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# EDITED TRANSCRIPT

ETH - Q4 2012 Ethan Allen Interiors Earnings Conference Call

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**OVERVIEW:**

ETH reported 4Q12 net sales of \$185.3m and diluted EPS excluding special items of \$0.27.



## CORPORATE PARTICIPANTS

**Farooq Kathwari** *Ethan Allen Interiors Inc. - Chairman, President, CEO*

**David Callen** *Ethan Allen Interiors Inc. - VP, Finance and Treasurer*

## CONFERENCE CALL PARTICIPANTS

**Brad Thomas** *KeyBanc Capital Markets - Analyst*

**Budd Bugatch** *Raymond James & Associates - Analyst*

**Todd Schwartzman** *Sidoti & Company - Analyst*

**Halley Goodman** *Goldman Sachs - Analyst*

**John Baugh** *Stifel Nicolaus - Analyst*

**Joe Feldman** *Telsey Advisory Group - Analyst*

**Maggie Gilliam** *Gilliam & Co - Analyst*

## PRESENTATION

### Operator

Good day ladies and gentlemen and thank you for standing by. Welcome to the Ethan Allen's earnings release conference call. At this time, all participants are in a listen-only mode. Later we will conduct a question-and-answer session and instructions will be given at that time.

(Operator Instructions)

I would now like to introduce your host for today, Mr. Farooq Kathwari, Chairman, President and CEO. Sir, please go ahead.

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**Farooq Kathwari** - *Ethan Allen Interiors Inc. - Chairman, President, CEO*

Thank you and thank you for participating in our conference call. At this stage I'll first pass it on to Dave.

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**David Callen** - *Ethan Allen Interiors Inc. - VP, Finance and Treasurer*

Great, thanks Farooq. Thank you and good morning. I am David Callen, Ethan Allen's Vice President of Finance and Treasurer. Welcome to Ethan Allen's earnings conference call for our fiscal quarter and year ended June 30, 2012. This call is being webcast live on [Ethanallen.com](http://Ethanallen.com) where you'll also find our press release, which contains supporting details including reconciliations of non-GAAP information referred to in our press release and on this call.

Our comments today will include forward-looking statements that are subject to risks, which may cause the actual results to be materially different than expected when making those statements. Please refer to our filings with the SEC for a complete review of those risks. The Company assumes no obligation to update or revise any forward-looking matters discussed during the call. After our Chairman and CEO, Farooq Kathwari, provides his opening remarks, I will follow with some details on the financial results. Farooq will then provide more details about our ongoing business initiatives before opening up the phone lines for questions. With that, here is Farooq Kathwari.



**Farooq Kathwari** - *Ethan Allen Interiors Inc. - Chairman, President, CEO*

Thank you, Dave. We had a very productive fiscal 2012. We implemented many important initiatives and also improved our financial performance. For fiscal year ended June 30, 2012, sales increased 7.4% to \$729.4 million with diluted earnings per share ex-special items of \$0.94, an increase of 62%. In addition, we absorbed costs associated with the liquidation of inventory to make room for a major new product introduction, as well as our ongoing manufacturing initiatives, in the US, Mexico, and now Honduras.

For the quarter ended June 30, sales increased by 4.1% and our net income per diluted share, excluding special items was \$0.27 compared to \$0.21 in the prior year quarter, an increase of 28.5%. As we have stated previously, we continue to absorb incremental costs due to liquidation of floor inventory. During this quarter, we absorbed \$0.03 per diluted share. This impact is not adjusted from our non-GAAP numbers. To clarify, EPS of \$0.27 has not been adjusted for the \$0.03 impact. Adjusting for this impact, net income per share increased by 42.9% during the quarter. Our written sales as booked orders increased 8.9%, with comparable written increasing 6.4%. That is for the year. For the quarter ending June 30, written sales increased 2.3% over a very strong 14.6% growth in the prior-year quarter.

We continue to improve our gross margins. For the year, it was 53.5% compared to 51.5% in the previous year. For the fourth quarter, the gross margin was 53.9% compared to 52.9%. The increase reflects greater percentage of Company operated retail sales to total sales and benefits from the leverage of our vertically integrated structure. We maintained strong liquidity with cash and securities of \$104.1 million at June 30, 2012. The \$104.1 million includes \$15.4 million maintained by us in special accounts in lieu of issuing letters of credit in order to reduce expenses. We have the option of issuing letters of credit from our bank line.

Inventories increased to \$155.7 million compared to \$141.7 million in the prior year reflecting build up for the Ethan Allen Express program, and also inventories in our Wholesale business to support our other initiatives, and also an increase in inventories, mostly sold in our Retail division. In fiscal -- for fiscal 2012, our capital expenditures increased to \$22.9 million as compared to \$9.1 million in the previous year, reflecting our investments in manufacturing, retail, and technology. For fiscal 2013, at this stage we expect to spend about \$20 million in capital expenditures. Our annual depreciation and amortization is also expected to be around \$20 million for fiscal 2013. We had a successful soft launch of Ethan Allen Express in June, with stronger marketing in July and August. This initiative is to help us reach a larger consumer base.

As we move forward, we have made very good progress in all areas of our vertically integrated structures. In manufacturing, in addition to the US manufacturing, we have started and invested to expand our plants in Mexico and Honduras. Our Retail division offers a major opportunity for growth in sales and earnings. In fiscal 2012 fourth quarter, we improved our operating results, showing a loss of 0.7% compared to a loss of 1.3% in the previous year. In fiscal 2013, our objective is to have a positive operating income for the Retail division. After Dave provides more information on our financial results, I will discuss our business initiatives in greater detail. Dave?

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**David Callen** - *Ethan Allen Interiors Inc. - VP, Finance and Treasurer*

Thank you, Farooq. Net sales for the quarter were \$185.3 million, up 4.1% over the prior year fourth-quarter. Our Retail segment reported net sales of \$143.7 million, an increase of 5% versus the prior year quarter, including comparable design center net sales growth of 3.6%. This growth was on top of very strong prior-year growth by our Retail division of 13%, including 12.1% comparable design center growth. Our Retail division written orders during the fourth quarter increased 2.3% over a very strong 14.6% growth the prior year's fourth quarter. Comparable design center written orders grew 0.6% over the 12.9% growth the prior year. The company's Retail division ended the quarter in both years with 147 design centers. There were 151 independently operated design centers at June 30, 2012, an increase of 12 locations from the 139 at the end of the prior fiscal year. This includes 70 design centers in China, an increase of 17 locations.

Our Wholesale segment net sales were \$112.8 million, an increase of 2.1% over the prior year quarter. The prior year's Wholesale sales benefited from higher shipments of introductory floor products than during the fourth quarter this year. Our consolidated gross margin for the fourth quarter was 53.9%, up 100 basis points from the 52.9% the prior-year quarter. As previously communicated, the new product initiatives and the resulting liquidation of display inventory impacted our financial results by approximately \$0.03 per diluted share during the quarter. As Farooq noted, this impact has not been adjusted from either our reported GAAP or our non-GAAP numbers.

Our Retail division's net sales made up 77.6% of our consolidated net sales this year in the quarter, from 76.9% the prior year. This mix, along with improvements in our operations, and favorable mix of accessories and imported case goods drove higher margins in the quarter. With the higher mix of Retail business, operating expenses as a percentage of consolidated net sales also increased. Our fourth-quarter operating expenses, including restructuring true-ups in both periods grew 4.3% to \$85.7 million. Our Honduras plant started production in April and is no longer treated as a special item in our non-GAAP reconciliation. During the quarter, we continued to invest in our Retail business in terms of management and designers, incurred costs to get our design centers ready for new products, and invested in technology throughout our business. All to position us for growth.

Our adjusted operating profit of \$14.2 million was 7.7% of net sales compared with 6.8% the prior year fourth-quarter. Our income tax rate for the fourth quarter was 40.8% versus 19.8% the prior year quarter. The tax rates in both years were affected by special items, including in the current year, valuation reserves on certain state deferred tax assets related to our Retail business. Our normalized tax rate for both reporting periods was 36.5%. Our adjusted earnings per diluted share for the quarter was \$0.27, up 28.6% over the prior year on 4.1% growth in net sales, demonstrating again the significant leverage opportunity of this vertically integrated business. Net sales for the fiscal year increased 7.4% to \$729.4 million. Our Retail division's net sales this year of \$559.4 million grew 10.6% on top of 15.4% growth the prior year. The Wholesale net sales of \$456.9 million grew 8% over the 16.7% expansion in our Wholesale business the prior year.

The Company's consolidated gross margin improved 200 basis points to 53.5% due to strong improvements in the efficiencies of our operations, a favorable mix of Retail division sales of the total, and an improved mix of products, including high proportion of accessories. Excluding special items in both years, operating income up \$51.8 million grew \$18 million or 53.5% on a 7.4% higher net sales. This was achieved while investing significantly all year in new product introductions, staffing in our Retail business, technology solutions throughout the business, and 5.1% higher advertising costs. Our adjusted earnings per diluted share for the fiscal year increased 62.1% to \$0.94 from \$0.58 the prior year -- prior fiscal year. During fiscal 2012 we invested \$22.9 million in capital expansions, further paid \$12.2 million in principal reductions on our debt, bought back \$1.4 million of our stock, and paid a \$8.1 million in cash dividends to our shareholders. With all these investments, and \$14 million additional inventory to support our initiatives, we ended the year with \$104.1 million in total cash and securities, which includes \$15.4 million of restricted cash held in lieu of letters of credit.

With \$18.6 million and depreciation and amortization for the year, our adjusted EBITDA excluding special items grew 22.2% this year to \$70.4 million or 9.6% of net sales. Certain macroeconomic factors that affect our clients have shown improvement. While others continue to be challenging along with significant uncertainties in global markets. We continue to operate the business with cautious optimism while aggressively pursuing our business initiatives. Farooq will now walk you through details on the many business initiatives underway.

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**Farooq Kathwari** - *Ethan Allen Interiors Inc. - Chairman, President, CEO*

All right, Dave. Thanks. Our focus remains on our five strategic objectives as follows. In offerings during fiscal 2012, we completed a major overhaul of our product programs. New products were introduced in our five lifestyles of elegance, explorer, vintage, romance, and modern. Our offerings are reaching a larger consumer base, both in diversity of style and value while maintaining consistency -- consistently superior quality across all our product programs.

During June we launched a new initiative, the Ethan Allen Express program. This initiative is to expand our reach to a larger consumer base. During the years following the great recession, we decided to expand our reach to a more affluent consumer base through the introduction of new products and through our advertising campaign. During the first two years of the recession, we felt that becoming too aggressive in discounting would not expand our reach and could hurt our brand. In the process, we doubled our consumer base with higher income demographics, and this also enhanced our brand perception of style, quality, and service.

Now the Ethan Allen Express program extends our reach to a larger demographic base both in income and age, while maintaining the aspirational value of our brand. For Ethan Allen Express, we selected products from our existing offerings representing good value, and with our 48 month no interest financing, it has made all our products more attainable to a larger consumer base. In addition, we will deliver these products faster as we intend to keep them in stock. For instance, in June, while it is still early, 94% of the orders received were shipped within two days from our Dublin, Virginia distribution facility. The June was a soft launch. We are now accelerating our advertising. In July and August we doubled our direct mail



advertising. While it is too early to gauge the success of this program, we are getting positive feedback. Throughout fiscal 2012, our message and main aspirational value of our brand and attainability was enhanced in our direct mail, in our national television, digital, and other mediums.

We have strengthened our interior design regional network by relocating and opening new design centers and acquiring qualified entrepreneurial interior designers. During the year, we opened new design centers in Annapolis, Maryland, Seattle, Washington, Boca Raton, Florida, Calgary, Canada. We also continued our focus on the international market. In China, as Dave mentioned, we ended with 70 locations. This fall we plan to open three international flagship design centers in Montréal, Canada, in Brussels, Belgium, to enter the European markets, and in Jeddah, Saudi Arabia. We ended the year with 298 design centers, 147 operated by the Company and 151 operated by licensees.

During the year, we continued to strengthen our interior design associates by adding 260 entrepreneurial designers in the Company's Retail division. In the last two years, we have added 58 managerial associates to the Retail division. Over 90% were promoted from within. We also continued our focus on the independent designer associates at our idea program. At June 30, 2012, we had 3,400 members.

We made investments in technology. During the year we upgraded our website. Our touch screens, and also added the Ethan Allen tablet for our interior designers. Our Retail division migrated to a more complete version of our Vision 8 information systems. In upholstery manufacturing, we also completed the implementation of our JD Edwards software upgrade, and also made good progress in developing two strong manufacturing operations, one in North Carolina, which is our main operation, and in Mexico.

In case goods, we focused on improving the productivity of our US plants and purchased a facility in Honduras to develop into a major case goods plant. We also started the implementation of the JD Edwards 8.1% software upgrade in our case goods manufacturing. Our manufacturing is positioned to service continued growth. We are positioned well. We remain cautiously optimistic. Economic conditions remain uncertain and consumer confidence is fragile. Our objective is to be ready to service our growth, while at the same time, maintain a cautious outlook by maintaining strong liquidity, controlled of our expenses, and inventories. At this stage, I would like to open for any questions or comments.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions)

Brad Thomas, KeyBanc capital.

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### Brad Thomas - KeyBanc Capital Markets - Analyst

Good morning Farooq, good morning David. Farooq, when we met about a month ago at your analyst day, you talked about trends and May and June being a little bit softer. Can you just give us a little bit more color about how the quarter wrapped up and how things are going thus far in July?

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### Farooq Kathwari - Ethan Allen Interiors Inc. - Chairman, President, CEO

Brad, actually, the end of June was somewhat stronger than we had expected. Even though, as you know, our increases are relatively small in written business compared to last year's growth of about 15%. So the quarter did start slow, ended up somewhat stronger, because as we have mentioned previously, the last three or four days of the month is when our designers end up closing business. Same with the situation in July. It has as, like the previous months, started somewhat slower, is building up, and we will see how it ends up as we enter into this weekend close of business. As you know, we have these monthly events for the first three weeks or so. Our designers work with clients, house calls, projects, and then somehow human nature is, they just close to the end of the month.

However, overall, economic conditions, as I mentioned, are somewhat fragile. Consumer confidence is impacted by everything that is taking place in the world and the gyrations of the stock market, from going down 200 points to going up 200 pounds. Our customer is impacted. So I think that our attitude is that we have to understand this uncertainty, be ready to grow our business, and as I said, be cautious about making sure that we manage our costs, our inventories. But we are continuing to invest so that we have the ability to grow.

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**Brad Thomas** - *KeyBanc Capital Markets - Analyst*

Thanks, Farooq. And then just a follow-up on the merchandising transition. It was obviously a drag on gross margin in the last two or three quarters. As we move into 2013, is the expectation that you would get really all of that back? So as we think about the contribution margin or the flow through to the bottom line in 2013, is it reasonable to assume that that should be a higher rate because you have these easier comparisons in the back half of the year?

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**Farooq Kathwari** - *Ethan Allen Interiors Inc. - Chairman, President, CEO*

Yes, Brad, one has to keep in mind a number of perspectives. First is that despite the fact that we absorbed these costs, we still ended with a 53.9% gross margin for the quarter. And it's really very, very healthy. And a few years back, if somebody had said we had that kind of a gross margin, we would've said, not possible. However, one of the main reasons also is the mix of our Retail sales to total sales. Yes, I think there will be some improvements -- potential improvements. On the other hand, we have also taken a look at the impacts of gross margin on our sale events and the impact of that. How aggressive do we become? So we have to manage and monitor the two. So if I were you, I would think this 54% gross margin is a very healthy gross margin, and I would keep that in mind, Brad.

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**Brad Thomas** - *KeyBanc Capital Markets - Analyst*

Got you. Thanks so much, and best of luck.

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**Farooq Kathwari** - *Ethan Allen Interiors Inc. - Chairman, President, CEO*

Thanks, Brad.

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**Operator**

Budd Bugatch, Raymond James.

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**Budd Bugatch** - *Raymond James & Associates - Analyst*

Good morning, Farooq, good morning, David. Thank you for taking my questions. I know you said that so far in July you've seen positive feedback. You said June ended stronger. Can you give us any feel of so far the trends in July and maybe year-over-year?

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**Farooq Kathwari** - *Ethan Allen Interiors Inc. - Chairman, President, CEO*

Budd, it is -- it's about the same, more or less what we experienced in the previous months. That is in the first three weeks or so, it is this relatively slow, and the last week it picks up. I would say that also keep in mind in end of June, early July, we had a price increase. So in June, like this year and the previous year we did get benefits off taking some business in June that will come in July. Now the Ethan Allen Express program, the objective of the Ethan Allen Express program is first to get the message across that Ethan Allen products are attainable. Which means great prices and faster delivery. And the more important part of that is to get traffic into our design center.



So what we're seeing is this. That while we are having sales and in our system, it's going to take us about at least three or four months before it really starts working, already we are seeing that people are coming in. And not necessarily buying all those room packages that we have, but selecting products, some from Express, and some from our custom programs, because we are shipping our custom programs also in four to five weeks. So objective is to bring more traffic, to get us -- to have us become more attainable, and I think -- I've got to say this, Budd. We are somewhat cautious because of tremendous uncertainties. If somebody were to say that they can really look into the future in the next few months, I mean it's hard to do that.

We are cautiously optimistic. We've got everything in place. We have great designers. We've got good product. We're going to -- we have less inefficiencies both in our manufacturing and our Retail, which should benefit us. But the end of the day, we need more sales. That's going to make an impact, and that I think, Budd, will depend upon how this quarter shapes up as we forward.

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**Budd Bugatch** - *Raymond James & Associates - Analyst*

Okay. And it looked like just on another point, you looked like you were getting very close to breakeven again in the Retail -- Company on Retail division. If my numbers are right, on an annual basis it looks like the Retail division is about \$3.7 million per average store. I think that's well down from where the peak was several years ago before the great recession. Where do you have to get now on Retail productivity per average store to be breakeven? How close are we?

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**Farooq Kathwari** - *Ethan Allen Interiors Inc. - Chairman, President, CEO*

We are pretty close. Our fourth quarter we had an operating loss of 0.7%. And we also absorbed these costs of product sales, floor sales, and all of that stuff. Without those sales we would have been positive in the fourth quarter. So we're already there, Budd. And the good news is, as I said in my comments, that's where the leverage is. Both in terms of sales -- we also invested a great deal.

I mentioned about adding management and adding designers. This recession has given us an opportunity to add entrepreneurial interior designers. People who run their businesses, we've added in the last, I think two, two and a half years, 600 of them. That's not a net number, the net is that we also had people who were not able to make it, and they left us. End of the day, our 2,000 interior design force is much more qualified today, and they have the ability to do more business. And that is where the leverage is. Despite the fact that we are not -- we are sort of breaking even in the Retail, we had pretty healthy overall margins. And as the Retail starts making an impact, it makes an impact at Retail and then it also helps us even do better at the Wholesale.

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**Budd Bugatch** - *Raymond James & Associates - Analyst*

Okay. And my final question is really for David. It's more of a housekeeping question. Can you give us maybe the total store count at the end of the quarter and how many Company-owned stores -- I think you give us the independent stores. So what was the total and what was the Company-owned counts?

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**David Callen** - *Ethan Allen Interiors Inc. - VP, Finance and Treasurer*

Sure, Budd. It was 147 design centers operated by the Company and 151 operated by our independent retailers, for a total of 298.

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**Budd Bugatch** - *Raymond James & Associates - Analyst*

So you had 70 in China and the balance in other parts of the world? Still three in Canada?



**Farooq Kathwari** - *Ethan Allen Interiors Inc. - Chairman, President, CEO*

In Canada we have more than three. In Canada we operate five in the Company Retail division and we have several licensees and Canada.

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**Budd Bugatch** - *Raymond James & Associates - Analyst*

Right, I thought there were three. Okay. All right. Thank you very much.

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**David Callen** - *Ethan Allen Interiors Inc. - VP, Finance and Treasurer*

Thanks, Budd.

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**Operator**

Todd Schwartzman, Sidoti and company.

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**Todd Schwartzman** - *Sidoti & Company - Analyst*

Good morning, Farooq. Good morning, David. A couple of things. I realize there are a lot of moving parts here with regarding delivery of sales and maybe we can take a stab at this. I know you talked a little bit about possible pull forward from July to June due to the price increase. But along those lines is there any evidence in hindsight now that would support some possible pull forward of deliveries into the March quarter from Q4 because of that terrific winter weather we had?

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**Farooq Kathwari** - *Ethan Allen Interiors Inc. - Chairman, President, CEO*

Let me understand. You're saying the impact in our fourth quarter from deliveries for the backlog that we had entering the fourth quarter?

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**Todd Schwartzman** - *Sidoti & Company - Analyst*

Yes. Was anything -- do you suspect that there was anything delivered in the fourth quarter -- in the third quarter, I should say, that might otherwise have been sold, ordered and delivered in Q4, but consumers were out their shopping because of that incredibly mild January, February, March that we had?

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**Farooq Kathwari** - *Ethan Allen Interiors Inc. - Chairman, President, CEO*

We did have a strong third-quarter if you take a look at our third quarter's -- our Retail division sales, we had a -- we shipped 12.3%, and we wrote 11% in the third quarter. And we were able -- we were able to ship a lot of that in that quarter also because of the fact a lot of that business came in January. It's possible because of this good weather, we had a very strong January. We also had very strong programs. We can end up by having a lot of business that commenced in the third quarter that was delivered in the fourth quarter. It was delivered in the third quarter, if that's your question.

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**Todd Schwartzman** - *Sidoti & Company - Analyst*

Got it. Any way to quantify what your designers did in June business that might otherwise have been in July?

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**Farooq Kathwari** - *Ethan Allen Interiors Inc. - Chairman, President, CEO*

Let's keep in mind we also had a price increase the previous year, Todd, so I think on a comparable basis I would say that if there was any business that was taken the June from July, we also had the same thing last year.

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**Todd Schwartzman** - *Sidoti & Company - Analyst*

That's helpful. What's your outlook now for commodity costs for the coming year?

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**Farooq Kathwari** - *Ethan Allen Interiors Inc. - Chairman, President, CEO*

Yes. Last year, one of the main cost increases from the manufacturing side was on lumber, materials for making our upholstery frames. Plywood wood costs had gone up, form costs had gone up. I was just looking at our numbers, we spent about \$1 million more last year just in those two areas in costs. Towards the end of the fourth quarter, they started moderating. So it appears that the plywood costs have moderated, the form costs have moderated. So going into this next fiscal year, I don't see the pressures we had last year.

Our fuel costs also to some degree are starting to moderate. When I take a look at our energy costs, for instance, the fuel costs, because it was a major portion. Because as you know, we deliver our products at one cost nationally. Our fuel costs have gone to \$4.18. But now has come down to close to \$4. So we are seeing a moderation in our fuel costs. And we watch it very, very carefully. Those are all good news.

At this stage, from a cost perspective, there are actually somewhat more pressures internationally, where we are having cost increases in the products that we are getting from overseas. Domestically again, the biggest cost factor is medical costs, and worker's compensation. That really has, when you talk about counting pennies, one penny here or two pennies there, all we need is one major accident and we can have, one penny of our earnings goes to that one major accident. So medical costs is really where the issue is. And we are managing it as best we can, both in workers compensation and also it is unfortunate, in this country, we want to increase employment, but on the other hand, people aren't manufacturing, and people give jobs. You have to consider the cost of medical costs. That's really where the biggest -- our focus is. Although we cannot completely control it, but that's what worries us the most.

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**Todd Schwartzman** - *Sidoti & Company - Analyst*

And can you speak to the fourth quarter demand for upholstery versus case goods domestically, and to what extent that translates in your overseas stores?

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**Farooq Kathwari** - *Ethan Allen Interiors Inc. - Chairman, President, CEO*

You're talking about overseas. You're talking about businesses in case goods, upholstery, accents?

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**Todd Schwartzman** - *Sidoti & Company - Analyst*

Yes, just the relative strength among them, if you could just kind of compare and contrast, and also whether there is anything that should be called out as far as being more of a domestic phenomenon, or are you just seeing pretty much across the network the same types of trends. In other words, upholstery continuing to outperform.

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**Farooq Kathwari** - *Ethan Allen Interiors Inc. - Chairman, President, CEO*

Upholstery is continuing to outperform. Our case goods, as we have seen in every recession, but especially this one, has not grown up as much as -- gone back to where it was. In the last three years it declined. Our upholstery has continued to grow, but this last year, our biggest growth was --



in terms of percentage was in our accent programs and our accessories. Dave also mentioned the impact of that in our gross margins because we do have higher gross margins in accents. That's a very important part of our program. And I would think that as we go forward, even though we have a very, very strong case goods program, we are adding -- we added tremendously great products. And we are also going to have two very strong marketing programs in the fall and in January of next year, which we will also have a positive impact on all of our programs, but case goods. But to answer your question, upholstery, accents are the ones that have increased more than case goods.

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**Todd Schwartzman** - *Sidoti & Company - Analyst*

Was case goods flat?

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**Farooq Kathwari** - *Ethan Allen Interiors Inc. - Chairman, President, CEO*

About, yes, I would say it is about flat. I don't have the numbers in front of me, but it is approximately flat, Todd.

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**Todd Schwartzman** - *Sidoti & Company - Analyst*

Okay. On advertising, Farooq, you had mentioned in July and again in August you expect to double the direct mail. Presumably a big chunk of that is for Express. Could you speak to overall though, in terms of total spend, net, what your expectation, what your net change, if any, in your expectation is now versus a month or two ago when we spoke to you for fiscal '13?

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**Farooq Kathwari** - *Ethan Allen Interiors Inc. - Chairman, President, CEO*

Yes. As Dave mentioned, last year, we increased our advertising by approximately 5%. That is for the Company. It includes national advertising and our retail advertising relating to our Company Retail division. Last month I had mentioned that we may this quarter increase our advertising by up to 15% between what we are doing in direct mail and on national television. We have doubled our direct mail. We are reaching in July and August 3 million households by direct mail and is mostly Express.

And in September we are going to do some national television advertising as well. And at this stage we are determining whether it is going to be Express or whether it's going to be the launch of a very, very exciting program from within our programs called American Colors. You will hear more about it as we go. We'll launch that to the consumer in October and we are also developing a strong national television advertising campaign. At this stage, this quarter is up 15%. Most -- probably the increase might be closer to between 7% to 10%.

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**Todd Schwartzman** - *Sidoti & Company - Analyst*

And of that 7% to 10%, what about, how much of it is the television piece, and how much does the presidential election play into any change year-over-year or sequentially in the TV spend?

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**Farooq Kathwari** - *Ethan Allen Interiors Inc. - Chairman, President, CEO*

Well, that's a good question because in July and August we did not do national television. We put our money in direct mail. And in September we will do some, and we are watching this, the cost of television due to this presidential -- they've gone up. So we are very cautious on that. We are very selective. And however, we believe it is still very important for us to be on national television in September, and in October, even though we are going to be competing with all of the politics. It is important, but we still have to be there. It has raised our costs, and that's why the money that we did not spend in July and August we will spend in September and October and November.



**Todd Schwartzman** - *Sidoti & Company - Analyst*

Okay. And lastly, more of a philosophical question regarding your approach to share repurchases. Have you shifted your focus with regard to stock buybacks, maybe more towards a dollar cost averaging kind of philosophy rather than just trying to be opportunistic when the stock is cheap?

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**Farooq Kathwari** - *Ethan Allen Interiors Inc. - Chairman, President, CEO*

Overall, my first perspective is to make sure that we have good liquidity. And while we have \$109 million?

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**David Callen** - *Ethan Allen Interiors Inc. - VP, Finance and Treasurer*

\$104 million.

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**Farooq Kathwari** - *Ethan Allen Interiors Inc. - Chairman, President, CEO*

\$104 million in cash, keep in mind that approximately what is it, \$60 million of that is customer deposits. I treat that very seriously and carefully. In our industry, especially in Retail, many of them would not be in business if they did not have customer deposits. But also the fact that this is not our money, it's our customers' money. So while I say I've got \$104 million, I always say the \$60 million that we can use and we don't borrow anything from our banks, is money that I want to protect. So we want to maintain at least \$110 million of cash.

After that, as I've said previously, our focus will be to have a reasonable dividend. We are spending money on capital expenditures. That's very important, and then as it makes sense, some share buy. We bought some shares this quarter because the prices were ridiculously low, \$17 or so, we bought some shares. If that happens, we'll buy some shares, and it helps us share, given our options and restricted stock, it brings us back and helps us in our share -- in our diluted shares, Todd. And that's what we'll do. We'll see how it goes, but in case we have the opportunity as we go forward and we generate more cash, then I'm sure with discussions with our Board we'll have an opportunity to consider buying some more shares back. We have over 1 million shares authorization to repurchase.

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**Todd Schwartzman** - *Sidoti & Company - Analyst*

Sounds good. Thank you, gentlemen.

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**Farooq Kathwari** - *Ethan Allen Interiors Inc. - Chairman, President, CEO*

Thank you, Todd.

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**Operator**

Matthew Fassler, Goldman Sachs. Mr. Fassler, please check your mute button.

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**Halley Goodman** - *Goldman Sachs - Analyst*

Hi. This is Halley Goodman, on behalf of Matt Fassler. All of our questions have been answered. Thank you very much.

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**Farooq Kathwari** - *Ethan Allen Interiors Inc. - Chairman, President, CEO*

Okay, thanks.

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**Operator**

John Baugh, Stifel Nicolaus.

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**John Baugh - Stifel Nicolaus - Analyst**

Thanks. Good morning, Farooq and David.

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**Farooq Kathwari - Ethan Allen Interiors Inc. - Chairman, President, CEO**

Hi, John, how are you?

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**John Baugh - Stifel Nicolaus - Analyst**

When you find that \$5 million floating around, I'll give you my address and you can cut me a check for it. Everything has been answered except one last little one. I'm wondering how you will measure the Express program's impact on your business. Basically I'm wondering how you will determine whether it's a new customer or incremental sale versus the cannibalization issue, they were going to buy something else more expensive, but the value is so compelling on the Express option they chose that. I was just wondering how you're going to be able to look at that internally and whether you've seen anything from what you've done.

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**Farooq Kathwari - Ethan Allen Interiors Inc. - Chairman, President, CEO**

John, we do. As our objective is to deliver faster, so we want make sure that we also are in stock. So we have a daily review of products that we sell. And so that we can replenish it. We are as I said, we are watching what it is doing. Certainly these products that we have put in Express, keep in mind they are all existing products. They are already starting to show, obviously, an increase from the previous year. However, it's really going to take us about, at least four to six months to gauge the impact of this program. This program will be an ongoing program. The objective of this program is to help us get the message across that Ethan Allen is attainable.

Secondly, the objective is to get traffic into our design centers, and then after that, as we have already noticed, when they come in, they do not necessarily by only the Express. They may take an item from Express. Like for instance, if they want a sofa fast, we have it in stock. Then we will -- in the next six months we will see how much of the product they are buying that we have in stock. How much of the incremental products is being purchased. What's the impact on traffic. And also the impact on the demographic that we are getting. So I would say in the next four to six months we will have a much better understanding. It's just too early.

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**John Baugh - Stifel Nicolaus - Analyst**

Farooq, on the in stock, I think I heard you some 90% number that was shipping within two days. Is that a number, a service level you expect to maintain or you just started with a big in stock position and the program is just getting started, and that number is going to go down in time? What I'm wondering is the confidence level that the retail sales associates can have in telling the consumer, this is going to ship quickly, one week, two weeks, four weeks, whatever the case may be.

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**Farooq Kathwari - Ethan Allen Interiors Inc. - Chairman, President, CEO**

They have online ability to see if it's in stock. They can order it right away, too. So from that point of view, before they say anything, they can see if it is in stock. It is 94%, but it's too early, as you also mentioned. On one hand, we want to maintain inventories. On the other hand, we don't want to have a glut of inventories. So on one hand we want to market it aggressively, on the other hand if we market it too aggressively and get into a



service problem it will create an issue of credibility. So, John, these are all issues we are watching very carefully. I think as we go forward, even though it's not for my own associates, they've got to deliver within two days, 95%. But as we go forward, if we do 85% that's sold within two days, that I think will be an acceptable number.

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**John Baugh** - *Stifel Nicolaus - Analyst*

Great. Thanks and good luck.

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**Farooq Kathwari** - *Ethan Allen Interiors Inc. - Chairman, President, CEO*

Thanks.

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**Operator**

Joe Feldman, Telsey Advisory Group. Mr. Feldman, please check your mute button.

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**Joe Feldman** - *Telsey Advisory Group - Analyst*

Whoops. Sorry about that. Here I am. Hi, good morning. I wanted to ask about supply chain a little bit. You know, it seems like we continue to see solid improvement from you guys there. Anything -- when the Honduras plant, can you remind us when that will really come up online and what kind of benefits that we might see from that, and are there any other international plants? I know you spent a few, the past several years coming back to the US, and just wondering if there is more beyond Honduras, outside the US.

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**Farooq Kathwari** - *Ethan Allen Interiors Inc. - Chairman, President, CEO*

Joe, Honduras we purchased last December.

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**Joe Feldman** - *Telsey Advisory Group - Analyst*

Right.

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**Farooq Kathwari** - *Ethan Allen Interiors Inc. - Chairman, President, CEO*

And the objective was to initially start making chairs. And these chairs were being made offshore. And we started making them, although most of the parts came from offshore in the initial period, and we started shipping our first chairs in April of this year. So record time we were able to put it together. We have good management, we have trained a lot of people. And again, as I mentioned all of that we absorbed in our cost structure.

It will take us another year or so in terms of getting this Honduras plant, which is what we are doing right now, to also start making the parts, not right now assembling the parts. And within I think 12 month period, it will be more of a fully functioning case goods plant. And I think at this stage we have a good balance. Balance in manufacturing, between upholstery, between our plant in North Carolina, about 600,000 square feet, about 1,000 associates. Our plant in Mexico, 240,000 square feet, all new construction by us, with over 500 associates is a good mix. It gives us an opportunity of leveraging both and as we grow, we have an opportunity of growing our business. In case goods, the same thing. In our US manufacturing and now Honduras gives us an opportunity of balancing, on top of it, we still have many great partners offshore who we need. So we will balance it. At this stage we don't have any intentions of setting up any other plant, if that was your question.



**Joe Feldman** - *Telsey Advisory Group - Analyst*

Yes, that's kind of where I was headed with that, too, was just if there is anything beyond. Thank you for that color. And also, anything to note on the financing programs? I know we always hear from you guys on that, just like the amount that people might be taking on. And I know you've had some very attractive programs with some very long dated zero interest. Anything to note on that front?

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**Farooq Kathwari** - *Ethan Allen Interiors Inc. - Chairman, President, CEO*

Joe, this 48 months financing in which people have to make equal payments during that 48 months is a great program. It gives an opportunity for people to see our products as much more attainable. We have many -- most of our product programs, that is Express or not, you can have a great beautiful Ethan Allen room under \$200 a month. So that has made us -- not only the question of financing, but it has made us become more attainable. And the demographics we are dealing with also gives us an opportunity of having, even though as you know there is no recourse to us, but the partner that provides us the financing also, I think has good results because of the demographics we are dealing with. So this is a very, very important program, and you are going to see us using it even more effectively than we are doing now.

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**Joe Feldman** - *Telsey Advisory Group - Analyst*

Got it. And then anything -- with regard to the financing, anything with the interchange fees? There's been some discussion lately, will that have any kind of effect on you, if the potential surcharge, because I would think a big ticket might create a fairly substantial surcharge potentially.

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**Farooq Kathwari** - *Ethan Allen Interiors Inc. - Chairman, President, CEO*

I see. You're talking about -- I used to be the Chairman of the National Retail Federation when we started that. That is introducing -- you're talking about reducing costs on these credit cards.

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**Joe Feldman** - *Telsey Advisory Group - Analyst*

Yes, exactly.

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**Farooq Kathwari** - *Ethan Allen Interiors Inc. - Chairman, President, CEO*

Well, you know, we're going to see that the benefit we will get -- I don't know really how much money we are going to get, but we should be able to get some money. That also, and this is, I'm sure you're following it, and Budd and John and others are following this whole anti-dumping situation, whereby we, I was the Chairman of the American Furniture Manufacturing Association, and I had to stay neutral, because as the Chairman I wanted to be neutral. And anyway, the government has disbursed millions of dollars and recently -- and we of course challenged it. And recently a case which was very similar to us, was ruled very favorably in which the government asked that that company, which had also been neutral, be paid. Now, the government is going to appeal it, and this for, Budd, I know is following it very well. And if the government owes us \$60 million, now, we're going to see when we collect it, but that's a very important part. We are very much there, but had a very favorable ruling against a case that is very similar to ours.

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**Joe Feldman** - *Telsey Advisory Group - Analyst*

Got it. That's good to know. Thanks. And just the last thing I wanted to ask you about was also back to international for a second, just on the actual selling side of things. I know, any commentary to share about the quarter with China or any of the efforts abroad?



**Farooq Kathwari** - *Ethan Allen Interiors Inc. - Chairman, President, CEO*

Joe, a lot of good growth. In China, in the last three or four months back, we had sent a team of our people who held seminars in four major cities. We also invested at that time a little over \$0.5 million in a couple of months in advertising. We are building our brand there. And we are going to do the same thing in this quarter where we are going to be investing in China. We also want to send a team of people. China is ready, we have a great operation there, a great partner.

On the international front, as you know, we last year started to focus on other markets. So we're going to now have a start up in Europe through Brussels, and expanding also in the Middle East, and we are also going into Canada and to do all of that we also had to make investments in our website. Our website is going to go from having servers right here in Danbury, to going to an environment, this cloud environment and also be translated into French. Going to Brussels, we've got to do it in French as well as in Dutch. So we are going to launch our website in international markets within the next 12 months.

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**Joe Feldman** - *Telsey Advisory Group - Analyst*

Got it. That's great. Thanks for the update on that. And good luck with this quarter. Thank you.

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**Farooq Kathwari** - *Ethan Allen Interiors Inc. - Chairman, President, CEO*

Thanks.

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**Operator**

(Operator Instructions)

Maggie Gilliam, Gilliam and Company.

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**Maggie Gilliam** - *Gilliam & Co - Analyst*

Sorry, I thought I put in to cancel my question, I will just follow-up on one thing if I may. I was just curious, at some point you're going to get a cadence that's very, very different in the order pattern. With the shortened lead time all the way around. Is that going to cause any sort of working capital adjustment? Is there going to be any kind of change in estimating when you're going to be shipping stuff and when the sales will be coming in? It will be a much more compressed time, well it not?

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**Farooq Kathwari** - *Ethan Allen Interiors Inc. - Chairman, President, CEO*

Yes, Maggie. That means we collect our money faster.

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**Maggie Gilliam** - *Gilliam & Co - Analyst*

Okay.

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**Farooq Kathwari** - *Ethan Allen Interiors Inc. - Chairman, President, CEO*

That's a positive news.



**Maggie Gilliam** - *Gilliam & Co - Analyst*

That positive news from that. But from a standpoint, the question was asked earlier about building up inventory in conjunction with getting prepared for the Express program. It may actually balloon a little bit later.

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**Farooq Kathwari** - *Ethan Allen Interiors Inc. - Chairman, President, CEO*

We will see. The only reason it will balloon is because we've got great sales.

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**Maggie Gilliam** - *Gilliam & Co - Analyst*

Okay.

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**Farooq Kathwari** - *Ethan Allen Interiors Inc. - Chairman, President, CEO*

It's not going to balloon if we don't have sales. It will go the other way, Maggie, if the sales are not there.

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**Maggie Gilliam** - *Gilliam & Co - Analyst*

Okay.

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**Farooq Kathwari** - *Ethan Allen Interiors Inc. - Chairman, President, CEO*

And keep in mind, all these products that we put in inventory are our best-selling products.

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**Maggie Gilliam** - *Gilliam & Co - Analyst*

Yes. Okay. Well, think it's very interesting that you're getting a lot of regular selling in amongst the Express program. Because that's the best of all worlds.

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**Farooq Kathwari** - *Ethan Allen Interiors Inc. - Chairman, President, CEO*

Yes, that exactly -- the objective really is to let people know that we are attainable, we have great value. And as you know, we made a very major decision that we will not make new products for the Express. It will be all existing in-line Ethan Allen products. Because exactly that's what happened. Consumers come in and they say, is this is Ethan Allen quality or have you changed it?

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**Maggie Gilliam** - *Gilliam & Co - Analyst*

Yes.

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**Farooq Kathwari** - *Ethan Allen Interiors Inc. - Chairman, President, CEO*

They are used to having companies having different brands and changing the quality. We haven't.

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**Maggie Gilliam** - *Gilliam & Co - Analyst*

Yes, exactly. No, that's perfect. Okay.

**Farooq Kathwari** - *Ethan Allen Interiors Inc. - Chairman, President, CEO*

All right, Maggie. Thank you.

**Operator**

Thank you. I see no additional questions in the queue at this time.

**Farooq Kathwari** - *Ethan Allen Interiors Inc. - Chairman, President, CEO*

All right. Thanks very much and good to talk to you. Any questions, please let me know, or Dave Callen know. Take care.

**Operator**

Ladies and gentlemen, thank you for participation in today's conference. This does conclude the program and you may now disconnect. Everyone, have a good day.

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