risk exposure and ultimate liability or realization. As a result, these estimates are often developed with our counsel, or other appropriate advisors, and are based on our current understanding of the underlying facts and circumstances. Because of uncertainties related to the ultimate outcome of these issues or the possibilities of changes in the underlying facts and circumstances, additional charges related to these issues could be required in the future.

Table of Contents**Basis of Presentation**

As of June 30, 2008, Ethan Allen Interiors Inc. has no material assets other than its ownership of the capital stock of Ethan Allen Global, Inc. and conducts all significant transactions through Ethan Allen Global, Inc.; therefore, substantially all of the financial information presented herein is that of Ethan Allen Global, Inc.

Results of Operations

Our revenues are comprised of (i) wholesale sales to independently owned and Company owned retail design centers and (ii) retail sales of Company owned design centers. See Note 16 to our Consolidated Financial Statements for the year ended June 30, 2008 included under Item 8 of this Annual Report.

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

	Fiscal Year Ended June 30,		
	2008	2007	2006
<u>Revenue:</u>			
Wholesale segment	\$ 616.2	\$ 656.0	\$ 736.1
Retail segment	724.6	698.6	691.0
Elimination of inter-segment sales	(360.8)	(349.3)	(360.7)
Consolidated revenue	\$ 980.0	\$ 1,005.3	\$ 1,066.4
<u>Operating Income:</u>			
Wholesale segment (1)	\$ 100.3	\$ 99.2	\$ 125.2
Retail segment (2)	(2.8)	15.2	19.7
Adjustment for inter-company profit(3)	(1.5)	_(3.3)	_(2.2)
Consolidated operating income	\$ 96.0	\$ 111.1	\$ 142.7

(1) Operating income for the Wholesale segment for the twelve months ended June 2007 and 2006 includes pre-tax restructuring and impairment charges of \$13.4 million and \$4.2 million, respectively.

(2) Operating income for the Retail segment for the twelve months ended June 2008 includes pre-tax restructuring and impairment charges of \$6.8 million.

(3) Represents the change in the inventory profit elimination entry necessary to adjust for the embedded wholesale profit contained in Ethan Allen-owned design center inventory existing at the end of the period.

Fiscal 2008 Compared to Fiscal 2007

Consolidated revenue for the fiscal year ended June 30, 2008 decreased by \$25.3 million, or 2.5%, to \$980 million, from \$1.005 billion in fiscal 2007. Net sales for the period largely reflect the delivery of product associated with booked orders and backlog existing as of beginning of the period. During the year, sales were impacted by a weak retail environment for home furnishings, particularly during the latter half of the year. We believe this is due to continued weakening of consumer confidence with the current economic conditions in the U.S. and abroad. These factors were partially offset by (i) the positive effects of our continued efforts to reposition the retail network, (ii) new product introductions, and (iii) an increase in the continued use of national television as an advertising medium, where we emphasize to clients our interior design services and the full line of our quality product offerings.

We have made considerable investment within the retail network to strengthen the level of service, professionalism, interior design competence, efficiency, and effectiveness of retail design center personnel. The implementation of the team concept is the latest phase of that progression, which resulted in the development of over 280 interior design teams. We believe that with this structure along with the emphasis in our messaging to clients that we are here to help as little or as much as they like, as well as offering the benefit of making appointments with our design professionals, we continue to improve the customer service experience.

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Wholesale revenue for fiscal 2008 decreased by \$39.8 million, or 6.1%, to \$616.2 million from \$656.0 million in the prior year. The year-over-year decrease was primarily attributable to a decline in the incoming order rate as a result of the softer retail environment for home furnishings noted throughout much of the current period and from fewer independent retail design centers, which decreased to 136 from 155 including six locations transferred in to the company's Retail division during the year.

Retail revenue from Ethan Allen-owned design centers for the twelve months ended June 30, 2008 increased by \$26.0 million, or 3.7%, to \$724.6 million from \$698.6 million for the twelve months ended June 30, 2007. The increase in retail sales by Ethan Allen-owned design centers was attributable to higher sales generated by newly opened (including relocated) or acquired design centers of \$66.8 million. This favorable variance was partially offset by unfavorable variances related to a decrease in comparable design center delivered sales of \$21.3 million, or 3.2%, and reduced revenue from sold and closed design centers of \$19.5 million. The number of Ethan Allen-owned design centers increased to 159 as of June 30, 2008 as compared to 158 as of June 30, 2007. During that twelve month period, we acquired five design centers from, and opened one previously owned by independent retailers, and opened eighteen new design centers (of which eleven were relocations).

Comparable design centers are those which have been operating for at least 15 months. Minimal net sales, derived from the delivery of customer ordered product, are generated during the first three months of operations of newly opened (including relocated) design centers. Design centers acquired by us from independent retailers are included in comparable design center sales in their 13th full month of Ethan Allen-owned operations.

Year-over-year, written business of Ethan Allen-owned design centers increased 0.6% and comparable design center written business decreased 5.6%. Over that same period, wholesale orders decreased 8.0%. Retail written business reflects the softer retail environment for home furnishings noted throughout much of the current year, likely offset, to some degree, by (i) our continued efforts to reposition the retail network, (ii) recent product introductions, and (iii) our continued use of national television as an advertising medium throughout much of the year.

Gross profit for fiscal 2008 declined slightly to \$526.1 million from \$526.6 million in fiscal 2007. The \$0.5 million decrease in gross profit was primarily attributable to a decline in wholesale sales volume partially offset by a shift in sales mix with retail sales representing a higher proportionate share of total sales in the current full year (74%) as compared to the prior full year (69%). The consolidated gross margin increased to 53.7% for fiscal 2008 from 52.4% in fiscal 2007 as a result, primarily, of the factors set forth above.

Operating profit, the elements of which are discussed in greater detail below, was impacted by the following items during the twelve months ended June 30, 2008 and 2007:

On January 10, 2008, we announced a plan to consolidate the operations of certain company owned retail design centers and retail service centers. In connection with this initiative, we have permanently ceased operations at ten design centers and six retail service centers which, for the most part, were consolidated into other existing operations. We also implemented our design team concept across the Retail division at the end of the fiscal year. These decisions resulted in a reduction in headcount of approximately 400 employees, with the reduction in headcount occurring during the third and fourth quarters of fiscal 2008. Additionally, other actions taken during fiscal 2008 were not included in the restructuring plan. Altogether, there were more than 500 fewer associates in our Retail business by the end of the fiscal year. We recorded a pre-tax restructuring and impairment charge of \$4.0 million during the third quarter of fiscal 2008 and \$2.8 million in the fourth quarter. Of the \$6.8 million for the fiscal year, \$3.3 million is for lease cancellation and other costs which will be paid out over periods ranging from less than one to seven years; \$2.7 million, which was non-cash in nature, related to fixed asset impairment charges, primarily for real property and leasehold improvements; and \$0.9 million was related to employee severance and benefits. Within the next six months, the Company expects to record a net gain of approximately \$2.5 million to \$3.5 million on the sale of real estate held for sale, net of restructuring for remaining charges

of lease termination and other costs, after which time the consolidation plan should be complete. The cumulative

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net pre-tax cost of implementing the 2008 restructuring is estimated to be between \$3.3 million and \$4.3 million (\$2.1 million and \$2.7 million after tax).

On September 6, 2006, we announced a plan to close our Spruce Pine, North Carolina case goods manufacturing facility and convert our Atoka, Oklahoma upholstery manufacturing facility into a regional distribution center. In connection with this initiative, we permanently ceased production at both locations, allocating production among our remaining domestic manufacturing locations and selected offshore suppliers. The decision impacted approximately 465 employees with the reduction in headcount occurring during the second and third quarters of fiscal 2007. We recorded a pre-tax restructuring and impairment charge of \$14.1 million during the quarter ended September 30, 2006, of which \$4.0 million was related to employee severance and benefits and other plant exit costs, and \$10.1 million, which was non-cash in nature, was related to fixed asset impairment charges, primarily for real property and machinery and equipment, stemming from the decision to cease production activities. During the first six months of fiscal 2007, adjustments totaling \$0.4 million were recorded to reverse remaining previously established accruals which were no longer deemed necessary.

Operating expenses increased \$14.6 million, or 3.5%, to \$430.1 million, or 43.9% of net sales, in fiscal 2008 from \$415.5 million, or 41.3% of net sales, in fiscal 2007. This increase was primarily attributable to increased costs associated with (i) occupancy, managerial salaries and benefits, and designer compensation largely because of our continued efforts to be located in more prominent locations and to upgrade our ability to provide professional service during the year, as well as (ii) the impact of higher fuel costs on warehousing and delivery. Partially offsetting these increases were (i) decreases in workers compensation insurance and health insurance and compensation costs as a result of improved claim experience, and (ii) a period-over-period reduction in the restructuring and impairment charges mentioned earlier.

Consolidated operating income for the year ended June 30, 2008 totaled \$96.0 million, or 9.8% of net sales, compared to \$111.1 million, or 11.1% of net sales, in the prior year. The decrease of \$15.1 million was primarily attributable to higher period-over-period operating expenses discussed above, partially offset by (i) a reduction in restructuring and impairment charges and (ii) a small decline in gross profit, all of which were discussed previously.

Wholesale operating income for fiscal 2008 totaled \$100.3 million, or 16.3% of net sales, as compared to \$99.2 million, or 15.1% of net sales, in the prior year. The improvement of \$1.1 million was primarily attributable to (i) the reduction in restructuring and impairment charges mentioned above, and (ii) improved performance within our remaining product sourcing operations, including a reduction in overhead as a result of past plant closures. These factors were partially offset by an overall decrease in wholesale shipments during the year.

Retail operating income decreased \$18.0 million to a \$2.8 million loss, or (0.4)% of sales, for fiscal 2008, from \$15.2 million, or 2.2% of sales, for fiscal 2007. The decrease in retail operating income generated by Ethan Allen-owned design centers was primarily attributable to higher operating expenses as a result of our continued efforts to reposition the retail network including the \$6.8 million restructuring and impairment charges recorded in the year. These unfavorable variances were partially offset by higher gross profit on the higher sales recorded during the year.

Interest and other miscellaneous income, net totaled \$7.9 million in fiscal 2008 as compared to \$10.4 million in fiscal 2007. The \$2.5 million decrease was mostly due to decreased investment income resulting from lower cash and short term investment balances maintained during the current period coupled with lower rates of interest.

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Interest and other related financing costs remained largely unchanged at \$11.7 million from \$11.8 million in the prior year. This amount mostly consists of interest expense on our senior unsecured debt issued in September 2005.

Income tax expense totaled \$34.1 million for fiscal 2008 as compared to \$40.5 million for fiscal 2007. Our effective tax rate for the current year was 37.0%, compared to 36.9% in the prior year. The effective tax rate was a

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result, primarily, of the adverse effects of recently-enacted changes within certain state tax legislation, increased state income tax liability arising in connection with the operation of a greater number of Company owned design centers, and increased foreign income tax liability associated with our five retail design centers operating in Canada and our manufacturing operation in Mexico. Partially offsetting these items were the benefits derived from the manufacturers' deduction provided for under The Jobs Creation Act of 2004 and certain tax planning initiatives.

Net income for fiscal 2008 was of \$58.1 million as compared to \$69.2 million in fiscal 2007. Net income per diluted share totaled \$1.97 in the current year and \$2.15 per diluted share in the prior year.

Fiscal 2007 Compared to Fiscal 2006

Consolidated revenue for the fiscal year ended June 30, 2007 decreased by \$61.1 million, or 5.7%, to \$1.005 billion, from \$1.066 billion in fiscal 2006. Net sales for the period largely reflect the delivery of product associated with booked orders and backlog existing as of beginning of the period. During the year, sales were impacted by (i) a weak retail environment for home furnishings, and (ii) a substantial reduction in backlog experienced during the prior year as a result of both a more favorable economic environment and our initiative to reduce the lead time associated with product delivery to both our independent retailers and consumers. These factors were partially offset by (i) the positive effects of our continued efforts to reposition the retail network, and (ii) new product introductions.

To date, the repositioning of the retail network has involved three primary elements: the opening of larger, new or relocated design centers in more prominent locations; development of a more focused advertising campaign to highlight our solutions-based approach and position Ethan Allen as an authority in style and design; and investment within the retail network to strengthen the existing management structure. Implementation of our project management initiative, which has resulted in the promotion and/or hiring of more than 300 project managers, has enabled us to increase the level of service, professionalism, interior design competence, efficiency, and effectiveness of retail design center personnel. With project managers actively partnering with design consultants and their customers, we believe we have improved the customer service experience and facilitated, to some degree, better awareness of potential cross-selling opportunities.

Wholesale revenue for fiscal 2007 decreased by \$80.1 million, or 10.9%, to \$656.0 million from \$736.1 million in the prior year. The year-over-year decrease was primarily attributable to a decline in the incoming order rate as a result of the softer retail environment for home furnishings noted throughout much of the current period.

Retail revenue from Ethan Allen-owned design centers for the twelve months ended June 30, 2007 increased by \$7.6 million, or 1.1%, to \$698.6 million from \$691.0 million for the twelve months ended June 30, 2006. The increase in retail sales by Ethan Allen-owned design centers was attributable to higher sales generated by newly opened (including relocated) or acquired design centers of \$62.0 million. This favorable variance was partially offset by unfavorable variances related to a decrease in comparable design center delivered sales of \$41.3 million, or 6.3%, and reduced revenue from sold and closed design centers, which generated \$13.1 million fewer sales during fiscal 2007 as compared to fiscal 2006. The number of Ethan Allen-owned design centers increased to 158 as of June 30, 2007 as compared to 139 as of June 30, 2006. During that twelve month period, we acquired 12 design centers from independent retailers and opened 10 design centers (3 of which were relocations).

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Comparable design centers are those which have been operating for at least 15 months. Minimal net sales, derived from the delivery of customer ordered product, are generated during the first three months of operations of newly opened (including relocated) design centers. Design centers acquired by us from independent retailers are included in comparable design center sales in their 13th full month of Ethan Allen-owned operations.

Year-over-year, written business of Ethan Allen-owned design centers increased 2.9% and comparable design center written business decreased 5.2%. Over that same period, wholesale orders decreased 8.6%. Retail written business reflects the softer retail environment for home furnishings noted throughout much of fiscal 2007, likely

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offset, to some degree, by (i) our continued efforts to reposition the retail network, (ii) recent product introductions, and (iii) our use of national television as an advertising medium throughout much of the year. Wholesale written business also reflects the impact of the aforementioned factors.

Gross profit for fiscal 2007 decreased to \$526.6 million from \$541.0 million in fiscal 2006. The \$14.4 million, or 2.7%, decrease in gross profit was primarily attributable to a decline in wholesale sales volume and inefficiencies experienced within our Spruce Pine, North Carolina and Atoka, Oklahoma manufacturing operations as a result of the phase-out of production at these facilities during the current year. Partially offsetting these factors were (i) a shift in sales mix with retail sales representing a higher proportionate share of total sales in fiscal 2007 (73%) as compared to the prior year (68%), and (ii) improved performance within our remaining product sourcing operations, including price stabilization with regard to the cost of foam and a reduction in overhead as a result of past plant closures. The consolidated gross margin increased to 52.4% for fiscal 2007 from 50.7% in fiscal 2006 as a result, primarily, of the factors set forth above.

Operating profit, the elements of which are discussed in greater detail below, was impacted by the following items during the twelve months ended June 30, 2007 and 2006:

On September 6, 2006, we announced a plan to close our Spruce Pine, North Carolina case goods manufacturing facility and convert our Atoka, Oklahoma upholstery manufacturing facility into a regional distribution center. In connection with this initiative, we permanently ceased production at both locations, allocating production among our remaining domestic manufacturing locations and selected offshore suppliers. The decision impacted approximately 465 employees with the reduction in headcount occurring during the second and third quarters of fiscal 2007. We recorded a pre-tax restructuring and impairment charge of \$14.1 million during the quarter ended September 30, 2006, of which \$4.0 million was related to employee severance and benefits and other plant exit costs, and \$10.1 million, which was non-cash in nature, was related to fixed asset impairment charges, primarily for real property and machinery and equipment, stemming from the decision to cease production activities. During the three months ended March 31, 2007 and December 31, 2006, adjustments totaling \$0.2 million and \$0.3 million, respectively, were recorded to reverse remaining previously established accruals which were no longer deemed necessary.

On September 7, 2005, we announced a plan to convert one of our existing manufacturing facilities into a regional distribution center. The facility, formerly involved in the production of wood case goods furniture, is located in Dublin, Virginia. In connection with this initiative, we permanently ceased production at the Dublin location, allocating production among our remaining domestic manufacturing locations and selected offshore suppliers, and consolidated the distribution operations of our existing Old Fort, North Carolina location into this larger facility. The decision impacted approximately 325 employees, of which approximately 75 have been employed in new positions. We recorded a pre-tax restructuring and impairment charge of \$4.2 million during the quarter ended September 30, 2005, of which \$1.3 million was related to employee severance and benefits and other plant exit costs, and \$2.9 million, which was non-cash in nature, was related to fixed asset impairment charges, primarily for machinery and equipment, stemming from the decision to cease production activities. During fiscal 2007, adjustments totaling \$0.2 million were recorded to reverse remaining previously established accruals which were no longer deemed necessary.

Including the restructuring and impairment charges referred to above, **operating expenses** increased \$17.2 million, or 4.3%, to \$415.5 million, or 41.3% of net sales, in fiscal 2007 from \$398.3 million, or 37.4% of net sales, in fiscal 2006. This increase was primarily attributable to increased costs associated with (i) our continued efforts to reposition the retail network which, during the year, resulted in higher costs associated with managerial salaries and benefits, occupancy, delivery and warehousing, and designer compensation, and (ii) the period-over-period change in the aforementioned restructuring and impairment charges. Partially offsetting these increases were (i) a decrease within certain compensation and benefit related costs, including share-based compensation expense, (ii) a decrease in retail advertising costs, and (iii) a reduction in operating costs associated with closed manufacturing facilities, including reduced losses incurred in connection with the disposition of certain property, plant and equipment.

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Including the restructuring and impairment charges referred to above, **consolidated operating income** for the year ended June 30, 2007 totaled \$111.1 million, or 11.1% of net sales, compared to \$142.7 million, or 13.4% of net sales, in the prior year. The decrease of \$31.6 million was primarily attributable to (i) higher period-over-period operating expenses and (ii) a decline in gross profit, both of which were discussed previously.

Including the restructuring and impairment charges referred to above, **wholesale operating income** for fiscal 2007 totaled \$99.2 million, or 15.1% of net sales, as compared to \$125.2 million, or 17.0% of net sales, in the prior year. The decrease of \$26.0 million was primarily attributable to (i) a decline in wholesale sales volume, (ii) the period-over-period change in the aforementioned restructuring and impairment charges, and (iii) inefficiencies experienced within our Spruce Pine, North Carolina and Atoka, Oklahoma manufacturing operations as a result of the phase-out of production at these facilities during fiscal 2007. These factors were partially offset by (i) improved performance within our remaining product sourcing operations, including price stabilization with regard to the cost of foam and a reduction in overhead as a result of past plant closures, (ii) a reduction in certain compensation and benefit related costs, including share-based compensation expense, and (iii) a decrease in operating costs associated with closed manufacturing facilities, including reduced losses incurred in connection with the disposition of certain property, plant and equipment.

Retail operating income decreased \$4.5 million to \$15.2 million, or 2.2% of sales, for fiscal 2007, from \$19.7 million, or 2.9% of sales, for fiscal 2006. The decrease in retail operating income generated by Ethan Allen-owned design centers was primarily attributable to higher operating expenses as a result of our continued efforts to reposition the retail network and a decline in sales volume associated with comparable design centers and design centers closed or sold during the period. These unfavorable variances were partially offset by higher sales volume generated by newly-opened (including relocations) or acquired design centers.

Interest and other miscellaneous income, net totaled \$10.4 million in fiscal 2007 as compared to \$4.9 million in fiscal 2006. The \$5.4 million increase was due, primarily, to (i) increased investment income resulting from higher interest rates and higher cash and short-term investment balances maintained during fiscal 2007, (ii) increased gains recorded in connection with the sale of selected real estate assets, and (iii) prior year losses incurred in connection with our past joint venture with U.K.-based MFI Furniture Group, Plc., the operations of which had ceased as of June 30, 2006.

Interest and other related financing costs increased \$2.3 million to \$11.8 million from \$9.5 million in the prior year. The increase was due, primarily, to interest expense incurred in connection with our issuance of senior unsecured debt in September 2005.

Income tax expense totaled \$40.5 million for fiscal 2007 as compared to \$52.4 million for fiscal 2006. Our effective tax rate for fiscal 2007 was 36.9%, down from 38.0% in the prior year. The lower effective tax rate was a result, primarily, of the benefits derived from the manufacturers deduction provided for under The Jobs Creation Act of 2004 and certain tax planning initiatives. Partially offsetting these items were the adverse effects of recently-enacted changes within certain state tax legislation, increased state income tax liability arising in connection with the operation of a greater number of Company owned design centers, and increased foreign income tax liability associated with our five retail design centers operating in Canada.

For fiscal 2007, we recorded **net income** of \$69.2 million as compared to \$85.7 million in fiscal 2006. Net income per diluted share totaled \$2.15 in fiscal 2007 and \$2.51 per diluted share in the prior year.

Liquidity and Capital Resources

As of June 30, 2008, we held cash and cash equivalents totaling \$74.4 million. Our principal sources of liquidity include cash and cash equivalents, cash flow from operations, and borrowing capacity under a \$200.0 million revolving credit facility.

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The credit facility includes an accordion feature which provides for an additional \$100.0 million of liquidity, if needed, as well as sub-facilities for trade and standby letters of credit of \$100.0 million and swingline loans of \$5.0 million. The credit facility contains various covenants which may limit our ability to: incur debt; engage in mergers and consolidations; make restricted payments; sell certain assets; make investments; and issue stock. We are also required to meet certain financial covenants including a fixed charge coverage ratio, which shall not be less than 3.00 to 1 for any period of four consecutive fiscal quarters ended on or after June 30, 2005, and a leverage ratio, which shall not be greater than 3.00 to 1 at any time. As of June 30, 2008, we had satisfactorily complied with these covenants.

In addition, on September 27, 2005, we completed a private offering of \$200.0 million in ten-year senior unsecured notes due 2015 (the Senior Notes). The Senior Notes were offered by Ethan Allen Global, Inc. (Global), a wholly-owned subsidiary of the Company, and have an annual coupon rate of 5.375%. We have used the net proceeds of \$198.4 million to expand our retail network, invest in our manufacturing and logistics operations, and for other general corporate purposes.

In July 2007, Standard & Poor's (S&P) lowered our corporate and senior unsecured credit ratings from A- to BBB+. Despite S&P's view that we (i) maintain a satisfactory business model consisting of a well-known brand, dedicated distribution network, and efficient manufacturing, and (ii) possess ample liquidity, the ratings action was initiated in response to continued softness in the housing market and its resultant impact on the home furnishings industry, including the credit protection measures of its participants. The change in our credit rating had no impact on (i) our ability to satisfactorily comply with our existing debt covenants or (ii) the pricing we are subject to under our credit facility.

A summary of net cash provided by (used in) operating, investing, and financing activities for each of the last three fiscal years is provided below (in millions):

	Fiscal Year Ended June 30,		
	2008	2007	2006
<u>Operating Activities</u>			
Net income plus depreciation and amortization	\$ 82.7	\$ 92.2	\$ 107.3
Working capital	(5.5)	20.9	17.0
Excess tax benefits from share-based payment arrangements	(2.1)	(5.0)	(0.5)
Other (non-cash items, long-term assets and liabilities)	11.0	11.1	7.8
Total provided by operating activities	\$ 86.1	\$ 119.2	\$ 131.6
<u>Investing Activities</u>			
Capital expenditures	\$ (60.0)	\$ (59.0)	\$ (41.5)
Acquisitions	(7.8)	(15.3)	(7.8)
Asset sales	6.9	5.4	4.4
Other	(0.5)	0.2	0.1
Total used in investing activities	\$ (61.3)	\$ (68.7)	\$ (44.8)
<u>Financing Activities</u>			
Revolving credit borrowings (payments), net	\$	\$	\$ (8.0)
Issuances (payments) of long-term debt, net			198.1
Issuances of common stock	0.5	0.5	2.3
Purchases and retirement of company stock	(75.6)	(57.2)	(84.1)
Payment of cash dividends	(25.5)	(24.8)	(23.1)
Excess tax benefits from share-based payment arrangements	2.1	5.0	0.5
Payment of deferred financing costs		(0.1)	(2.2)

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Total provided by (used in) financing activities	\$	(98.5)	\$	(76.6)	\$	83.5
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Operating Activities

During fiscal 2008, cash provided by operating activities decreased \$33.1 million because working capital (accounts receivable, inventories, prepaid and other current assets, customer deposits, payables, accrued expenses, and other current liabilities) arising in the ordinary course of business decreased in the prior fiscal year, and increased in the current fiscal year. Lower net income largely the result of lower sales than in the prior fiscal year was the other primary driver of the decrease in cash provided by operating activities.

Investing Activities

In fiscal 2008, cash used in investing activities was lower by \$7.4 million due, primarily, to a \$7.5 million decrease in cash utilized to fund acquisition activity. The level of capital expenditures remained relatively constant in fiscal 2008 as compared to fiscal 2007. The current level of capital spending is principally attributable to (i) new design center development and renovation, and (ii) entity-wide technology initiatives. We anticipate that cash from operations will be sufficient to fund future capital expenditures.

Financing Activities

For fiscal 2008, cash used in financing activities increased \$21.9 million as a result, primarily, of an increase in payments for the acquisition of treasury stock, and to a lesser extent by changes in excess tax benefits arising in connection with the exercise of share-based awards. On July 22, 2008, we declared a dividend of \$0.25 per common share, payable on October 27, 2008, to shareholders of record as of October 10, 2008. We expect to continue to declare quarterly dividends for the foreseeable future.

As of June 30, 2008, our outstanding debt totaled \$203.0 million, the current and long-term portions of which amounted to less than \$0.1 million and \$203.0 million, respectively. The aggregate scheduled maturities of long-term debt for each of the next five fiscal years are: less than \$0.1 million in both fiscal 2009 and fiscal 2010, \$3.9 million in fiscal 2011; and less than \$0.1 million in both fiscal 2012 and in fiscal 2013. The balance of our long-term debt (\$199.0 million) matures in fiscal 2016.

We had no revolving loans outstanding under the credit facility as of June 30, 2008, and stand-by letters of credit outstanding under the facility at that date totaled \$14.9 million. Remaining available borrowing capacity under the facility was \$185.1 million at June 30, 2008.

The following table summarizes, as of June 30, 2008, the timing of cash payments related to our outstanding contractual obligations (in thousands):

	Less than 1 Year	1-3 Years	4-5 Years	More than 5 Years
Total				

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Long-term debt obligations:										
Debt maturities	\$	203,029	\$	40	\$	3,917	\$	30	\$	199,042
Contractual interest		81,567		11,049		22,094		21,511		26,913
Operating lease obligations		245,703		39,221		64,287		47,916		94,279
Letters of credit		14,881		14,881						
Purchase obligations (1)										
Other long-term liabilities		277		28		34		26		189
Total contractual obligations	\$	545,457	\$	65,219	\$	90,332	\$	69,483	\$	320,423

(1) For purposes of this table, purchase obligations are defined as agreements that are enforceable and legally binding and that specify all significant terms, including: fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions; and the approximate timing of the transaction. While we are not a party to any significant long-term supply contracts or purchase commitments, we do, in the normal course of business, regularly initiate purchase orders for the procurement of (i) selected finished goods sourced from third-party suppliers, (ii) lumber, fabric, leather and other raw materials used in production, and (iii) certain outsourced services. All purchase orders are based on current needs and are fulfilled by suppliers within short time periods. At June 30, 2008, our open purchase orders with respect to such goods and services totaled approximately \$55 million.

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Further discussion of our contractual obligations associated with outstanding debt and lease arrangements can be found in Notes 7 and 8, respectively, to the Consolidated Financial Statements included under Item 8 of this Annual Report.

We believe that our cash flow from operations, together with our other available sources of liquidity, 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 June 30, 2008, we had working capital of \$174.7 million and a current ratio of 2.29 to 1.

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, we have 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. All of our common stock repurchases and retirements are recorded as treasury stock and result in a reduction of shareholders' equity.

During fiscal 2008, 2007 and 2006, we repurchased and/or retired the following shares of our common stock:

	2008 (1)	2007(2)(3)	2006(4)
Common shares repurchased	2,259,631	1,548,700	2,545,200
Cost to repurchase common shares	\$ 69,745,024	\$ 53,955,970	\$ 85,106,563
Average price per share	\$ 30.87	\$ 34.84	\$ 33.44

(1) During fiscal 2008, we also retired 661,688 shares of common stock tendered upon the exercise of outstanding employee stock options (592,861 to cover share exercise and 68,827 to cover related employee tax withholding liabilities). The value of such shares on the date redeemed was \$23,033,359, representing an average price per share of \$34.81.

(2) The cost to repurchase shares in fiscal 2007 reflects \$3,436,230 in common stock repurchases with a June 2007 trade date and a July 2007 settlement date.

(3) During fiscal 2007, we also retired 555,531 shares of common stock tendered upon the exercise of outstanding employee stock options (410,073 to cover share exercise and 145,458 to cover related employee tax withholding liabilities). The value of such shares on the date redeemed was \$21,506,193, representing an average price per share of \$38.71.

(4) The cost to repurchase shares in fiscal 2006 reflects \$1,000,807 in common stock repurchases with a June 2006 trade date and a July 2006 settlement date.

For each of the fiscal years presented above, we funded our purchases of treasury stock with existing cash on hand and cash generated through current period operations. During the last three fiscal years, the Board of Directors increased the then remaining share repurchase authorization as follows: to 2.5 million shares on November 15, 2005; to 2.5 million shares on July 25, 2006; to 2.5 million shares on July 24, 2007 and to 2.0 million shares on November 13, 2007. As of June 30, 2008, we had a remaining Board authorization to repurchase 1.6 million shares.

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, 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. Details of those arrangements for which we act as guarantor or obligor are provided below.

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Retailer-Related Guarantees

Independent Retailer Credit Facility

We have obligated ourselves, on behalf of one of our independent retailers, with respect to a \$1.5 million credit facility (the "Credit Facility") comprised of a \$1.1 million revolving line of credit and a \$0.4 million term loan. This obligation requires us, in the event of the retailer's default under the Credit Facility, to repurchase the retailer's inventory, applying such purchase price to the retailer's outstanding indebtedness under the Credit Facility. Our obligation remains in effect for the life of the term loan. The original agreement, which expired in April 2008, was replaced with a new agreement with the same terms and conditions which expires in December 2008. The maximum potential amount of future payments (undiscounted) that we could be required to make under this obligation is limited to the amount outstanding under the Credit Facility at the time of default (subject to pre-determined lending limits based on the value of the underlying inventory) and, as such, is not an estimate of future cash flows. No specific recourse or collateral provisions exist that would enable recovery of any portion of amounts paid under this obligation, except to the extent that we maintain the right to take title to the repurchased inventory. We anticipate that the repurchased inventory could subsequently be sold through our retail design center network.

As of June 30, 2008, the amount outstanding under the Credit Facility totaled approximately \$1.3 million, with \$1.0 million outstanding under the revolving credit line and \$0.3 million under the term loan. Based on the underlying creditworthiness of the respective retailer, we believe this obligation will expire without requiring funding by us. However, in accordance with the provisions of FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*, a liability has been established to reflect our non-contingent obligation under this arrangement as a result of modifications made to the Credit Facility subsequent to January 1, 2003. As of June 30, 2008, the carrying amount of such liability is less than \$50,000.

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 us and that financial service provider (the "Program Agreement"). 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. Our obligation remains in effect for the term of the Program Agreement which expires in July 2012. 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.

Product Warranties

Our products, including our case goods, upholstery and home accents, generally carry explicit product warranties that extend from three to five years and are provided based on terms that are generally accepted in the industry. All of 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 occasion, certain warranty and other related claims involve

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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 to be 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. As of June 30, 2008, the Company's product warranty liability totaled \$1.6 million.

Impact of Inflation

We believe inflation had an impact on our business the last three fiscal years but we have generally been able to increase prices, create operational efficiencies, or seek lower cost alternatives in order to offset increases in operating costs and effectively manage our working capital.

Business Outlook

While we cannot forecast, with any degree of certainty, changes in the various macro-economic factors that influence the incoming order rate, we believe that we are well-positioned both for the possibility of continued market softness and the next phase of economic growth based upon our existing business model which includes: (i) an established brand; (ii) a comprehensive complement of home decorating solutions; and (iii) a vertically-integrated operating structure.

As macro-economic factors change, however, it is also possible that our costs associated with production (including raw materials and labor), distribution (including freight and fuel charges), and retail operations (including compensation and benefits, delivery and warehousing, occupancy, and advertising expenses) may increase. We cannot reasonably predict when, or to what extent, such events may occur or what effect, if any, such events may have on our consolidated financial condition or results of operations.

The home furnishings industry remains extremely competitive with respect to both the sourcing of products and the retail sale of those products. Domestic manufacturers continue to face pricing pressures as a result of the manufacturing capabilities developed during recent years in other countries, specifically within Asia. In response to these pressures, a large number of U.S. furniture manufacturers and retailers, including us, have increased their overseas sourcing activities in an attempt to maintain a competitive advantage and retain market share. At the present time, we domestically manufacture and/or assemble approximately 60% of our products. We continue to believe that a balanced approach to product sourcing, which includes the domestic manufacture of certain product offerings coupled with the import of other selected products, provides the greatest degree of flexibility and is the most effective approach to ensuring that acceptable levels of quality, service and value are attained.

In addition, we believe that our retail strategy, which involves (i) a continued focus on providing a wide array of product solutions and superior customer service, (ii) the opening of new or relocated design centers in more prominent locations, while encouraging independent retailers to do the same, (iii) the implementation of design teams within our retail network, and (iv) further expansion internationally, provides an opportunity to further grow our business.

Further discussion of the home furnishings industry has been included under Item 1 of this Annual Report.

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Recent Accounting Pronouncements

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations* (SFAS No. 141(R)), which replaces SFAS No. 141. SFAS No. 141(R) establishes principles and requirements for how an acquirer in a business combination recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any controlling interest; recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS No. 141(R) is to be applied prospectively to business combinations for which the acquisition date is on or after an entity's fiscal year that begins after December 15, 2008 (July 1, 2009 for the Company). The impact of this Statement on the Company's financial position, results of operations and cash flows will be dependent on the terms, conditions and details of such acquisitions.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, which allows the Company to choose to measure selected financial assets and financial liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007 (July 1, 2008 for the Company). We are currently in the process of evaluating the impact of this authoritative guidance on our consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, which provides a single definition of fair value, and requires additional disclosure about the use of fair value to measure assets and liabilities. SFAS No. 157 emphasizes that fair value is a market-based measurement defined as the price that would be received to sell an asset or liability in an orderly transaction between market participants at the measurement date. Thus, SFAS No. 157 adheres to a definition of fair value based upon exit price as opposed to entry price (i.e. the price paid to acquire an asset or liability). This pronouncement is effective for fiscal years beginning after November 15, 2007 (July 1, 2008 for the Company). We are currently in the process of evaluating the impact of this authoritative guidance on our consolidated financial statements.

Item 7A. 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. Our policy has been to utilize United States dollar denominated borrowings to fund 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 do 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 do not impact earnings or cash flows. At June 30, 2008, we had no floating-rate debt obligations outstanding. As of that same date, our fixed-rate debt obligations consist, primarily, of the Senior Notes issued on September 27, 2005. The estimated fair value of the Senior Notes as of June 30, 2008, which is based on changes, if any, in interest rates and our creditworthiness subsequent to the date on which the debt was issued, and which has been determined using quoted market prices, was \$182.1 million as compared to a carrying value of \$198.8 million.

Foreign currency exchange risk is primarily limited to our operation of five Ethan Allen-owned retail design centers located in Canada as substantially all purchases of imported parts and finished goods are denominated in

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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.

Historically, we have not entered into financial instrument, including derivative, transactions for trading or other speculative purposes or to manage interest rate or currency exposure. However, in connection with the issuance of the Senior Notes, Global, in July and August 2005, entered into 6 separate forward contracts to hedge the risk-free interest rate associated with \$108.0 million of the related debt in order to minimize the negative impact of interest rate fluctuations on earnings, cash flows and equity. The forward contracts were entered into with a major banking institution thereby mitigating the risk of credit loss. Upon issuance of the Senior Notes in September 2005, the related forward contracts were settled. At the present time, we have no current plans to engage in further hedging activities.

Item 8. Financial Statements and Supplementary Data

Our Consolidated Financial Statements and Supplementary Data are listed under Item 15 of this Annual Report.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders

Ethan Allen Interiors Inc.:

We have audited the accompanying consolidated balance sheets of Ethan Allen Interiors Inc. and Subsidiaries (the Company) as of June 30, 2008 and 2007, and the related consolidated statements of operations, shareholders' equity and cash flows for each of the years in the three-year period ended June 30, 2008. We also have audited the Company's internal control over financial reporting as of June 30, 2008, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on these consolidated financial statements and an opinion on the Company's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the consolidated financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made

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only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Ethan Allen Interiors Inc. and Subsidiaries as of June 30, 2008 and 2007, and the results of their operations and their cash flows for each of the years in the three-year period ended June 30, 2008, in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, Ethan Allen Interiors Inc. and Subsidiaries maintained, in all material respects, effective internal control over financial reporting as of June 30, 2008, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

As discussed in Notes 1 and 11 to the consolidated financial statements, effective July 1, 2005, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment*. Also, as discussed in Notes 1 and 12 to the consolidated financial statements, effective July 1, 2007, the Company adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109*.

/s/ KPMG LLP

Stamford, Connecticut
August 21, 2008

Table of Contents**ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES****Consolidated Balance Sheets****June 30, 2008 and 2007**

(In thousands, except share data)

	2008	2007
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 74,376	\$ 147,879
Accounts receivable, less allowance for doubtful accounts of \$2,535 at June 30, 2008 and \$2,042 at June 30, 2007	12,672	14,602
Inventories (note 4)	186,265	181,884
Prepaid expenses and other current assets	32,860	33,104
Deferred income taxes (note 12)	4,005	4,960
Total current assets	310,178	382,429
Property, plant and equipment, net (note 5)	350,432	322,185
Goodwill and other intangible assets (notes 3 and 6)	96,823	92,500
Other assets	4,540	5,484
Total assets	\$ 761,973	\$ 802,598
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Current maturities of long-term debt (note 7)	\$ 41	\$ 40
Customer deposits	47,297	52,072
Accounts payable	26,444	26,650
Accrued compensation and benefits	32,568	35,243
Accrued expenses and other current liabilities	29,152	33,434
Total current liabilities	135,502	147,439
Long-term debt (note 7)	202,988	202,868
Other long-term liabilities	20,383	12,003
Deferred income taxes (note 12)	27,327	30,646
Total liabilities	386,200	392,956
Shareholders' equity (notes 9, 10, 11 and 15):		
Class A common stock, par value \$.01, 150,000,000 shares authorized, 48,251,780 shares issued at June 30, 2008 and 47,454,450 shares issued at June 30, 2007	482	474
Class B common stock, par value \$.01, 600,000 shares authorized; no shares issued and outstanding at June 30, 2008 and June 30, 2007		
Preferred stock, par value \$.01, 1,055,000 shares authorized, no shares issued and outstanding at June 30, 2008 and 2007		
Additional paid-in capital	354,725	330,268
	355,207	330,742
Less: Treasury stock (at cost), 19,565,901 shares at June 30, 2008 and 16,644,582 shares at June 30, 2007	(588,783)	(496,005)
Retained earnings	606,648	573,535
Accumulated other comprehensive income	2,701	1,370

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Total shareholders' equity		375,773		409,642
Total liabilities and shareholders' equity	\$	761,973	\$	802,598

See accompanying notes to consolidated financial statements.

Table of Contents**ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES****Consolidated Statements of Operations****For Years Ended June 30, 2008, 2007 and 2006**

(In thousands, except per share data)

	2008	2007	2006
Net Sales	\$ 980,045	\$ 1,005,312	\$ 1,066,390
Cost of sales	453,980	478,729	525,408
Gross profit	526,065	526,583	540,982
Operating expenses:			
Selling	229,590	223,146	224,404
General and administrative	193,639	178,876	169,665
Restructuring and impairment charge (note 2)	6,836	13,442	4,241
Total operating expenses	430,065	415,464	398,310
Operating income	96,000	111,119	142,672
Interest and other miscellaneous income, net	7,891	10,369	4,926
Interest and other related financing costs (note 7)	11,713	11,762	9,493
Income before income taxes	92,178	109,726	138,105
Income tax expense (note 12)	34,106	40,499	52,423
Net income	\$ 58,072	\$ 69,227	\$ 85,682
<u>Per share data (notes 10 and 17):</u>			
Net income per basic share	\$ 1.98	\$ 2.19	\$ 2.58
Basic weighted average common shares	29,267	31,566	33,210
Net income per diluted share	\$ 1.97	\$ 2.15	\$ 2.51
Diluted weighted average common shares	29,470	32,261	34,086
Dividends declared per common share	\$ 0.88	\$ 0.80	\$ 0.72

See accompanying notes to consolidated financial statements.

Table of Contents**ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES****Consolidated Statements of Cash Flows****For the years Ended June 30, 2008, 2007 and 2006**

(In thousands)

	2008	2007	2006
Operating activities			
Net income	\$ 58,072	\$ 69,227	\$ 85,682
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	24,670	23,013	21,599
Compensation expense related to share-based awards	1,260	821	1,900
Provision (benefit) for deferred income taxes	(2,364)	200	(792)
Excess tax benefits from shared-based awards	(2,093)	(5,015)	(495)
Restructuring and impairment charge	1,762	9,439	2,915
(Gain) loss on disposal of property, plant and equipment	110	(391)	2,841
Other	221	500	584
Changes in operating assets and liabilities, net of effects of acquired businesses:			
Accounts receivable	618	6,677	3,697
Inventories	(91)	14,531	3,479
Prepaid and other current assets	3,626	220	3,767
Other assets	660	657	690
Customer deposits	(9,086)	(4,201)	(4,596)
Accounts payable	3,230	(4,334)	8,730
Accrued expenses and other current liabilities	(3,784)	7,993	1,882
Other liabilities	9,326	(148)	(294)
Net cash provided by operating activities	86,137	119,189	131,589
Investing activities:			
Proceeds from the disposal of property, plant and equipment	6,943	5,431	4,433
Capital expenditures	(60,038)	(59,073)	(41,505)
Acquisitions	(7,777)	(15,297)	(7,791)
Cash payment on hedging contracts			(930)
Other	(462)	198	978
Net cash used in investing activities	(61,334)	(68,741)	(44,815)
Financial activities:			
Borrowings on revolving credit facility			17,000
Payments on revolving credit facility			(25,000)