NIKE INC
Form 11-K
November 23, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 11-K

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

For the fiscal year ended May 31, 2012

OR

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

For the transition period from to

Commission File No. 001-10635

NIKE, Inc.

(Full title of the plan)

401(k) Savings and Profit Sharing Plan for Employees of NIKE, Inc.

(Name of issuer of the securities held pursuant to the plan)

One Bowerman Drive

Beaverton, Oregon 97005

(Address of the plan and address of issuer s principal executive offices)

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401(k) Savings and Profit Sharing Plan for Employees of NIKE, Inc.

Financial Statements and Supplemental Schedules

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Note: Other schedules required by 29 CFR Section 2520.103-10 of the Department of Labor s Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974 have been omitted because they are not applicable.

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Report of Independent Registered Public Accounting Firm

To the Participants and Administrator of

401(k) Savings and Profit Sharing Plan for Employees of NIKE, Inc.

In our opinion, the accompanying statements of net assets available for benefits and the related statements of changes in net assets available for benefits present fairly, in all material respects, the net assets available for benefits of 401(k) Savings and Profit Sharing Plan for Employees of NIKE, Inc. (the Plan) at May 31, 2012 and 2011, and the changes in net assets available for benefits for the year ended May 31, 2012 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Plan s management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplemental Schedule of Assets (Held at End of Year) at May 31, 2012, and Schedule of Assets (Acquired and Disposed of Within Year) for the year ended May 31, 2012 are presented for the purpose of additional analysis and are not a required part of the basic financial statements but are supplementary information required by the Department of Labor s Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974. These supplemental schedules are the responsibility of the Plan s management. The supplemental schedules have been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

/s/ PricewaterhouseCoopers LLP

Portland, Oregon

November 21, 2012

PricewaterhouseCoopers LLP, 1300 SW Fifth Avenue, Suite 3100, Portland, OR 97201

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401(k) Savings and Profit Sharing Plan for Employees of NIKE, Inc.

Statements of Net Assets Available for Benefits

May 31, 2012 and 2011

	2012	2011
Assets		
Investments, at fair value		
Collective trust funds	$ 1,304,605,985	$ 1,158,430,251
NIKE, Inc. Class B common stock	522,643,543	441,550,034
Registered investment companies	70,014,666	77,231,534
Corporate and foreign bonds	37,435,516	34,410,762
Guaranteed investment contract	3,414,452	
Interest bearing cash	109	10,661
Common and foreign stocks	20,406	1,440
Total investments	1,938,134,677	1,711,634,682
Receivables		
Employer contributions	42,389,605	40,431,957
Notes receivable from participants	26,552,534	22,606,115
Participant contributions	2,484,700	1,648,075
Accrued interest and dividends	2,511,330	810,639
Due from broker for securities sold	468,917	512,849
Total receivables	74,407,086	66,009,635
Cash	30,027	161,055
Total assets	2,012,571,790	1,777,805,372
Liabilities		
Due to broker for securities purchased	298,035	924,621
Accrued expenses	126,351	127,521
Total liabilities	424,386	1,052,142
Net assets available for benefits at fair value	2,012,147,404	1,776,753,230
Adjustment from fair value to contract value for interest in collective trust relating to fully benefit-responsive investment contracts	(245,789)	(509,521)
Net assets available for benefits	$ 2,011,901,615	$ 1,776,243,709

The accompanying notes are an integral part of these financial statements.

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401(k) Savings and Profit Sharing Plan for Employees of NIKE, Inc.

Statement of Changes in Net Assets Available for Benefits

Year Ended May 31, 2012

Additions	
Investment income	
Net appreciation in fair value of investments	$ 58,294,096
Interest and dividends	12,227,511
Total investment income	70,521,607
Less: Investment expenses	(356,489)
Net investment income	70,165,118
Interest income on notes receivable from participants	1,073,973
Contributions	
Employer, net of forfeitures	82,784,266
Participant	69,037,172
Rollover	5,709,244
Total contributions	157,530,682
Total additions	228,769,773
Deductions	
Benefits paid to participants	(79,535,814)
Administrative expenses	(1,303,176)
Total deductions	(80,838,990)
Net increase before transfer of assets	147,930,783
Transfer of affiliates assets relating to the Plan merger	87,727,123
Net increase	235,657,906
Net assets available for benefits	
Beginning of year	1,776,243,709
End of year	$ 2,011,901,615

The accompanying notes are an integral part of these financial statements.

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401(k) Savings and Profit Sharing Plan for Employees of NIKE, Inc.

Notes to Financial Statements

May 31, 2012 and 2011

1. Description of the Plan

The following description of the 401(k) Savings and Profit Sharing Plan for Employees of NIKE, Inc. (the Plan) provides only general information. Participants should refer to the Plan document for a more complete description of the Plan s provisions.

General

The Plan was established to provide for the retirement income requirements of and sharing in Company profits by all employees of NIKE, Inc. (the Company) and a retirement savings program for the employees of the Company not covered by a collective bargaining agreement. The Plan is subject to the provisions of the Employee Retirement Income Security Act of 1974 (ERISA), as amended. Administration of the Plan is performed by the Administrative Subcommittee of the Retirement Committee. The Plan is amended from time to time in order to comply with changes in applicable laws and to make changes in Plan administration.

The Northern Trust Company (Northern Trust or the Trustee) is the Trustee and Aon Hewitt Associates (Aon Hewitt or the Recordkeeper) is th Recordkeeper of the Plan s assets. Selected assets are held in the custody of Charles Schwab & Co. Inc. (Charles Schwab or the Custodian) and are maintained by the Trustee. The Plan s investment decisions are overseen by the Investment Subcommittee of the Retirement Committee. Members of the Retirement Committee are appointed by the Board of Directors of the Company.

On January 1, 2012, the Company merged the Cole Haan Retirement Savings Plan, Converse Inc. 401(k) Savings Plan, and Hurley International LLC Tax Advantaged Plan (collectively, the Affiliate Plans) with and into the Plan (the Plan Merger). As a result of the Plan Merger, all assets and liabilities of the Affiliate Plans became assets and liabilities of the Plan, and the Affiliate Plans ceased to exist as of the close of business on January 1, 2012.

Eligibility

All employees, except those employees who are (1) covered by a collective bargaining agreement, (2) living outside the United States and not covered by the Company expatriate program, (3) working at the Company s Memphis Apparel Distribution Center, whose employment is established pursuant to the Company s Seasonal On Call Casual Employee Reserve (SOCCER) program, (4) not common-law employees, such as leased employees and individuals designated by Nike as independent contractors, or (5) residing in Puerto Rico and working at the Puerto Rico facility, become eligible to receive profit sharing contributions on the first day of the Plan fiscal year coinciding with or immediately preceding completion of one year of employment with at least 1,000 hours of service. Employees are eligible to participate in the 401(k) portion of the Plan on the first day of employment.

Contributions

Participants may contribute up to 50% of their pre-tax annual compensation to the Plan, subject to annual individual deferral limitations under the Internal Revenue Code (IRC). Participants who have attained age 50 before the end of the Plan year are eligible to make catch-up contributions, as defined by the IRC. Participants may also contribute amounts representing distributions from other qualified defined benefit or defined contribution plans. Additionally, the Company will match participant contributions at a rate of 100% of the first 5% of the participant s total base pay that is contributed to the account.

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401(k) Savings and Profit Sharing Plan for Employees of NIKE, Inc.

Notes to Financial Statements

May 31, 2012 and 2011

Prior to May 13, 2011, the Company match contributions related to the Plan s 401(k) feature were invested in NIKE, Inc. Class B common stock and as of June 1, 2001, these match contributions became subject to participant self-direction after the initial investment in Company stock was made to the Plan. Participants could redeem their shares in Company stock and reinvest the cash into other managed funds. As of May 13, 2011, the Company match followed participants fund selections and NIKE, Inc. Class B common stock became one of the investment choices. No more than 10% of a participant s deferral and corresponding match can go into the NIKE stock fund and a participant can only transfer a portion of his or her existing account balance to purchase NIKE stock if the percentage of their account balance invested in NIKE stock is less than or equal to 20%. Transfers out of the NIKE stock fund are permitted at any time.

Under the Plan s profit sharing features, the Company may make discretionary annual contributions as designated by the Company s Board of Directors. However, this amount cannot be greater than the amount allowable as a tax deduction under the IRC. The annual contributions will be funded no later than the date the Company s federal income tax return is filed.

Profit sharing contributions are invested in various fixed income and equity funds similar to those offered under the Plan s 401(k) features. Investments held by the Plan on behalf of participants related to profit sharing contributions are nonparticipant-directed. In a nonparticipant-directed program, the Investment Committee, under the guidance of investment managers, directs the specific investments held by the Plan. See Note 7 for applicable disclosures. Investments held by the Plan on behalf of participants related to 401(k) contributions are participant-directed. In a participant-directed program, the individual participant selects the investments for his or her individual account.

Participant Accounts

Separate individual 401(k) and profit sharing accounts are maintained for each participant. Each participant s 401(k) account is credited with the participant s contributions and rollovers, the Company s matching contributions, Plan expenses and an allocation of the Plan s investment income or losses based upon the participant s election of investment options. Participants direct the investment of their contributions into various investment options offered by the Plan.

An eligible profit sharing participant is entitled to an annual allocation of the employer profit sharing contribution and former participant profit sharing forfeitures after restoration of previously forfeited accounts. Employer profit sharing contributions and former participant forfeitures are allocated first in the proportion of the participant s annual compensation to compensation of all participants, up to a maximum of 4% of the compensation of each participant. Contributions and forfeitures exceeding 4% of all participants annual compensation, if any, are allocated in the ratio of each participant s excess compensation to total excess compensation of all participants, not to exceed 4% of such excess compensation. Excess compensation is defined as compensation in excess of the social security wage base. The balance of contributions and forfeitures, if any, is allocated to participants in the ratio of each participant s annual compensation to the total of all participants annual compensation, subject to the IRC Section 415 defined maximum limitations. Participants do not direct the investment of profit sharing contributions.

Profit sharing investment income or loss and Plan expenses are allocated daily based on a ratio of each participant s profit sharing account balance to the total profit sharing account balances.

The total benefit to which a participant is entitled is the benefit that can be provided from the participant s vested 401(k) and profit sharing accounts.

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401(k) Savings and Profit Sharing Plan for Employees of NIKE, Inc.

Notes to Financial Statements

May 31, 2012 and 2011

Vesting

Participants in the 401(k) portion of the Plan are immediately vested in their elective, rollover, and Company matching contributions, plus actual earnings thereon. The Company contributions into the profit sharing portion of the Plan vest at 25% per year after completing two years of service, and vesting increases 25% for each additional year of service until fully vested after five years. Participants in the profit sharing portion of the Plan become fully vested in the Company s contributions in the event of total and permanent disability, death, attainment of 65 years of age, or termination of the Plan.

Forfeitures

Upon a participant s termination, the unvested portion of the participant s profit sharing account is forfeited. Profit sharing forfeitures may be used to reduce future employer contributions or be allocated back to active participants. During the year ended May 31, 2012, profit sharing forfeitures of $1,491,250 were used to reduce employer contributions. At May 31, 2012 and 2011, accumulated profit sharing forfeitures totaled $1,653,965 and $913,363, respectively.

Notes Receivable from Participants

Participants may borrow a portion of their elective and rollover contributions by applying to the Administrative Subcommittee. Participants may borrow from their accounts amounts equal to the lesser of 50% of their vested account balance or $50,000 reduced by the balance of any outstanding loans. The term of the loan repayments range up to five years for general purpose loans and up to ten years for the purchase of a primary residence. The loans are secured by the balance in the participant s account and bear interest at the prime rate plus one percentage point. Principal and interest are paid ratably through monthly deductions.

Benefit Payments

On termination of service due to death, disability, hardship, resignation, discharge and retirement, a participant is eligible to receive payments in the amount equal to the value of the participant s vested interest in his or her account.

Vested benefits are distributed to participants in a lump-sum payment upon termination or are transferred to another qualified trust. Participants with vested benefits greater than $1,000 can elect to receive a distribution or leave their balance in the Plan. Terminated participants with balances greater than $1,000 may leave their vested benefits in the Plan until reaching the age of 65. Participants may apply to the Administrative Subcommittee to withdraw their voluntary 401(k) contributions in the event the participant is over age 59-1/2, or the participant has a financial hardship as stipulated in the Plan provisions. No withdrawals may be made from the unvested portion of the Company s matching contributions, profit sharing contributions, or earnings thereon.

Plan Termination

Although it has not expressed any intent to do so, the Company has the right under the Plan to discontinue its contributions at any time and to terminate the Plan subject to the provisions of ERISA. In the event of Plan termination, the accounts of all participants would become fully vested. The net assets of the Plan would be distributed among the participants and beneficiaries of the Plan in proportion to their interests after proper allocation of any Plan expenses incurred upon termination.

2. Significant Accounting Policies
Basis of Accounting

The accompanying financial statements have been prepared on the accrual basis of accounting.

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401(k) Savings and Profit Sharing Plan for Employees of NIKE, Inc.

Notes to Financial Statements

May 31, 2012 and 2011

Recent Accounting Pronouncements and Developments

In January 2010, the Financial Accounting Standards Board (FASB) issued updated guidance to improve disclosures regarding fair value measurements. This update requires entities to (i) disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers and (ii) present separately (i.e., on a gross basis rather than as one net number), information about purchases, sales, issuances and settlements in the roll forward of changes in Level 3 fair value measurements. The update requires fair value disclosures by major class rather than by category of assets and liabilities in the Statements of Net Assets Available for Benefits. Disclosures regarding the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements for assets and liabilities in both Level 2 and Level 3 are also required. For all portions of the update except the gross presentation of activity in the Level 3 roll forward, this standard is effective for interim and annual reporting periods beginning after December 15, 2009. For the gross presentation of activity in the Level 3 roll forward, this guidance is effective for fiscal years beginning after December 15, 2010. See Note 4 for applicable disclosures.

In May 2011, the FASB issued ASU 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards (IFRS), which is intended to improve the comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with GAAP and IFRS. The amendments are of two types: (i) those that clarify the FASB s intent about the application of existing fair value measurement and disclosure requirements and (ii) those that change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. The update is effective for annual periods beginning after December 15, 2011. The Plan s management is in the process of evaluating the impact of the adoption of this update on the Plan s financial statements.

Investment Valuation and Income Recognition

Managed funds consist of investments in preferred, common and foreign stock, corporate, preferred, and foreign bonds, collective trust funds, registered investment companies, U.S. government securities, guaranteed insurance contracts, and interest bearing cash. Investments in preferred, common and foreign stocks listed on a national securities exchange and over-the-counter securities are valued at the last reported sale price on the valuation date or, if no sales are reported for that day, the last published sale price. Bonds are valued based on market values quoted by dealers who are market makers in these securities, by independent pricing services, or by a methodology approved by Northern Trust. The fair value of the fixed income securities is determined based on valuations provided by an independent pricing service, which uses multiple valuation techniques that incorporate available market information and proprietary valuation models, which consider market characteristics, such as benchmark yield curve, credit spreads, estimated default rates and other security features. Investments in registered investment companies are stated at net asset value, based upon the fair market value of the underlying securities, as determined or provided by Northern Trust. Guaranteed insurance contracts are stated at fair value. Fair value represents an adjustment to contract value based on the market value of the investment in a principal market. Contract value represents contributions made under the contract, plus earnings, less participant benefit payments and administrative expenses. There are no reserves against contract value for credit risk of the contract issuer or otherwise.

Collective trust funds represent investments held in pooled funds. The investments are contributed from employee benefit plans maintained by more than one employer or a controlled group of corporations that is maintained by a bank, trust company, or similar institution that is regulated, supervised, and subject to periodic examination by a state or federal agency. The Plan s interests in the collective trust funds are valued based on information provided by Northern Trust using the net asset value from the audited financial statements of the collective trust funds. The Plan invests in two collective trust funds, the Schwab Stable Asset Fund and the Union Bond & Trust Company Morley Stable Value Fund (Morley Stable Value Fund), which hold fully benefit-responsive investment contracts. These collective trust funds can be redeemed daily by participants subject to limitations on noncompeting options. The Morley Stable Value Fund s trustee reserves the right to delay plan sponsor-initiated redemptions for up to 365 days. There are no other restrictions on collective trust transactions.

Investment contracts held by a defined contribution plan are required to be reported at fair value. However, contract value is the relevant measurement attribute for that portion of the net assets

401(k) Savings and Profit Sharing Plan for Employees of NIKE, Inc.

Notes to Financial Statements

May 31, 2012 and 2011

available for benefits of a defined contribution plan attributable to fully benefit-responsive investment contracts because contract value is the amount participants would receive if they were to initiate permitted transactions under the terms of the Plan. The Plan invests in investment contracts through a collective trust fund and guaranteed insurance contract. The Statements of Net Assets Available for Benefits present the fair value of the investment in the collective trust funds as well as the adjustment of the investment in the collective trust funds from fair value to contract value relating to the investment contracts. The Statement of Changes in Net Assets Available for Benefits is prepared on a contract value basis.

Investments are purchased and sold at the fair value of the underlying investments and receive the interest and dividend earnings of the underlying investments. Purchases and sales of securities are recorded on a trade date basis. Interest income is recorded on the accrual basis. Dividends are recorded on the ex-dividend date. The Plan presents, in the Statement of Changes in Net Assets Available for Benefits, the net appreciation or depreciation in the fair value of its investments, which consist of the realized gains or losses and the unrealized appreciation or depreciation on those investments.

Notes Receivable from Participants

Notes receivable from participants are measured at their unpaid principal balance plus any accrued but unpaid interest. Delinquent notes receivable are reclassified as distributions based upon the terms of the Plan document.

Benefits Payable

Benefits are recorded when paid. Accordingly, benefits payable to persons that have elected to withdraw from the Plan but not yet paid have not been accrued. At May 31, 2012 and 2011, there were $849,252 and $475,195, respectively, payable to participants.

Expenses

Expenses of administering the Plan and those which are directly related to investment transactions are paid out of the assets of the Plan.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of additions to and deductions from net assets available for benefits during the reporting period. Actual results could differ from those estimates.

Risks and Uncertainties

The Plan invests in various investment securities that are exposed to various risks, such as interest rate, market and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities, and thus the net asset value of the funds, will occur in the near term and that such changes could materially affect participant s account balances and the amount reported in the Statements of Net Assets Available for Benefits and the Statement of Changes in Net Assets Available for Benefits. Market values of investments may decline for a number of reasons, including changes in prevailing market and interest rates, increases in defaults and credit rating downgrades. The fair values assigned to the investments by the Plan are based upon available information believed to be reliable, which may be affected by conditions in the financial markets. The Plan may not be able to sell its investments when it desires to do so or to realize what it perceives to be its fair value in the event of a sale.

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401(k) Savings and Profit Sharing Plan for Employees of NIKE, Inc.

Notes to Financial Statements

May 31, 2012 and 2011

Subsequent Events

The Plan has evaluated subsequent events through November 21, 2012 and determined that no significant subsequent events have occurred requiring adjustments to the financial statements or disclosures.

3. Investments

The following presents investments that represent 5% or more of the Plan s net assets at May 31, 2012:

Participant-directed	
NIKE, Inc. Class B Common Stock	$ 522,643,543
Collective trust funds	
Northern Trust Global Investments Collective Daily S&P 500 Equity Index Fund	317,080,621
Northern Trust Global Investments Collective Daily Aggregate Bond Index Fund	164,513,968
Northern Trust Global Investments Collective Daily Russell 2000 Equity Index Fund	151,527,888
Northern Trust Bank NA Collective Daily All Country World Exchange Fund	151,113,388
Morley Stable Value Fund	132,456,842
Nonparticipant-directed	
Collective trust funds	
Northern Trust Global Investments Collective Daily S&P 500 Equity Index Fund	121,638,169

The following presents investments that represent 5% or more of the Plan s net assets at May 31, 2011:

Participant-directed	
NIKE, Inc. Class B Common Stock	$ 441,550,034
Collective trust funds	
Northern Trust Global Investments Collective Daily S&P 500 Equity Index Fund	236,689,807
Northern Trust Bank NA Collective Daily All Country World Exchange Fund	161,526,571
Northern Trust Global Investments Collective Daily Russell 2000 Index Fund	143,241,224
Northern Trust Global Investments Collective Daily Aggregate Bond Index Fund	119,539,339
Schwab Stable Value Fund	101,758,071
Nonparticipant-directed	

Collective trust funds	
Northern Trust Global Investments Collective Daily S&P 500 Equity Index Fund	117,000,195

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401(k) Savings and Profit Sharing Plan for Employees of NIKE, Inc.

Notes to Financial Statements

May 31, 2012 and 2011

During the year ended May 31, 2012, all of the Plan s investments (including gains and losses on investments bought and sold, as well as held during the year) appreciated in value as follows:

NIKE, Inc. Class B common stock	$ 119,129,313
Morley Stable Value Fund	248,223
Collective trust funds	(44,848,649)
Registered investment companies	(15,391,744)
Corporate bonds	(719,869)
Preferred and common stocks	(123,178)
	$ 58,294,096

4. Fair Value Measurement

In determining fair value, the Plan uses a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are described below:

Level 1 Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Plan has the ability to access.

Level 2 Inputs to the valuation methodology include:

Quoted prices for similar assets or liabilities in active markets;

Quoted prices for identical or similar assets or liabilities in inactive markets;

Inputs, other than quoted prices, that are observable for the asset or liability;

Inputs that are derived principally from, or corroborated by, observable market data by correlation or other means.

If the asset or liability has a specified (contractual) term, the Level 2 input must be observable for substantially the full term of the asset or liability.

Level 3 Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset s or liability s fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

The valuation methods described in Note 2 may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Plan believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date. There have been no changes in the methodologies used at May 31, 2012 and 2011.

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401(k) Savings and Profit Sharing Plan for Employees of NIKE, Inc.

Notes to Financial Statements

May 31, 2012 and 2011

The following tables set forth by level, within the fair value hierarchy, the Plan s assets at fair value as of May 31, 2012 and 2011:

	Assets at Fair Value at May 31, 2012			
	Level 1	Level 2	Level 3	Total
Collective trust funds				
Equity index funds	$	$ 619,721,910	$	$ 619,721,910
Common stock funds		254,330,070		254,330,070
Other fixed income funds		262,957,562		262,957,562
Real estate funds		27,108,757		27,108,757
Stable value funds		821		

(Gain) loss on disposal of property, plant and equipment	12	346
Other	104	44
Change in operating assets and liabilities, net of effects of acquired businesses:		
Accounts receivable	(408)	2,205
Inventories	(2,707)	(8,022)
Prepaid and other current assets	(1,538)	(2,105)
Customer deposits	6,328	6,205
Accounts payable	39	270
Accrued expenses and other current liabilities	8,523	5,182
Other assets and liabilities	(343)	(259)
Net cash provided by operating activities	24,440	17,632
Investing activities:		
Proceeds from the disposal of property, plant & equipment	-	4
Capital expenditures	(2,777)	(2,653)
Other investing activities	32	47
Net cash provided by (used in) investing activities	(2,745)	(2,602)
Financing activities:		
Payments on long-term debt and capital lease obligations	(165)	(14,059)
Purchases and retirements of company stock	-	(1,100)
Payment of cash dividends	(5,065)	(5,239)
Other financing activities	637	4
Net cash provided by (used in) financing activities	(4,593)	(20,394)

Effect of exchange rate changes on cash	125	107
Net increase (decrease) in cash, cash equivalents, and restricted cash	17,227	(5,257)
Cash, cash equivalents, and restricted cash at beginning of period	22,363	65,031
Cash, cash equivalents, and restricted cash at end of period	$ 39,590	$ 59,774

See accompanying notes to consolidated financial statements.

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ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Consolidated Statements of Shareholders' Equity

Three Months Ended September 30, 2018

(Unaudited)

(In thousands)

	Common Stock	Additional Paid-in Capital	Treasury Stock	Accumulated Other Comprehensive Income (loss)	Retained Earnings	Non-Controlling Interests	Total
Balance at June 30, 2018	$ 490	$ 376,950	$ (656,551)	$ (6,171)	$ 669,013	$ 139	$ 383,870
Stock issued on share-based awards	-	637	-	-	-	-	637
Compensation expense associated with share-based awards	-	491	-	-	-	-	491
Dividends declared on common stock	-	-	-	-	(5,072)	-	(5,072)
Comprehensive income	-	-	-	1,247	8,840	(26)	10,061
Balance at September 30, 2018	$ 490	$ 378,078	$ (656,551)	$ (4,924)	$ 672,781	$ 113	$ 389,987

See accompanying notes to consolidated financial statements.

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ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

(1) Basis of Presentation

Founded in 1932, Ethan Allen Interiors Inc. ("Interiors") is a Delaware corporation incorporated on May 25, 1989. The consolidated financial statements include the accounts of Interiors, its wholly owned subsidiary Ethan Allen Global, Inc. ("Global"), and Global's subsidiaries (collectively "we", "us", "our", "Ethan Allen", or the "Company"). All intercompany accounts and transactions have been eliminated in the consolidated financial statements.

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

(2) Interim Financial Presentation

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

(3) Income Taxes

The Company reviews its expected annual effective income tax rates and makes changes on a quarterly basis as necessary based on certain factors such as changes in forecasted annual operating income; changes to actual or forecasted permanent book to tax differences; impacts from future tax audits with state, federal or foreign tax authorities; impacts from tax law changes; or change in judgment as to the realizability of deferred tax assets. The Company identifies items which are non-recurring in nature and treats these as discrete events. The tax effect of such items is recorded in the quarter in which the related events occur. Due to the volatility of these factors, the Company's consolidated effective income tax rate can change significantly quarter over quarter.

The Company conducts business globally and, as a result, the Company and its subsidiaries files income tax returns in the U.S. and in various state and foreign jurisdictions. In the normal course of business, the Company is subject to periodic examination in such domestic and foreign jurisdictions by tax authorities. The Company and certain subsidiaries are currently under audit in the U.S. from 2015 through 2016. While the amount of uncertain tax impacts with respect to the entities and years under audit may change within the next twelve months, it is not anticipated that any of the changes will be significant. It is reasonably possible that some of these audits may be completed during the next twelve months and that various issues relating to uncertain tax impacts will be resolved within the next twelve months as exams are completed or as statutes expire and will impact the effective tax rate.

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

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

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

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

(4) Restricted Cash

Prior to June 30, 2018 we held restricted cash and investments in lieu of providing letters of credit for the benefit of the provider of our worker's compensation and other insurance liabilities. By June 30, 2018, this obligation had been reduced to $5.9 million, which was then exchanged for a letter of credit for the benefit of this provider, and the restrictions were removed. The following table presents the components of total cash, cash equivalents, and restricted cash as set forth in our consolidated statements of cash flows. See also Note 12.

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

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

(5) Inventories

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

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

(6) Borrowings

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

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

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

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

At the Company’s option, revolving loans under the Facility bear interest, based on the average availability, at an annual rate of either (a) the London Interbank Offered rate (“LIBOR”) plus 1.5% to 1.75%, or (b) the higher of (i) the prime rate, (ii) the federal funds effective rate plus 0.50%, or (iii) LIBOR plus 1.0% plus in each case 0.5% to 0.75%.

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

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

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

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

At both September 30, 2018 and June 30, 2018, there was $6.2 million of standby letters of credit outstanding under the Facility. Total availability under the Facility was $108.8 million at both September 30, 2018 and June 30, 2018.

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

The following table summarizes, as of September 30, 2018, the timing of cash payments related to our outstanding long-term debt obligations for the remaining nine months of fiscal 2019, and each of the five fiscal years subsequent to June 30, 2019, and thereafter (in thousands).

Periods ending June 30,	
2019	$413
2020	550
2021	437
2022	59
2023	20
2024 and thereafter	-
Total scheduled debt payments	$1,479

(7) Litigation

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

Regulations issued under the Clean Air Act Amendments of 1990 required the industry to reformulate certain furniture finishes or institute process changes to reduce emissions of volatile organic compounds. Compliance with many of these requirements has been facilitated through the introduction of high solids coating technology and alternative formulations. In addition, we have instituted a variety of technical and procedural controls, including reformulation of finishing materials to reduce toxicity, implementation of high velocity low pressure spray systems, development of storm water protection plans and controls, and further development of related inspection/audit teams, all of which have served to reduce emissions per unit of production. We remain committed to implementing new waste minimization programs and/or enhancing existing programs with the objective of (i) reducing the total volume of waste, (ii) limiting the liability associated with waste disposal, and (iii) continuously improving environmental and job safety programs on the factory floor which serve to minimize emissions and safety risks for employees. To reduce the use of hazardous materials in the manufacturing process, we will continue to evaluate the most appropriate, cost-effective control technologies for finishing operations and production methods. We believe that our facilities are in material compliance with all such applicable laws and regulations. Our currently anticipated capital expenditures for environmental control facility matters are not material.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

On a quarterly basis, we review our litigation activities and determine if an unfavorable outcome to us is considered “remote”, “reasonably possible” or “probable” as defined by U.S. GAAP. Where we determine an unfavorable outcome is probable and is reasonably estimable, we accrue for potential litigation losses. The liability we may ultimately incur with respect to such litigation matters, in the event of a negative outcome, may be in excess of amounts currently accrued, if any; however, we do not expect that the reasonably possible outcome of these litigation matters would, individually or in the aggregate, have a material adverse effect on our financial condition, results of operations or cash flows. Where we determine an unfavorable outcome is not probable or reasonably estimable, we do not accrue for any potential litigation loss.

Although the outcome of the various claims and proceedings against us cannot be predicted with certainty, management believes that the likelihood is remote that any existing claims or proceedings, individually or in the aggregate, will have a material adverse effect on our financial position, results of operations or cash flows.

(8) Share-Based Compensation

All options are issued at the closing stock price on each grant date, and have a contractual term of 10 years. A summary of stock option activity occurring during the three months ended September 30, 2018 is presented below:

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

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

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

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

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

(9) Earnings Per Share

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

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

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

(10) Accumulated Other Comprehensive Income

Accumulated other comprehensive income consists of foreign currency translation adjustments which are the result of changes in foreign currency exchange rates related to our operations in Canada, Belgium, Honduras, and Mexico, and exclude income taxes given that the earnings of non-U.S. subsidiaries are deemed to be reinvested for an indefinite time. The following table sets forth the activity in accumulated other comprehensive income (loss) for the fiscal year-to-date period ended September 30, 2018 (in thousands).

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

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

(11) Segment Information

Our wholesale and retail operating segments represent strategic business areas of our vertically integrated enterprise that operate separately and provide their own distinctive services. This vertical structure enables us to offer our complete line of home furnishings and accents more effectively while controlling quality and cost. We evaluate performance of the respective segments based upon revenues and operating income. Inter-segment transactions result, primarily, from the wholesale sale of inventory to the retail segment, including the related profit margin.

As of September 30, 2018, the Company operated 147 design centers (our retail segment) and our independent retailers operated 153 design centers. Our wholesale segment net sales include sales to our retail segment, which are eliminated in consolidation, sales to our independent retailers and unaffiliated third parties. Our retail segment net sales accounted for 77% of our consolidated net sales in the three months ended September 30, 2018. Our wholesale segment net sales accounted for 23%.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

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

	Three months ended September 30, 2018	2017
Net sales:		
Wholesale segment	$118,072	$111,587
Retail segment	145,214	141,575
Elimination of inter-company sales	(75,501)	(71,860)
Consolidated Total	$187,785	$181,302
Operating income:		
Wholesale segment	$14,315	$13,462
Retail segment	(1,559)	(2,773)
Adjustment of inter-company profit (1)	(957)	860
Consolidated Total	$11,799	$11,549
Depreciation & Amortization:		
Wholesale segment	$1,961	$1,987
Retail segment	3,039	3,099
Consolidated Total	$5,000	$5,086
Capital expenditures:		
Wholesale segment	$850	$751
Retail segment	1,927	1,902
Consolidated Total	$2,777	$2,653

	September 30, 2018	June 30, 2018
Total Assets:		
Wholesale segment	$259,199	$241,616
Retail segment	321,106	317,590
Inventory profit elimination (2)	(29,351)	(28,773)
Consolidated Total	$550,954	$530,433

(1) Represents the change in wholesale profit contained in the retail segment inventory at the end of the period.
(2) Represents the wholesale profit contained in the retail segment inventory that has not yet been realized. These profits are realized when the related inventory is sold.

(12) Recently Adopted Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued accounting standard ASU 2014-09, *Revenue from Contracts with Customers* (Accounting Standards Codification Topic 606), which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The new standard supersedes virtually all existing authoritative accounting guidance on revenue recognition and requires additional disclosures and greater use of estimates and judgments. We adopted the new standard in the first quarter of fiscal 2019. We reviewed substantially all of our contracts and other revenue streams and determined that while the application of the new standard did not have a material change in the amount of or timing for recognizing revenue, it did impact our financial statement disclosures related to revenue and related accounts. See Note 13 for information on these disclosures.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

In November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash.* It is intended to reduce diversity in the presentation of restricted cash and restricted cash equivalents in the statement. The statement requires that restricted cash and restricted cash equivalents be included as components of total cash and cash equivalents as presented on the statement of cash flows. The Company had not previously included restricted cash as a component of cash and equivalents as presented on the statement of cash flows. The new guidance was adopted by the Company effective July 1, 2018 under the retrospective adoption method, and prior year restricted cash has been reclassified to conform to current year presentation. See also Note 4.

(13) Revenue Recognition

We implemented ASU 2014-09, *Revenue from Contracts with Customers* (Accounting Standards Codification Topic 606, “ASC 606”), in the first quarter of fiscal 2019 using the cumulative effect approach, which required us to apply the new guidance retrospectively to revenue transactions completed on or after July 1, 2018. Adopting this new standard did not have a material impact on our consolidated financial statements but did result in enhanced presentation and disclosures.

Our revenue consists substantially of product sales. We report product sales net of discounts and recognize them at the point in time when control transfers to the customer. For sales to our customers in our wholesale segment, control typically transfers when the product is shipped. For sales in our retail segment, control generally transfers upon delivery to the customer.

Estimated refunds for returns and allowances are recorded using our historical return patterns. Under the new standard, we record estimated refunds for sales returns on a gross basis rather than on a net basis, and have recorded an asset for product we expect to receive from customers in “Prepaid expenses and other current assets”, and a corresponding refund liability in ”accrued expenses and other current liabilities” on the Consolidated Balance Sheets. At September 30, 2018, these amounts were not material.

In many cases we receive deposits from customers before we have transferred control of our product to our customers, resulting in contract liabilities. These contract liabilities (“Customer Deposits”) are reported as within current liabilities on our Consolidated Balance Sheet. At the beginning of fiscal 2019, we had $61.2 million of Customer Deposits. During the quarter ended September 30, 2018, we recognized revenue of $46.7 million related to our Customer Deposits.

Upon adoption of ASC 606, we have elected the following accounting policies and practical expedients:

We recognize shipping and handling expense as fulfillment activities (rather than as a promised good or service) when the activities are performed even if those activities are performed after the control of the good has been transferred. Accordingly, we record the expenses for shipping and handling activities at the same time we recognize revenue.

We exclude from the measurement of the transaction price all taxes imposed on and concurrent with a specific revenue-producing transaction and collected by the entity from a customer, including sales, use, excise, value-added, and franchise taxes (collectively referred to as sales taxes).

We do not adjust revenue for the effects of financing components if the contract has a duration of one year or less, as we believe that we will receive payment from the customer within one year of when we transfer control of the related goods.

The following table disaggregates our revenue by product category by segment for the quarter September 30, 2018:

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

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ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (Unaudited)

Upholstery furniture includes fabric-covered items such as sleepers, recliners and other motion furniture, chairs, ottomans, custom pillows, sofas, loveseats, cut fabrics and leather.

Case goods furniture includes items such as beds, dressers, armoires, tables, chairs, buffets, entertainment units, home office furniture, and wooden accents.

Accents includes items such as window treatments and drapery hardware, wall décor, florals, lighting, clocks, mattresses, bedspreads, throws, pillows, decorative accents, area rugs, wall coverings and home and garden furnishings.

Other includes revenue for product delivery, the Ethan Allen Hotel room rentals and banquets, third-party furniture protection plans, non-inventoried parts, and consulting and other fees, net of discounts, allowances and other sales incentives.

(14) Subsequent Events

None

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

The following discussion of financial condition and results of operations should be read in conjunction with (i) our Consolidated Financial Statements, and notes thereto, included in Item 1 of Part I of this Quarterly Report on Form 10-Q and (ii) our Annual Report on Form 10-K for the year ended June 30, 2018.

Forward-Looking Statements

Management's discussion and analysis of financial condition and results of operations and other sections of this Quarterly Report on Form 10-Q contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), which represent our management’s beliefs and assumptions concerning future events based on information currently available to us relating to our future results. Such forward-looking statements are identified in this Quarterly Report on Form 10-Q and in documents incorporated herein by reference by use of forward-looking words such as "anticipate", "believe", "plan", "estimate", "expect", "intend", “will”, “may”, “continue”, “project”, ”target”, “outlook”, “forecast”, “guidance”, and similar expressions and the neg such forward-looking words. These forward-looking statements are subject to management decisions and various assumptions about future events, and are not guarantees of future performance. Actual results could differ materially from those anticipated in the forward-looking statements due to a number of risks and uncertainties including, but not limited to: competition from overseas manufacturers and domestic retailers; our anticipating or responding to changes in consumer tastes and trends in a timely manner; our ability to maintain and enhance our brand, marketing and advertising efforts and pricing strategies; changes in global and local economic conditions that may adversely affect consumer demand and spending, our manufacturing operations or sources of merchandise and international operations; changes in U.S. policy related to imported merchandise; an economic downturn; potentially negative or unexpected tax consequences of changes to fiscal and tax policies; our limited number of manufacturing and logistics sites; fluctuations in the price, availability and quality of raw materials; environmental, health and safety requirements; product safety concerns; disruptions to our technology infrastructure (including cyber attacks); increasing labor costs, competitive labor markets and our continued ability to retain high-quality personnel and risks of work stoppages; loss of key personnel; our ability to obtain sufficient external funding to finance our operations and growth; access to consumer credit; the effect of operating losses on our ability to pay cash dividends; additional impairment charges that could reduce our profitability; our ability to locate new design center sites and/or negotiate favorable lease terms for additional design centers or for the expansion of existing design centers; the results of operations for any quarter are not necessarily indicative of our results of operations for a full year; possible failure to protect our intellectual property; and those matters discussed in “Item 1A – Risk Factors” of our Annual Report on Form 10-K for the year ended June 30, 2018, and elsewhere in this Quarterly Report on Form 10-Q and our SEC filings. Accordingly, actual circumstances and results could differ materially from those contemplated by the forward-looking statements.

Given the risks and uncertainties surrounding forward-looking statements, you should not place undue reliance on these statements. Many of these factors are beyond our ability to control or predict. Our forward-looking statements speak only as of the date of this Quarterly Report on Form 10-Q. Other than as required by law, we undertake no obligation to update or revise forward-looking statements, whether as a result of new information, future events, or otherwise.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Critical Accounting Policies

The Company's consolidated financial statements are based on the accounting policies used. Certain accounting polices require that estimates and assumptions be made by management for use in the preparation of the financial statements. Critical accounting policies are those that are central to the presentation of the Company's financial condition and results and that require subjective or complex estimates by management. We implemented Accounting Standard Update No. 2014-09, Revenue from Contracts with Customers (Accounting Standards Codification Topic 606, "ASC 606"), in the first quarter of fiscal 2019. There have been no other changes with respect to the Company's critical accounting policies from those disclosed in its 2018 Annual Report on Form 10-K filed with the SEC on August 2, 2018. Also see Note 12, Recently Adopted Accounting Pronouncements, and Note 13, Revenue Recognition.

Overview

We are a leading interior design company and manufacturer and retailer of quality home furnishings. Founded over 85 years ago, today we are a leading international home fashion brand doing business in North America, Europe, Asia and the Middle East. We are vertically integrated from design through delivery, affording our clientele a value proposition of style, quality and price. We offer complementary interior design service to our clients and sell a full range of furniture products and decorative accents through ethanallen.com and a network of approximately 300 design centers in the United States and abroad. The design centers represent a mix of independent licensees and our own Company operated retail segment. We own and operate nine manufacturing facilities including six manufacturing plants and one sawmill in the United States and one manufacturing plant each in Mexico and Honduras.

Our business model is to maintain continued focus on (i) communicating our messages with strong advertising and marketing campaigns, (ii) capitalizing on the strength of our interior design professionals and management in our retail design centers, (iii) utilizing ethanallen.com as a key marketing tool to drive traffic to a network of 200 North American design centers located near our demographic base, (iv) investing in new technologies across key aspects of our vertically integrated business, and (v) leveraging the benefits of our vertical integration by maintaining our manufacturing capacity in North America where we manufacture approximately 75% of our products.

Our competitive advantages arise from:

providing fashionable high quality products of the finest craftsmanship;

offering complimentary design service through an estimated 2,000 motivated interior design professionals network-wide, which we believe makes us the world's leading interior design network;

offering a wide array of custom products across our upholstery, case goods, and accent product categories;

enhancing our technology in all aspects of the business; and

leveraging our vertically integrated structure.

We have completed a major transformation of our product offerings, having refreshed over 70% of our entire product line over the past three years. Our GSA business continues to grow, and the GSA is now one of our ten largest customers. Our internet sales, while still a minor portion of our sales, are growing at a rate that continues to out-pace our brick and mortar design centers. In the spring and summer of 2018, we launched our new Uptown collection, featuring a modern perspective on classic designs.

We are in the midst of a major brand-building marketing program utilizing multiple mediums including direct mail, television, print, digital and social marketing. This program targets a broad demographic base beyond our core customer. We expect that as we continue to market to this broader base, our brand awareness will increase and ultimately drive increased revenues over time. Consequently, our first quarter fiscal 2018 advertising expense increased by 12.8% over the same prior year period.

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

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

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ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Results of Operations

A summary of our consolidated operations is presented in the following tables. In this Item 2 of this quarterly report, unless otherwise noted, all comparisons in the discussion following are from the three month period ended September 30, 2018 to the comparable prior year fiscal three month period ($ in millions except per share amounts).

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

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

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

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

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

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

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ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

A summary by business segment of annual percentage changes from the preceding fiscal year are presented in the following tables:

	Three months ended September 30, 2018	2017
Wholesale segment		
Revenue	5.8 %	(2.6 %)
Operating Income	6.3 %	(18.4%)
Backlog	(21.6%)	50.7 %

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

We measure the performance of our design centers based on net sales and written orders booked on a comparable period basis. Comparable design centers are those which have been operating for at least 15 months, including relocated design centers provided the original and relocated design center location had been operating for at least 15 months on a combined basis. During the first three months of operations of newly opened design centers, written orders are booked but minimal net sales are achieved through the delivery of products. Design centers we acquire from independent retailers are included in comparable design center sales in their 13th full month of Ethan Allen-owned operations. The frequency of our promotional events as well as the timing of the end of those events can also affect the comparability of orders booked during a given period. Our international net sales are composed of our wholesale segment sales to independent retailers and our retail segment sales to consumers through the Company operated international design centers. International net sales as a percent of our consolidated net sales were 7.9% in the current year quarter and 11.0% in the prior year quarter. The following tables show selected design center location information.

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

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ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

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

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

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

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

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

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

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

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

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

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

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

Liquidity and Capital Resources

At September 30, 2018, we held cash and cash equivalents of $39.6 million. At June 30, 2018, we held cash and cash equivalents of $22.4 million. Our principal sources of liquidity include cash and cash equivalents, cash flow from operations, amounts available under the Facility, and other borrowings.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

For a detailed discussion of our debt obligations and timing of our related cash payments see Note 6 to the Consolidated Financial Statements included under Item 1 of this Quarterly Report.

A summary of net cash provided by (used in) operating, investing, and financing activities for the three months ended September 30, 2018 and 2017 is provided below (in millions):

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

Cash Provided by (Used in) Operating Activities

Year-to-date, cash of $24.4 million was provided by operating activities, an increase of $6.8 million. This was largely due to changes in the ordinary course of business for working capital items, primarily an inventory increase to support the order backlog. Working capital items consist of current assets (accounts receivable, inventories, prepaid and other current assets) less current liabilities (customer deposits, payables, and accrued expenses and other current liabilities).

Cash Provided by (Used in) Investing Activities

Year-to-date, $2.7 million of cash was used in investing activities, an increase of $0.1 million. Capital expenditures remained consistent with the prior year. Current year capital expenditures primarily related to retail design center improvements. We anticipate that cash from operations will be sufficient to fund future capital expenditures. Effective July 1, 2018, the company considers restricted cash as a component of cash and cash equivalents as presented on the statement of cash flows. Previously the net change in restricted cash was considered an investing activity. Prior periods have been reclassified to conform to current year presentation. See also notes 4 and 12.

Cash Provided by (Used in) Financing Activities

Year-to-date, $4.6 million was used in financing activities, which is $15.8 million less cash used than the $20.4 million of cash used during the first three months of fiscal 2018. This was primarily due to a $13.2 million pre-payment on the term loan in the prior fiscal year. During the current fiscal year to date period we paid dividends of $5.1 million compared to $5.2 million in the prior year to date period, paying $0.19 per share in both periods. The Company has continuously paid dividends for every quarter since 1996 and we expect to continue to do so as economic conditions and liquidity permit.

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We believe that our cash flow from operations, together with our other available sources of liquidity including the Facility and refinancing alternatives, will be adequate to make all required payments of principal and interest on our debt, to permit anticipated capital expenditures, and to fund working capital and other cash requirements. As of September 30, 2018, we had working capital of $100.2 million compared to $93.2 million at June 30, 2018, an increase of $7.0 million, or 7.5%. The Company had a current ratio of 1.74 to 1 at September 30, 2018 and 1.77 to 1 at June 30, 2018.

In addition to using available cash to fund changes in working capital, necessary capital expenditures, acquisition activity, the repayment of debt and the payment of dividends, the Company has been authorized by our board of directors to repurchase our common stock from time to time, either directly or through agents, in the open market at prices and on terms satisfactory to us. During the three months ending September 30, 2018 there were no share repurchases.

At September 30, 2018, we had a remaining Board authorization to repurchase 2,518,046 shares of our common stock pursuant to our previously announced share repurchase program.

Contractual Obligations

There has been no material change to the amount or timing of cash payments related to our outstanding contractual obligations as set forth in Part II, Item 7 – Management’s Discussion and Analysis of Financial Condition and Results of Operations of our Annual Report on Form 10-K for the year ended June 30, 2018 as filed with the SEC on August 2, 2018.

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

Except as indicated below, we do not utilize or employ any off-balance sheet arrangements, including special-purpose entities, in operating our business. As such, we do not maintain any (i) retained or contingent interests, (ii) derivative instruments (other than as specified below), or (iii) variable interests which could serve as a source of potential risk to our future liquidity, capital resources and results of operations.

We may, from time to time in the ordinary course of business, provide guarantees on behalf of selected affiliated entities or become contractually obligated to perform in accordance with the terms and conditions of certain business agreements. The nature and extent of these guarantees and obligations may vary based on our underlying relationship with the benefiting party and the business purpose for which the guarantee or obligation is being provided. The only such program in place at both September 30, 2018 and June 30, 2018 was for our consumer credit program described below.

Ethan Allen Consumer Credit Program

The terms and conditions of our consumer credit program, which is financed and administered by a third-party financial institution on a non-recourse basis to Ethan Allen, are set forth in an agreement between the Company and that financial service provider (the “Program Agreement”) which was last amended effective January 2014. Any independent retailer choosing to participate in the consumer credit program is required to enter into a separate agreement with that same third-party financial institution which sets forth the terms and conditions under which the retailer is to perform in connection with its offering of consumer credit to its customers (the “Retailer Agreement”). We have obligated ourselves on behalf of any independent retailer choosing to participate in our consumer credit program by agreeing, in the event of default, breach, or failure of the independent retailer to perform under such Retailer Agreement, to take on certain responsibilities of the independent retailer, including, but not limited to, delivery of goods and reimbursement of customer deposits. Customer receivables originated by independent retailers remain non-recourse to Ethan Allen. The Program Agreement will terminate on July 31, 2019, but includes a provision for automatic one-year renewals unless either party gives notice of termination. While the maximum potential amount of future payments (undiscounted) that we could be required to make under this obligation is indeterminable, recourse provisions exist that would enable us to recover, from the independent retailer, any amount paid or incurred by us related to our performance. Based on the underlying creditworthiness of our independent retailers, including their historical ability to perform satisfactorily in connection with the terms of our consumer credit program, we believe this obligation will expire without requiring funding by us. To ensure funding for delivery of products sold, the terms of the Program Agreement also contain a right for the financial services provider to demand from the Company collateral at a variable rate based on the volume of program sales if the Company does not meet a covenant regarding minimum working capital or tangible net worth. At both September 30, 2018 and June 30, 2018, we were in compliance with such covenant.

Product Warranties

Our products, including our case goods, upholstery and home accents, generally carry explicit product warranties that extend up to twelve years and are provided based on terms that are generally accepted in the industry. All our domestic independent retailers are required to enter into and perform in accordance with the terms and conditions of a warranty service agreement. We record provisions for estimated warranty and other related costs at time of sale based on historical warranty loss experience and make periodic adjustments to those provisions to reflect actual experience. On rare occasions, certain warranty and other related claims involve matters of dispute that ultimately are resolved by negotiation, arbitration or litigation. In certain cases, a material warranty issue may arise which is beyond the scope of our historical experience. We provide for such warranty issues as they become known and are deemed both probable and estimable. It is reasonably possible that, from time to time, additional warranty and other related claims could arise from disputes or other matters beyond the scope of our historical experience. At both September 30, 2018 and June 30, 2018 the Company’s product warranty liability totaled $1.5 million.

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ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Business Outlook

We continue to strengthen our vertically integrated structure from concept of idea, to engineering, to manufacturing, to retail and logistics. We intend to maintain strong manufacturing capabilities in North America, which we believe is a long-term competitive advantage that will allow us to advance our objectives of maintaining fast order delivery, exceptional quality and improving capacity to ship stocked and custom made-to-order items more quickly, which in turn will allow us to grow our business. Having refreshed over 70% of our products in the last three years, our current product offerings are fresh and relevant.

Our marketing programs continue to be strengthened with messaging focused on our stylish products, quality and service offerings. We expect to continue to expand our advertising during fiscal 2019 as we broaden the reach of our messaging to drive more traffic to our design centers and to ethanallen.com.

Our network of professionally trained interior design professionals differentiate us significantly from our competitors. We continue to strengthen the level of service, professionalism, and interior design competence, as well as to improve the efficiency of our retail operations. We believe that over time, we will continue to benefit from (i) continuous repositioning of our retail network, (ii) frequent new product introductions, (iii) new and innovative marketing promotions and effective use of targeted advertising media, and (iv) continued use of the latest technology combined with personal service from our interior design professionals.

We expect the home furnishings industry to remain extremely competitive with respect to both the sourcing of products and the wholesale and retail sale of those products for the foreseeable future. Domestic manufacturers continue to face pricing pressures because of the lower manufacturing costs on imports, particularly from Asia. While we also utilize overseas sourcing for approximately one quarter of our products, we choose to differentiate ourselves by maintaining a substantial North American manufacturing base, the majority of which is located in the United States. This structure enables us to leverage our vertically integrated structure to our advantage. We continue to believe that a balanced approach to product sourcing, which includes our own North American manufacturing of about 75% of our product offerings coupled with the import of other selected products, provides the greatest degree of flexibility and shorter lead times and is the most effective approach to ensuring that acceptable levels of quality, service and value are attained.

With our vertical enterprise well positioned, we maintain a cautiously optimistic outlook. Our retail strategy will continue with its focus on (i) providing relevant product offerings, a wide array of product solutions, and superior interior design solutions through our large staff of interior design professionals, (ii) continuing strong advertising and marketing campaigns to get our message across and to continue broadening our customer base, (iii) the opening of new or relocated design centers in more prominent locations, and encouraging independent retailers to do the same, (iv) leveraging the use of technology and personal service within our retail network and online through www.ethanallen.com, and (v) further expansion internationally. We believe this strategy provides an opportunity to grow our business.

Recent Accounting Pronouncements

In February 2016, the FASB issued ASU 2016-02, *Leases*, which is intended to improve financial reporting about leasing transactions. The ASU will require lessees that lease assets with lease terms of more than twelve months to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases. Lessors will remain largely unchanged from current GAAP. In addition, the ASU will require disclosures to help investors and other financial statement users better understand the amount, timing and uncertainty of cash flows arising from leases. This pronouncement is effective for the Company on July 1, 2019, and early adoption is permitted. The Company is currently evaluating the impact on our consolidated financial statements.

Where You Can Find Other Information

Our website is *www.ethanallen.com*. Information contained on our website is not part of this Quarterly Report on Form 10-Q. Information that we furnish or file with the SEC, including our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and any amendments to, or exhibits included in, these reports are available for download, free of charge, on our website soon after such reports are filed with or furnished to the SEC. Our SEC filings, including exhibits filed therewith, are also available on the SEC’s website at www.sec.gov.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to market risks relating to fluctuations in interest rates and foreign currency exchange rates.

Interest rate risk exists primarily through our borrowing activities. We utilize United States dollar denominated borrowings to fund substantially all our working capital and investment needs. Short-term debt, if required, is used to meet working capital requirements and long-term debt is generally used to finance long-term investments. There is inherent rollover risk for borrowings as they mature and are renewed at current market rates. The extent of this risk is not quantifiable or predictable because of the variability of future interest rates and our future financing requirements.

For floating-rate obligations, interest rate changes do not affect the fair value of the underlying financial instrument but would impact future earnings and cash flows, assuming other factors are held constant. Conversely, for fixed-rate obligations, interest rate changes affect the fair value of the underlying financial instrument but would not impact earnings or cash flows. At September 30, 2018, we did not have any floating-rate debt obligations outstanding under our Facility. We currently do not engage in any interest rate hedging activity and we have no intention of doing so in the foreseeable future. Based on the average interest rate of the loans under the Facility during the quarter ended September 30, 2018, and to the extent that borrowings were outstanding, a 10% change in the interest rate would not have a material effect on our consolidated results of operations and financial condition. For information regarding the Company’s other risk factors, see Item 7A – Quantitative and Qualitative Disclosures About Market Risk in our Annual Report on Form 10-K for the year ended June 30, 2018 as filed with the SEC on August 2, 2018.

Foreign currency exchange risk is primarily limited to our operation of Ethan Allen operated retail design centers located in Canada and our plants in Mexico and Honduras, as substantially all purchases of imported parts and finished goods are denominated in United States dollars. As such, gains or losses resulting from market changes in the value of foreign currencies have not had, nor are they expected to have, a material effect on our consolidated results of operations. A decrease in the value of foreign currencies relative to the United States dollar may affect the profitability of our international vendors and independent international retailers, but as we employ a balanced sourcing strategy, we believe any impact would be moderate.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

We carried out an evaluation, under the supervision and with the participation of our management, including the Chairman of the Board and Chief Executive Officer ("CEO") and the Executive Vice President Administration and Chief Financial Officer ("CFO"), of the effectiveness of the design and operation of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this report. Based on such evaluation, the CEO and CFO have concluded that, as of September 30, 2018, our disclosure controls and procedures were effective in ensuring that material information relating to us (including our consolidated subsidiaries), which is required to be disclosed by us in our periodic reports filed with or submitted to the SEC is (i) recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms, and (ii) accumulated and communicated to management, including the CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal quarter ended September 30, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

There have been no material changes to the matters discussed in Part I, Item 3 - Legal Proceedings in our Annual Report on Form 10-K for the year ended June 30, 2018 as filed with the SEC on August 2, 2018. See Note 7 of the Notes to Consolidated Financial Statements contained in Part I, Item 1 of this Quarterly Report on Form 10-Q for a description of our legal proceedings.

ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Item 1A. Risk Factors

There have been no material changes to the matters discussed in "Item IA – Risk Factors" in our Annual Report on Form 10-K for the year ended June 30, 2018 as filed with the SEC on August 2, 2018.

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

Issuer Purchases of Equity Securities

Certain information regarding purchases made by or on behalf of us or any affiliated purchaser (as defined in Rule 10b-18(a)(3) under the Exchange Act) of our common stock during the three months ended September 30, 2018 on a trade date basis is provided below:

On November 21, 2002, our Board of Directors approved a share repurchase program authorizing us to repurchase up to 2,000,000 shares of our common stock, from time to time, either directly or through agents, in the open market at prices and on terms satisfactory to us. Subsequent to that date, the Board of Directors increased the aggregate authorization under the repurchase program on several separate occasions, the last of which was on April 24, 2018 when the Board of Directors increased the aggregate authorization to approximately 3,000,000 shares. There is no expiration date on the repurchase authorization and the amount and timing of future share repurchases, if any, will be determined as market and business conditions warrant. The maximum number of shares that may yet be purchased under our publicly announced repurchase program is 2,518,046 shares.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

Not applicable.

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ETHAN ALLEN INTERIORS INC. AND SUBSIDIARIES

Item 6. Exhibits

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

* - Furnished herewith.

SIGNATURES

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

ETHAN ALLEN INTERIORS INC.
(Registrant)

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

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

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