Lumber Liquidators Holdings, Inc.
Form 10-Q
July 25, 2012
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2012

or

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

For the transition period from to

Commission File Number: 001-33767

Lumber Liquidators Holdings, Inc.

(Exact name of registrant as specified in its charter)

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

(757) 259-4280

(Registrant s telephone number, including area code)

Not Applicable

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

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

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

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

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

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

As of July 23, 2012, there were 27,047,332 shares of the registrant s common stock, par value of $0.001 per share, outstanding.

Table of Contents

LUMBER LIQUIDATORS HOLDINGS, INC.

Quarterly Report on Form 10-Q

For the quarter ended June 30, 2012

TABLE OF CONTENTS

Table of Contents

PART I

FINANCIAL INFORMATION

Item 1. Financial Statements.

Lumber Liquidators Holdings, Inc.

Condensed Consolidated Balance Sheets

(in thousands, except share data)

	June 30, 2012 *(unaudited)*	December 31, 2011
Assets		
Current Assets:		
Cash and Cash Equivalents	$ 31,521	$ 61,675
Merchandise Inventories	211,598	164,139
Prepaid Expenses	5,206	4,292
Other Current Assets	5,541	7,863
Total Current Assets	**253,866**	**237,969**
Property and Equipment, net	46,147	44,147
Goodwill	9,693	9,693
Other Assets	1,953	3,045
Total Assets	**$ 311,659**	**$ 294,854**
Liabilities and Stockholders Equity		
Current Liabilities:		
Accounts Payable	$ 51,205	$ 38,161
Customer Deposits and Store Credits	23,002	18,120
Accrued Compensation	5,226	2,509
Sales and Income Tax Liabilities	3,779	5,092
Other Current Liabilities	7,377	6,839
Total Current Liabilities	**90,589**	**70,721**
Deferred Rent	3,487	3,328
Deferred Tax Liability	6,030	5,721
Stockholders Equity:		
Common Stock ($0.001 par value; 35,000,000 authorized; 27,189,232 and 27,894,543 outstanding, respectively)	28	28
Treasury Stock, at cost (1,363,195 and 53,085 shares, respectively)	(35,599)	(1,116)
Additional Capital	120,684	110,163
Retained Earnings	126,577	106,203
Accumulated Other Comprehensive Loss	(137)	(194)
Total Stockholders Equity	**211,553**	**215,084**
Total Liabilities and Stockholders Equity	**$ 311,659**	**$ 294,854**

See accompanying notes to condensed consolidated financial statements

Table of Contents

Lumber Liquidators Holdings, Inc.

Condensed Consolidated Statements of Income

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

(unaudited)

	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
Net Sales	**$ 210,347**	**$ 175,460**	**$ 398,381**	**$ 335,140**
Cost of Sales	131,867	115,736	249,764	217,623
Gross Profit	**78,480**	**59,724**	**148,617**	**117,517**
Selling, General and Administrative Expenses	58,685	51,051	115,503	99,504
Operating Income	19,795	8,673	33,114	18,013
Other (Income) Expense	(32)	(67)	(73)	(155)
Income Before Income Taxes	19,827	8,740	33,187	18,168
Provision for Income Taxes	7,650	3,453	12,813	7,104
Net Income	**$ 12,177**	**$ 5,287**	**$ 20,374**	**$ 11,064**
Net Income per Common Share Basic	**$ 0.44**	**$ 0.19**	**$ 0.74**	**$ 0.40**
Net Income per Common Share Diluted	**$ 0.43**	**$ 0.19**	**$ 0.72**	**$ 0.39**
Weighted Average Common Shares Outstanding:				
Basic	27,506,529	27,687,617	27,716,537	27,630,250
Diluted	28,032,391	28,430,209	28,270,934	28,404,455

See accompanying notes to condensed consolidated financial statements

Table of Contents

Lumber Liquidators Holdings, Inc.

Condensed Consolidated Statements of Other Comprehensive Income

(in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	**2011**	**2012**	**2011**
Net Income	**$ 12,177**	**$ 5,287**	**$ 20,374**	**$ 11,064**
Foreign Currency Translation Adjustments	(47)	(22)	57	(23)
Comprehensive Income	**$ 12,130**	**$ 5,265**	**$ 20,431**	**$ 11,041**

See accompanying notes to condensed consolidated financial statements

Table of Contents

Lumber Liquidators Holdings, Inc.

Condensed Consolidated Statements of Cash Flows

(in thousands)

(unaudited)

	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
Cash Flows from Operating Activities:		
Net Income	$ 20,374	$ 11,064
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Depreciation and Amortization	4,822	3,992
Stock-Based Compensation Expense	2,150	1,935
Changes in Operating Assets and Liabilities:		
Merchandise Inventories	(47,605)	(27,185)
Accounts Payable	12,894	7,084
Customer Deposits and Store Credits	4,889	7,470
Prepaid Expenses and Other Current Assets	1,441	(1,642)
Other Assets and Liabilities	3,487	735
Net Cash Provided by Operating Activities	**2,452**	**3,453**
Cash Flows from Investing Activities:		
Purchases of Property and Equipment	(6,675)	(8,297)
Net Cash Used in Investing Activities	**(6,675)**	**(8,297)**
Cash Flows from Financing Activities:		
Payments for Share Repurchases	(34,483)	(140)
Proceeds from the Exercise of Stock Options	6,469	2,116
Excess Tax Benefits on Stock Option Exercises	1,934	1,414
Net Cash (Used in) Provided by Financing Activities	**(26,080)**	**3,390**
Effect of Exchange Rates on Cash and Cash Equivalents	**149**	**(20)**
Net Decrease in Cash and Cash Equivalents	**(30,154)**	**(1,474)**
Cash and Cash Equivalents, Beginning of Period	**61,675**	**34,830**
Cash and Cash Equivalents, End of Period	**$ 31,521**	**$ 33,356**

See accompanying notes to condensed consolidated financial statements

Lumber Liquidators Holdings, Inc.

Notes to Condensed Consolidated Financial Statements

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

(unaudited)

NOTE 1. BASIS OF PRESENTATION

Lumber Liquidators Holdings, Inc. (the Company) is a multi-channel specialty retailer of hardwood flooring, and hardwood flooring enhancements and accessories, operating as a single business segment. The Company offers an extensive assortment of exotic and domestic hardwood species, engineered hardwoods and laminates direct to the consumer. The Company also features the renewable flooring products, bamboo and cork, and provides a wide selection of flooring enhancements and accessories, including moldings, noise-reducing underlay and adhesives. These products are primarily sold under the Company s private label brands, including the premium Bellawood brand floors. The Company sells primarily to homeowners or to contractors on behalf of homeowners through a network of 268 store locations in primary or secondary metropolitan areas in 46 states and nine store locations in Canada at June 30, 2012. In addition to the store locations, the Company s products may be ordered, and customer questions/concerns addressed, through both the call center in Toano, Virginia, and the website, www.lumberliquidators.com. The Company finishes the majority of the Bellawood products on its finishing line in Toano, Virginia, which along with the call center, corporate offices, and a distribution center, represent the Corporate Headquarters.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q for interim financial reporting pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). While these statements reflect all normal recurring adjustments which are, in the opinion of management, necessary for a fair presentation of the results of the interim period, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. Therefore, the interim condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes included in the Lumber Liquidators Holdings, Inc. annual report filed on Form 10-K for the year ended December 31, 2011.

The consolidated financial statements of the Company include the accounts of its wholly owned subsidiaries. All significant intercompany transactions have been eliminated in consolidation. The prior year balance sheet now segregates treasury stock from additional capital.

Results of operations for the three and six months ended June 30, 2012 are not necessarily indicative of the results to be expected for the full year.

NOTE 2. FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amounts of financial instruments such as cash and cash equivalents, notes receivable, accounts payable and other liabilities approximate fair value because of the short-term nature of these items. Of these financial instruments, the cash equivalents are classified as Level 1 as defined in the Financial Accounting Standards Board ASC 820 fair value hierarchy. The Company had cash equivalents of $170 at June 30, 2012 and $16,064 at December 31, 2011.

NOTE 3. NOTES RECEIVABLE

As of June 30, 2012, notes receivable from a Brazilian merchandise vendor, included in other assets, had an outstanding balance of $671. These two notes were established in 2005 and 2006 and bore interest at 15% and 12% per annum, which had been included in other (income) expense. During the three months ended June 30, 2012, the vendor was not able to ship against certain open purchase orders. Through discussion and inspection of facilities, the Company determined it unlikely that shipments would resume. As a result, the Company was not able to deduct principal and interest payments against the amount due for shipments, and has fully reserved the principal amount of the notes, with the provision included in selling, general and administrative expenses in both the three and six month periods ended June 30, 2012. As of December 31, 2011, these notes receivable had an outstanding balance of $696, of which $322 had been included in other current assets.

NOTE 4. STOCK REPURCHASE PROGRAM

On February 22, 2012, the Company s Board of Directors authorized the repurchase of up to $50,000 of the Company s

Table of Contents

common stock. The Company s stock repurchase program allows it to repurchase its common stock from time to time on the open market or in privately negotiated transactions. During the three months ended June 30, 2012, the Company repurchased 915,208 shares of its common stock on the open market at an average price of $27.74 per share for an aggregate cost of $25,405. During the six months ended June 30, 2012, the Company repurchased 1,302,177 shares of its common stock on the open market at an average price of $26.34 per share for an aggregate cost of $34,325. The Company has not purchased any stock through privately negotiated transactions. At June 30, 2012, the Company had authorized repurchases of $15,675 of its common stock remaining under the $50,000 stock repurchase program.

NOTE 5. NET INCOME PER COMMON SHARE

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	**2011**	**2012**	**2011**
Net Income	$ 12,177	$ 5,287	$ 20,374	$ 11,064
Weighted Average Common Shares Outstanding Basic	27,506,529	27,687,617	27,716,537	27,630,250
Effect of Dilutive Securities:				
Common Stock Equivalents	525,862	742,592	554,397	774,205
Weighted Average Common Shares Outstanding Diluted	28,032,391	28,430,209	28,270,934	28,404,455
Net Income per Common Share Basic	$ 0.44	$ 0.19	$ 0.74	$ 0.40
Net Income per Common Share Diluted	$ 0.43	$ 0.19	$ 0.72	$ 0.39

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	**2011**	**2012**	**2011**
Stock Options	637,343	777,770	637,343	777,770
Restricted Stock Awards		8,496		8,496

NOTE 6. RELATED PARTY TRANSACTIONS

The Company s founder and current chairman of the Board has an ownership interest in ANO LLC and certain other entities (collectively, ANO and Related Companies). As of June 30, 2012, the Company leased the Corporate Headquarters, which includes a store location, and 26 of its other store locations from ANO and Related Companies, representing 9.7% of the total number of store leases in operation. Rental expense related to ANO and Related Companies was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	**2011**	**2012**	**2011**
Rental expense related to ANO and Related Companies	$ 687	$ 686	$ 1,328	$ 1,362

NOTE 7. COMMITMENTS AND CONTINGENCIES

On May 21, 2012, Harbor Freight Tools USA, Inc. and Central Purchasing, LLC (together, Plaintiffs) filed a Complaint against the Company and others, including a purported Company employee, in the Superior Court for the County of Los Angeles, California. The Plaintiffs contend that they previously employed several individuals now working for the Company, and allege, among other claims, the improper use and possession by the Company and/or its employees of trade secrets belonging to the Plaintiffs and unfair business practices. The Plaintiffs seek unspecified monetary damages, punitive damages, injunctive, equitable and other relief. The Company disputes the Plaintiffs claims and is defending the matter vigorously. While it is not possible to determine the ultimate disposition of this proceeding and whether it will be resolved consistent with the Company s beliefs, the Company does not, at this time, expect the outcome of this proceeding to have a material adverse effect on its results of operations, financial position or cash flows.

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

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

Cautionary Note Regarding Forward-Looking Statements

This report includes statements of our expectations, intentions, plans and beliefs that constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 and are intended to come within the safe harbor protection provided by those sections. These statements, which involve risks and uncertainties, relate to matters such as sales growth, comparable store net sales, impact of cannibalization, price changes, earnings performance, stock-based compensation expense, margins, return on invested capital, strategic direction, the demand for our products, and store openings. We have used words such as may, will, should, expects, intends, plans, anticipates, believes, thinks, estimates, seeks, predicts, could, projects, potential and other similar terms and references to assumptions, in this report to identify forward-looking statements. These forward-looking statements are made based on expectations and beliefs concerning future events affecting us and are subject to uncertainties, risks and factors relating to our operations and business environments, all of which are difficult to predict and many of which are beyond our control, that could cause our actual results to differ materially from those matters expressed or implied by these forward-looking statements. These risks and other factors include those listed in this report and in our other reports filed with the SEC including the Item 1A, Risk Factors, section of the Form 10-K for the year ended December 31, 2011.

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

This management discussion should be read in conjunction with the financial statements and notes included in Part I, Item 1. Financial Statements of this quarterly report and the audited financial statements and notes and management discussion included in our annual report filed on Form 10-K for the year ended December 31, 2011.

Overview and Trends

Lumber Liquidators is the largest specialty retailer of hardwood flooring in the United States. We believe we have achieved a reputation for offering great value, superior service and a broad selection of high-quality hardwood flooring products. We offer an extensive selection of premium hardwood flooring products under multiple proprietary brands at everyday low prices designed to appeal to a diverse customer base. We believe that our vertically integrated business model enables us to offer a broad assortment of high-quality products to our customers at a lower cost than our competitors. At June 30, 2012, we sold our products through 277 Lumber Liquidators stores in 46 states in the U.S. and in Canada, a call center, websites and catalogs.

Our focus in 2012 is to enhance our value proposition to the customer and improve our operating margin through the following key strategic initiatives:

- Revenue growth driven primarily through increases in the number of customers invoiced. Across our store base, we are broadening the reach and frequency of our advertising to increase recognition of our value proposition. We believe there is significant opportunity to expand our store base in both new and existing markets. When opening a new store in an existing market, we emphasize total market return.

- Gross margin expansion through continued execution of our sourcing initiatives and optimization of our supply chain. We are committed to our product assortment, in-stock inventory position, attachment rates for moldings and accessories and reducing the net cost of product.

- Continuous improvement in our operations by developing the best people to serve our customers or to serve those that do.

In 2010 and 2011, we invested significant resources in the expertise of our executive and operational management team, in our integrated information technology solution, and in our product sourcing, allocation and distribution. During that same time, we aggressively grew our store base to take advantage of market share opportunities in a challenging demand environment for large-ticket, discretionary home remodeling spend. Additional resources were required to implement and stabilize a number of these infrastructure initiatives. We believe our investment in infrastructure resources in 2012 will be significantly less than 2011 and 2010, and as a result, we expect to increase our operational efficiency.

Table of Contents

We operate primarily in the highly fragmented wood flooring market for existing homeowners. This market is dependent on home-related, large-ticket discretionary spending, which is influenced by a number of complex economic and demographic factors that may vary locally, regionally and nationally. In the first half of 2012, including the important spring remodeling season, a number of these factors continued to stabilize, and even improved in a year over year comparison to 2011, though remaining at historically low levels. We continue to expect volatile consumer demand for large-ticket, discretionary purchases and the consumer to remain cautious and price sensitive through the second half of 2012.

In February of 2012, our Board of Directors authorized the repurchase of up to $50 million of our common stock. This share repurchase program marks an important step in returning value to our shareholders, and expresses confidence in our proven store model. Through June 30, 2012, we had repurchased approximately 1.3 million shares of our common stock using approximately $34.3 million in cash. We expect to continue to repurchase shares of our common stock from time to time through open market purchases or through privately negotiated transactions.

Brazilian Supplier

As of June 30, 2012, we had two notes receivable from a Brazilian supplier which had a total outstanding balance of approximately $0.7 million. These two notes were established in 2005 and 2006 and bore interest at 15% and 12% per annum, which had been included in other (income) expense. In addition, this supplier reimbursed us for product which did not meet our standards, either when inspected or installed, and as of June 30, 2012, we were owed approximately $0.4 million related to these reimbursements.

During the second quarter of 2012, the supplier was not able to ship against certain open purchase orders. Through discussion and inspection of facilities, we determined it unlikely that shipments would resume. As a result, we were not able to deduct principal and interest payments against the amount due for shipments, and we have fully reserved the principal amount of the notes and reimbursements due as of June 30, 2012. The reserve against the principal of the notes increases selling, general and administrative (SG&A) expenses, and the reserve against the reimbursements owed increases cost of sales. In both the three and six month periods ended June 30, 2012, net income per common share diluted was reduced approximately $0.02 as a result of these reserves.

Results of Operations

Net Sales

	For the three months ended June 30, 2012	For the three months ended June 30, 2011	For the six months ended June 30, 2012	For the six months ended June 30, 2011
	(dollars in thousands)			
	increase (decrease)			
Net sales	$ 210,347	$ 175,460	$ 398,381	$ 335,140
Percentage increase	19.9%	4.0%	18.9%	4.8%
Average sale [1]	6.3%	(0.4%)	2.8%	2.6%
Average retail price per unit sold [2]	3.0%	8.7%	0.9%	7.6%
Number of stores open at end of period	277	250	277	250
Number of stores opened in period	10	11	14	27
Comparable Stores:				
Net sales	12.4%	(7.9%)	10.1%	(6.2%)
Customers invoiced [3]	5.8%	(7.5%)	6.8%	(8.6%)
Net sales of stores operating for 13 to 36 months	22.9%	1.2%	22.3%	4.5%
Net sales in markets with all stores comparable (no cannibalization)	13.7%	(4.1%)	11.8%	(2.7%)

1

Average sale, calculated on a total company basis, is defined as the average invoiced sale per customer, measured on a monthly basis and excluding transactions of less than $250 (which are generally sample orders, or add-ons or fill-ins to previous orders) and of more than $30,000 (which are usually contractor orders)

[2] Average retail price per unit sold is calculated on a total company basis and excludes certain service revenue, which consists primarily of freight charges for in-home delivery

[3] Approximated by applying our average sale to total net sales at comparable stores

Table of Contents

Net sales for the second quarter of 2012 increased $34.9 million, or 19.9%, over the second quarter of 2011 as net sales in comparable stores increased $21.7 million and net sales in non-comparable stores increased $13.2 million. We generally consider a store comparable on the first day of the thirteenth full calendar month after opening. Net sales for the six months ended June 30, 2012 increased $63.2 million, or 18.9%, over the same prior year period as a result of a $33.5 million increase in comparable store net sales and a $29.7 million increase in non-comparable store net sales.

Net sales in comparable stores increased 12.4% in comparing the second quarter of 2012 to 2011 and in comparing the six-month periods, increased 10.1%. In both the three and six month comparisons, increases in net sales in comparable stores were driven by a combination of a higher average sale and a greater number of customers invoiced.

The average sale in the second quarter of 2012 was approximately $1,625, an increase of 6.3% over the average sale in the second quarter of 2011. For the six months ended June 30, 2012, the average sale was approximately $1,570, an increase of 2.8% over the comparable prior year period. We believe these increases resulted primarily from:

- Higher average retail prices per unit sold as customers continue to prefer premium products across a broad range of merchandise categories.
- Increases in the sales mix of moldings and accessories, including certain flooring tools introduced in the second quarter of 2012, to 15.8% and 15.4% of total net sales in the three and six months ended June 30, 2012, respectively, from 14.4% and 14.1% in the comparable prior year periods, respectively.
- Slight increases in the volume of flooring per sale, primarily measured in square feet.

The number of customers invoiced in comparable stores increased 5.8% and 6.8% in comparing the three and six months ended June 30, 2012, respectively, to the comparable prior year periods. We believe these increases were primarily a result of:

- Greater recognition of our value proposition due to our efforts to expand our advertising reach and frequency.
- Fewer non-comparable stores operating in existing markets in comparing 2012 to 2011. At June 30, 2012, we were operating 14 non-comparable stores in markets which included at least one comparable store, down from 30 stores at June 30, 2011.
- A greater number of stores in operation for 13 to 36 months, or the first two years as a comparable store, when increases in net sales are generally higher than average due primarily to greater brand awareness in the market.

New store locations continue to positively impact our net sales growth. We have opened 54 new locations since January 1, 2011 in a nearly equal split between new and existing markets, including 10 in the second quarter of 2012 and 14 in total for the six months ended June 30, 2012. Of the 40 new locations in 2011, we opened 11 in the second quarter and 27 in total for the six months ended June 30, 2011. We opened our first Canadian stores in March 2011, and now have nine locations operating primarily in the greater Toronto area. We continue to expect to open a total of 20 to 25 new locations in 2012.

The number of stores opened each quarter over the last two years has not been consistent, and as a result, the average age of a non-comparable store has also varied. At our non-comparable locations, monthly net sales generally increase with maturity, resulting in a progressively more favorable impact on operating margin. In the first quarter of 2012, the average non-comparable store had approximately eight months of operation, much more mature than the average of approximately five months of operation in the first quarter of 2011. By the second quarter of 2012, however, the average non-comparable store had been operating for approximately six months, which was consistent with the maturity of an average non-comparable store in the second quarter of 2011.

We evaluate our net sales performance by market. We segregate our markets into those where all stores are comparable and those which have at least one comparable store and one non-comparable store, often referred to as cannibalized markets. In cannibalized markets, we evaluate the total increase in net sales of the market.

In markets where all stores are comparable (no cannibalization), net sales for the three and six month periods ended June 30, 2012 increased 13.7% and 11.8%, respectively, over the prior year periods. These increases were 130 basis points and 170 basis points higher than the net increases at all comparable stores, respectively.

Table of Contents

In markets with at least one comparable store and at least one non-comparable store (cannibalized markets), we increased the total net sales of the market by 32.7% and 32.6% in the three and six month periods ended June 2012, respectively, compared to the prior year periods.

Gross Profit and Gross Margin

	For the three months ended June 30,		For the six months ended June 30,	
	2012	2011	2012	2011
	(dollars in thousands)			
Net Sales	$ 210,347	$ 175,460	$ 398,381	$ 335,140
Cost of Sales	131,867	115,736	249,764	217,623
Gross Profit	$ 78,480	$ 59,724	$ 148,617	$ 117,517
Gross Margin	37.3%	34.0%	37.3%	35.1%

We believe that the significant drivers of gross margin expansion (contraction) and their estimated impact in comparing the second quarter of 2012 to 2011, the second quarter of 2011 to 2010, the six months ended June 30, 2012 to the same period in 2011, and the six months ended June 30, 2011 to the same period in 2010 are as follows:

Driver	Description	For the three months ended June 30, 2012	For the three months ended June 30, 2011	For the six months ended June 30, 2012	For the six months ended June 30, 2011
		(in basis points)			
Cost of Product	Cost of acquiring the products we sell from our suppliers, including the impact of our sourcing initiatives; Changes in the mix of products sold; Changes in the average retail price per unit sold.	250	150	150	150
Transportation	International and domestic transportation costs, including the impact of international container rates; Customs and duty charges; Fuel and fuel surcharges; Impact of vendor-mill shipments received directly by our store locations; Transportation charges from our distribution centers to our store locations; Transportation charges between store locations and the cost of delivery to our customers.	120	(170)	90	(110)
All Other	Investments in our quality control procedures; Warranty costs; Changes in finishing costs to produce a unit of our proprietary brands; Inventory shrink; Net costs of producing samples.	(40)	(50)	(20)	(30)
Total Change in Gross Margin from the prior year		**330**	**(70)**	**220**	**10**

Cost of Product: Gross margin benefited from our sourcing initiatives and shifts in our sales mix. Sourcing initiatives included vendor allowances, line reviews and increases in our direct sourcing relationships, primarily due to the acquisition of certain assets of Sequoia Floorings Inc. in September 2011. Shifts in our sales mix included an increase in moldings and accessories and an increase in certain premium products, particularly in merchandise categories with a lower than average retail price point. These benefits were partially offset by the impact of our April Big Sale.

Our second quarter gross margin has historically been weaker than the first quarter due to our April Big Sale, our broadest chain-wide sale, featuring liquidation deals, odd-lots and promotional pricing on certain products within our everyday assortment. Though we believe the event drives incremental net sales, generally those net sales are at a reduced gross margin. We believe the incremental net sales from the April Big Sale reduced our gross margin by approximately 20 basis points in the second quarter of 2012 and approximately 40 basis points in the second quarter of 2011. The 2012 April Big Sale represented a smaller portion of total second quarter net sales than in 2011 as promotional discounts were limited to fewer products, and a greater degree of pricing discipline was maintained in converting traffic to invoiced sales.

12

Table of Contents

Transportation: Gross margin benefited from lower average international container rates, initiatives to enhance the efficiency of warehouse to store deliveries, including greater use of intermodal delivery, and generally lower domestic fuel costs. In addition, greater control over transfer and delivery costs from the first sales floor to the customer benefited gross margin by approximately 35 basis points and 30 basis points in comparing the three and six months ended June 30, 2012, respectively, to the prior year.

These benefits were partially offset by a reduction in the percentage of units received directly by our stores. In the three and six month periods ended June 30, 2012, 18.6% and 18.1% of our unit purchases, respectively, were received directly at the store, down from 27.7% and 25.2% in the prior year periods, respectively. Through June 30, 2012, we have completed line reviews in the product categories of laminate, bamboo, cork and engineered hardwood, and as a result, we are transitioning certain existing products to new vendor mills. The initial volume of products from new vendor mills is generally distributed through our warehouses until a normalized unit flow is established. Thereafter, many of these products will be received directly at the store. These product transitions also increased available inventory at the store location, resulting in greater costs of shipping from our warehouses to our store locations.

All Other Costs: Gross margin was adversely impacted by the $0.4 million reserve against the collection of reimbursements due from a Brazilian supplier in comparing both the three and six months ended June 30, 2012 to the prior year. In addition, due primarily to on-going product transitions, we increased the inventory reserve for loss and obsolescence by $0.6 million and $0.8 million in the three and six month periods in 2012, respectively, compared to increases of $0.1 million and $0.2 million in the prior year periods, respectively. Also, strong customer demand for samples in 2012 has increased the costs of sample production, adversely impacting gross margin in both the three and six month periods ended June 30, 2012 in comparison to the prior year.

Operating Income and Operating Margin

	For the three months ended June 30,		For the six months ended June 30,	
	2012	2011	2012	2011
	(dollars in thousands)			
Gross Profit	$ 78,480	$ 59,724	$ 148,617	$ 117,517
SG&A Expenses	58,685	51,051	115,503	99,504
Operating Income	$ 19,795	$ 8,673	$ 33,114	$ 18,013
Operating Margin	9.4%	4.9%	8.3%	5.4%

Operating income for the second quarter ended June 30, 2012 increased $11.1 million over the second quarter of 2011 as the $18.8 million increase in gross profit discussed above was partially offset by a $7.6 million increase in SG&A expenses. Operating income for the six months ended June 30, 2012 increased $15.1 million over the same period in 2011 as the $31.1 million increase in gross profit discussed above was partially offset by a $16.0 million increase in SG&A expenses. The increases in SG&A expenses were principally due to the following factors:

- Salaries, commissions and benefits increased $5.3 million and $10.1 million for the three and six months ended June 30, 2012, respectively, from the comparable prior year periods. As a percentage of net sales, salaries, commissions and benefits increased to 12.0% and 12.5% for the three and six months ended June 30, 2012, respectively, from 11.3% and 11.8% for the three and six months ended June 30, 2011, respectively. These increases were due primarily to significantly higher accruals related to our management bonus plan, an increase in certain benefit costs and higher commission rates earned by our store management.

- Advertising expenses increased $0.7 million to $15.7 million, or 7.5% of net sales, for the three months ended June 30, 2012, from $15.0 million, or 8.6% of net sales, for the comparable prior year period. For the six months ended June 30, 2012, advertising expenses increased $1.7 million to $29.9 million, or 7.5% of net sales, down from 8.4% of net sales for the six months ended June 30, 2011. We continued to both leverage our national advertising campaigns over a larger store base and reallocate our advertising to more effective media channels, increasing our reach and frequency.

Occupancy costs increased $1.0 million to $7.4 million, or 3.5% of net sales, in the three months ended June 30, 2012, from $6.4 million, or 3.7% of net sales, in the second quarter of 2011. For the six months ended June 30, 2012, occupancy costs increased $2.0 million to $14.9 million, or 3.8% of net sales, from $12.9 million, or 3.8% of net sales, for the first six months of 2011. Higher net sales more than offset cost increases due to store base growth and certain incremental warehousing and distribution costs.

Table of Contents

Depreciation and amortization expenses were 1.1% and 1.2% of net sales for the three months and six months ended June 30, 2012, respectively, compared to 1.2% of net sales for the comparable periods in the prior year.

Stock-based compensation expense was 0.5% of net sales for both the three and six months ended June 30, 2012, compared to 0.6% of net sales for the comparable periods in the prior year.

Other SG&A expenses as a percentage of net sales were 3.3% and 3.5% for the three and six months ended June 30, 2012, respectively, and 3.8% in both the three and six months ended June 30, 2011. The decrease as a percentage of net sales in 2012 was due primarily to higher net sales, but also included approximately 25 basis points in each period for certain reimbursements from our primary installation partner pursuant to an amended agreement, effective in the first quarter of 2012. Partially offsetting these benefits was the approximately $0.7 million reserve against the notes receivable due from a Brazilian supplier, higher legal fees, primarily in the first quarter of 2012, and an increase in certain bankcard discount rates due to greater consumer preference for extended-term promotional programs offered through our proprietary credit card.

Provision for Income Taxes

	For the three months ended June 30,		For the six months ended June 30,	
	2012	2011	2012	2011
	(dollars in thousands)			
Provision for Income Taxes	$ 7,650	$ 3,453	$ 12,813	$ 7,104
Effective Tax Rate	38.6%	39.5%	38.6%	39.1%

The effective income tax rate decreases in comparing 2012 to 2011 are primarily due to lower state income taxes and the timing of certain reserve changes, mainly in the second quarter of the prior year.

Net Income

	For the three months ended June 30,		For the six months ended June 30,	
	2012	2011	2012	2011
	(dollars in thousands)			
Net Income	$ 12,177	$ 5,287	$ 20,374	$ 11,064
As a percentage of net sales	5.8%	3.0%	5.1%	3.3%

Net income increased $6.9 million, or 130.4%, comparing the second quarter of 2012 to 2011, and increased $9.3 million, or 84.2%, comparing the six months ended June 30, 2012 to the six months ended June 30, 2011.

Seasonality

Our net sales fluctuate slightly as a result of seasonal factors, and we adjust merchandise inventories in anticipation of those factors, causing variations in our build of merchandise inventories. Generally, we experience higher than average net sales in the spring and fall, when more home remodeling activities are taking place, and lower than average net sales in the winter months and during the hottest summer months. These seasonal fluctuations, however, are minimized to some extent by our national presence, as markets experience different seasonal characteristics.

Liquidity and Capital Resources

Our principal liquidity requirements have been to meet our working capital and capital expenditure needs. In addition, we have used available funds to periodically repurchase shares of our common stock under our stock repurchase program. Our principal sources of liquidity are $31.5 million of cash and cash equivalents at June 30, 2012, our cash flow from operations, and our $50.0 million of availability under our revolving credit facility. We expect to use this liquidity for general corporate purposes, including providing additional long-term capital to support the growth of our business (primarily through opening new stores) and maintaining our existing stores. We believe that our cash flow from operations, together with our existing liquidity sources, will be sufficient to fund our operations and anticipated capital expenditures over at least the next 24 months.

In 2012, we now expect capital expenditures to total between $11 million and $14 million. In addition to general capital requirements, we have or intend to:

- open between 20 and 25 new store locations;
- continue to relocate and remodel existing stores, including an expanded showroom format;
- continue to invest in our integrated technology solution;
- significantly upgrade our forklifts;
- invest in our supply chain initiatives; and
- continue to improve the effectiveness of our marketing programs.

Cash and Cash Equivalents

During the first six months of 2012, cash and cash equivalents decreased $30.2 million to $31.5 million. The decrease of cash and cash equivalents was primarily due to the use of $34.5 million to repurchase common stock and $6.7 million to purchase property and equipment which was partially offset by $2.5 million of net cash provided by operating activities and $8.4 million of proceeds received from stock option exercises.

During the first six months of 2011, cash and cash equivalents decreased $1.5 million to $33.4 million. The decrease of cash and cash equivalents was primarily due to the use of $8.3 million to purchase property and equipment which was partially offset by $3.5 million of net cash provided by operating activities and $3.5 million of proceeds received from stock option exercises.

Merchandise Inventories

Merchandise inventories at June 30, 2012 increased $47.5 million from December 31, 2011, due to an increase in available for sale inventory, partially offset by a decrease in inbound in-transit inventory. We consider merchandise inventories either available for sale or inbound in-transit, based on whether we have physically received and inspected the products.

Merchandise inventories and available inventory per store in operation were as follows:

	As of June 30, 2012	As of December 31, 2011	As of June 30, 2011
		(in thousands)	
Inventory Available for Sale	$ 183,885	$ 135,850	$ 157,734
Inventory Inbound In-Transit	27,713	28,289	24,545
Total Merchandise Inventories	**$ 211,598**	**$ 164,139**	**$ 182,279**
Available Inventory Per Store	**$ 664**	**$ 517**	**$ 631**

Available inventory per store as of June 30, 2012 has increased in comparison to prior periods due primarily to the continued supplier transition in certain key merchandise categories as a result of our sourcing initiatives and our expanded assortment of accessories. Subsequent to the completion of several line reviews, inventory levels were elevated in the laminate, bamboo and engineered hardwood merchandise categories as we transitioned certain existing products to new vendor mills. With these transitions taking place in the important spring remodeling season, elevated inventory levels safeguarded positive trends in net sales. We expect to complete the assortment expansion and product transition by the end of October 2012, and we continue to target available inventory per store to range from $540,000 to $560,000 at the end of the current year.

Though we believe our strengthened product allocation and supply chain network will minimize adverse impacts related to elevated inventory levels and product transition, we have increased our inventory reserve for loss and obsolescence to $1.3 million at June 30, 2012 from $0.5 million and $0.6 million at December 31, 2011 and June 30, 2011, respectively.

Cash Flows

Operating Activities. Net cash provided by operating activities was $2.5 million and $3.5 million for the six months ended June 30, 2012 and 2011, respectively. Net cash provided by operating activities decreased primarily due to a larger build in merchandise inventories net of the change in accounts payable, partially offset by more profitable operations.

Investing Activities. Net cash used in investing activities was $6.7 million and $8.3 million for the six months ended June 30, 2012 and 2011, respectively, with the decrease primarily due to fewer new store openings and lower expenditures for our integrated information technology solution.

Financing Activities. Financing activities utilized $26.1 million in net cash for the six months ended June 30, 2012, and provided $3.4 million in net cash for the six months ended June 30, 2011. Net cash used in financing activities during the first six months of 2012 included $34.3 million to repurchase shares of our common stock under our $50.0 million share repurchase plan. Net cash provided by financing activities in both 2012 and 2011 also included proceeds from the exercise of stock options.

Critical Accounting Policies and Estimates

Critical accounting policies are those that we believe are both significant and that require us to make difficult, subjective or complex judgments, often because we need to estimate the effect of inherently uncertain matters. We base our estimates and judgments on historical experiences and various other factors that we believe to be appropriate under the circumstances. Actual results may differ from these estimates, and we might obtain different estimates if we used different assumptions or conditions. We have had no significant changes in our critical accounting policies and estimates since our last annual report on Form 10-K for the year ended December 31, 2011.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Interest Rate Risk.

We are exposed to interest rate risk through the investment of our cash and cash equivalents. We invest our cash in short-term investments with maturities of three months or less. Changes in interest rates affect the interest income we earn, and therefore impact our cash flows and results of operations. In addition, any future borrowings under our revolving credit agreement would be exposed to interest rate risk due to the variable rate of the facility.

We currently do not engage in any interest rate hedging activity and currently have no intention to do so in the foreseeable future. However, in the future, in an effort to mitigate losses associated with these risks, we may at times enter into derivative financial instruments, although we have not historically done so. We do not, and do not intend to, engage in the practice of trading derivative securities for profit.

Exchange Rate Risk.

The majority of our revenue, expense and capital purchasing activities are transacted in U.S. dollars. However, because a portion of our operations consists of activities outside of the U.S., we have transactions in other currencies, including the Canadian dollar, Chinese yuan and Brazilian real.

We currently do not engage in any exchange rate hedging activity and currently have no intention to do so in the foreseeable future. However, in the future, in an effort to mitigate losses associated with these risks, we may at times engage in transactions involving various derivative instruments to hedge revenues, inventory purchases, assets, and liabilities denominated in foreign currencies.

Item 4. Controls and Procedures.

Evaluation of disclosure controls and procedures. Our management evaluated, with the participation of our Chief Executive Officer and our Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this quarterly report on Form 10-Q. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report.

Changes in internal control over financial reporting. There was no change in our internal control over financial reporting that occurred during the period covered by this quarterly report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II

OTHER INFORMATION

Item 1. Legal Proceedings.

On May 21, 2012, Harbor Freight Tools USA, Inc. and Central Purchasing, LLC (together, Plaintiffs) filed a Complaint against us and others, including a purported employee, in the Superior Court for the County of Los Angeles, California. The Plaintiffs contend that they previously employed several individuals now working for us, and allege, among other claims, the improper use and possession by us and/or our employees of trade secrets belonging to the Plaintiffs and unfair business practices. The Plaintiffs seek unspecified monetary damages, punitive damages, injunctive, equitable and other relief. We dispute the Plaintiffs claims and are defending the matter vigorously. While it is not possible to determine the ultimate disposition of this proceeding and whether it will be resolved consistent with our beliefs, we do not, at this time, expect the outcome of this proceeding to have a material adverse effect on our results of operations, financial position or cash flows.

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

Item 1A. Risk Factors.

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A, Risk Factors, in our annual report on Form 10-K for the year ended December 31, 2011, which could materially affect our business, financial condition or future results. There have been no material changes to those risk factors since we filed our fiscal 2011 annual report on Form 10-K. The risks described in our annual report on Form 10-K are not the only risks we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or results of operations.

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

The following table presents our share repurchase activity for the quarter ended June 30, 2012 (dollars in thousands, except per share amounts):

Period	Total Number of Shares Purchased (1)	Average Price Paid per Share (1)	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (2)	Maximum Dollar Value that May Yet Be Purchased Under the Plans or Programs (2)
April 1, 2012 to April 30, 2012	267,778	$ 24.34	267,700	$ 34,559
May 1, 2012 to May 31, 2012	373,994	28.54	373,408	23,894
June 1, 2012 to June 30, 2012	274,100	29.97	274,100	15,675
Total	915,872	$ 27.74	915,208	$ 15,675

(1) In addition to the shares of common stock we purchased under our $50 million stock repurchase program, we repurchased 664 shares of our common stock at an aggregate cost of $18 thousand, or an average purchase price of $27.85 per share, in connection with the net settlement of shares issued as a result of the vesting of restricted stock during the quarter ended June 30, 2012.

(2) Except as noted in footnote 1 above, all of the above repurchases were made on the open market at prevailing market rates plus related expenses under our stock repurchase program, which authorized the repurchase of up to $50 million in common stock. Our stock repurchase program was authorized by our Board of Directors and publicly announced on February 22, 2012.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

None.

Table of Contents

Item 5. Other Information.

None.

Item 6. Exhibits.

The exhibits listed in the exhibit index following the signature page are furnished as part of this report.

Table of Contents

SIGNATURES

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

LUMBER LIQUIDATORS HOLDINGS, INC.

(Registrant)

Date: July 25, 2012

By: /s/ Daniel E. Terrell
Daniel E. Terrell

Chief Financial Officer

(Principal Financial and Principal Accounting Officer)

Table of Contents

EXHIBIT INDEX

Exhibit Number	Exhibit Description
10.1	Separation and Release Agreement between Lumber Liquidators Services, LLC and Seth P. Levy, effective as of June 30, 2012 (filed as Exhibit 10.1 to the Company s Current Report on Form 8-K, filed on July 5, 2012 (File No. 001-33767) and incorporated by reference)
31.01	Certification of Principal Executive Officer of Lumber Liquidators Holdings, Inc. pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.02	Certification of Principal Financial Officer of Lumber Liquidators Holdings, Inc. pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.01	Certification of Principal Executive Officer and Principal Financial Officer of Lumber Liquidators Holdings, Inc. pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101*	The following financial statements from the Company s Form 10-Q for the quarter ended June 30, 2012, formatted in XBRL: (i) Condensed Consolidated Balance Sheets, (ii) Condensed Consolidated Statements of Income, (iii) Condensed Consolidated Statements of Comprehensive Income, (iv) Condensed Consolidated Statements of Cash Flows, (v) Notes to Condensed Consolidated Financial Statements

* Furnished herewith.