

ETHAN ALLEN INTERIORS INC  
Form 10-K/A  
May 10, 2005

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549

**FORM 10-K/A  
(Amendment No. 1)**

FOR ANNUAL AND TRANSITION REPORTS PURSUANT TO SECTIONS 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934

(Mark One)

**Annual Report Pursuant to Sections 13 or 15(d) of the Securities Exchange Act of 1934**

For the fiscal year ended June 30, 2004

or

**Transition Report Pursuant to Sections 13 or 15(d) of the Securities Exchange Act of 1934**

Commission file Number 1-11692

Ethan Allen Interiors Inc.

(Exact name of registrant as specified in its charter)

Delaware

06-1275288

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

Ethan Allen Drive, Danbury, CT

06811

(Address of principal executive offices)

(Zip Code)

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

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

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

Securities registered pursuant to Section 12(g) of the Act: None

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

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Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).  Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (229.405 of this chapter) is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K/A or any amendment to this Form 10-K/A.

The aggregate market value of Common Stock, par value \$.01 per share, held by non-affiliates (based upon the closing sale price on the New York Stock Exchange) on December 31, 2003, (the last day of the Company's most recently completed second fiscal quarter) was approximately \$1,561,579,141. As of December 31, 2003 there were 37,286,990 shares of Common Stock, par value \$.01 per share, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE: The definitive Proxy Statement for the 2004 Annual Shareholders Meeting is incorporated by reference into Part III hereof.

## EXPLANATORY NOTE

As previously disclosed in the Current Report on Form 8-K as filed by Ethan Allen Interiors Inc. (the Company) on April 20, 2005, management of the Company, in consultation with the Audit Committee of the Board of Directors of the Company and its independent registered public accounting firm, KPMG LLP, have concluded that the Company's consolidated financial statements contained within (i) the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2004 (including all periods presented therein) and (ii) the Company's Quarterly Reports on Form 10-Q for the interim periods ended September 30, 2004 and December 31, 2004 (including all periods presented therein), should be restated, and that such previously filed financial statements should no longer be relied upon.

On February 7, 2005, the Office of the Chief Accountant of the Securities and Exchange Commission (SEC) issued a letter to the American Institute of Certified Public Accountants expressing its views regarding certain operating lease accounting issues and their application under accounting principles generally accepted in the United States of America. Management of the Company subsequently initiated a review of the Company's lease-related accounting practices and determined that the manner in which it accounted for (i) the amortization of leasehold improvements, (ii) landlord/tenant incentives (specifically, construction allowances), and (iii) the recognition of rent expense (income) when the lease term in an operating lease contains periods of free or reduced rents (i.e. rent holidays and/or rent escalation provisions) were not consistent with the views expressed by the SEC and/or the applicable accounting guidance and that certain previously filed financial statements required restatement. See Note 2, *Restatement of Previously Issued Financial Statements*, in the accompanying Consolidated Financial Statements (including the notes thereto), and Management's Discussion and Analysis of Financial Condition and Results of Operations for the impact of the restatement. This amended Annual Report on Form 10-K/A amends and restates those items of the previously filed Form 10-K for the year ended June 30, 2004, which have been affected by the revisions.

This amended Annual Report on Form 10-K/A has not been updated except as required to reflect the effects of the foregoing restatement. In order to preserve the nature and character of the disclosures set forth in such items as originally filed, no attempt has been made in this amendment to modify or update the disclosures in the original Annual Report on Form 10-K except for the foregoing restatement. As a result, this amended Annual Report on Form 10-K/A contains forward-looking information which has not been updated for events subsequent to the date of the original filing, and all information contained in this amended Annual Report on Form 10-K/A and the original Annual Report on Form 10-K is subject to updating and supplementing as provided in the periodic reports that the Company has filed and/or will file with the SEC after the original filing date of the Annual Report on Form 10-K.

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**PART I****Item 1. Business****Background**

Incorporated in Delaware in 1989, Ethan Allen Interiors Inc., through its wholly-owned subsidiary, Ethan Allen Inc., and Ethan Allen Inc.'s subsidiaries (collectively, "Ethan Allen" or the "Company"), is a leading manufacturer and retailer of quality home furnishings and accessories, offering a full complement of home decorating solutions through the country's largest network of home furnishing retail stores. The Company was founded in 1932 and has sold products under the Ethan Allen brand name since 1937.

**Mission Statement**

The Company's primary business objective is to provide its customers with a convenient, full-service, one-stop shopping alternative for their home decorating needs. In order to meet its stated objective, the Company has developed and adheres to a focused and comprehensive business strategy. The elements of this strategy, each of which represent specific home decorating solutions, include (i) the Company's vertically-integrated operating structure, (ii) its products, (iii) its retail store network, (iv) its people, and (v) its numerous customer service offerings.

**Operating Segments**

The Company's operating segments represent strategic business areas which, although they operate separately, both offer the Company's complete line of home furnishings through their own distinctive services. The Company's operations are classified into two such segments: wholesale and retail.

The wholesale segment is principally involved in the development of the Ethan Allen brand, which encompasses the design, manufacture, domestic and off-shore sourcing, sale and distribution of a full range of home furnishings to a network of independently-owned and Ethan Allen-owned stores as well as related marketing and brand awareness efforts. Wholesale profitability includes the wholesale gross margin, which is earned on wholesale sales to all retail stores, including Ethan Allen-owned stores.

The retail segment sells home furnishings to consumers through a network of Company-owned stores. Retail profitability includes the retail gross margin, which represents the difference between retail sales price and the cost of goods purchased from the wholesale segment.

While the manner in which the Company's home furnishings are marketed and sold is consistent, the nature of the underlying recorded sales (i.e. wholesale versus retail) and the specific services that each operating segment provides (i.e. wholesale manufacture and distribution versus retail sales) are different. Within the wholesale segment, the Company maintains revenue information according to each respective product line (i.e. case goods, upholstery, or home accessories and other). Sales of case good items include, but are not limited to, beds, dressers, armoires, night tables, dining room chairs and tables, buffets, sideboards, coffee tables, entertainment units, bathroom vanities and home office furniture. Sales of upholstery home furnishing items include sleepers, recliners, chairs, sofas, loveseats, cut fabrics and leather. Skilled craftsmen cut, sew and upholster custom-designed upholstery items which are available in a variety of frame and fabric options. Home accessory and other items include window treatments, wall decor, lighting, clocks, wood accents, bedspreads, decorative accessories, area rugs, bedding, and home and garden furnishings.

Revenue information by product line is not readily available within the retail segment as it is not practicable. However, because wholesale production and sales are matched, for the most part, to incoming orders, the Company believes that the allocation of retail sales would be similar to that of the wholesale segment.

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The Company evaluates performance of the respective segments based upon revenues and operating income. Inter-segment eliminations result, primarily, from the wholesale sale of inventory to the retail segment, including the related profit margin. Inter-segment eliminations also include items not allocated to reportable segments.

***The Wholesale Segment:***

For fiscal years 2004, 2003 and 2002, the wholesale segment recorded net sales of \$673.8 million, \$661.0 million, and \$660.8 million, respectively. A breakdown of wholesale sales by product line for each of the last three fiscal years is provided below:

	<b>Fiscal Year Ended June 30,</b>		
	<b><u>2004</u></b>	<b><u>2003</u></b>	<b><u>2002</u></b>
Case Goods	52%	53%	56%
Upholstered Products	34	33	31
Home Accessories and Other	14	14	13
	100%	100%	100%

The Company has 12 manufacturing facilities which consist of 6 case good plants (including 2 sawmill operations), 5 upholstery plants and 1 home accent plant, all located in the United States. The Company also sources, domestically and off-shore, selected case good, upholstery, and home accessory items.

In the fourth quarter of fiscal 2004, the Company announced a plan to close and consolidate two of its manufacturing facilities. The plants, both involved in the production of case goods, were located in Boonville, New York and Bridgewater, Virginia. The plant closures resulted in a headcount reduction totaling approximately 460 employees; 270 employees effective June 25, 2004, and 190 employees throughout the first quarter of fiscal 2005. A pre-tax restructuring and impairment charge of \$12.8 million was recorded for costs associated with these plant closings, of which \$4.5 million related to employee severance and benefits and other plant exit costs, and \$8.3 million related to fixed asset impairment charges, primarily for real property and machinery and equipment associated with the closed facilities.

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In the third quarter of fiscal 2003, the Company announced a plan to close three of its smaller manufacturing facilities. Closure of these facilities resulted in a headcount reduction totaling approximately 580 employees; 340 employees effective April 21, 2003, and 240 employees throughout the last quarter of fiscal 2003 and the first quarter of fiscal 2004. A pre-tax restructuring and impairment charge of \$13.4 million was recorded for costs associated with these plant closings, of which \$4.5 million related to employee severance and benefits and other plant exit costs, and \$8.9 million related to fixed asset impairment charges, primarily for real property and machinery and equipment associated with the closed facilities. During the quarter ended September 30, 2003, adjustments totaling \$0.2 million were recorded to reverse certain of these previously established accruals which were no longer required.

In the fourth quarter of fiscal 2002, the Company announced a plan that involved the closure of one of its manufacturing facilities as well as the rough mill operation of a separate facility. Closure of these facilities resulted in a headcount reduction totaling approximately 220 employees; 150 employees effective June 29, 2002, and 70 employees throughout the first quarter of fiscal 2003. A pre-tax restructuring and impairment charge of \$5.1 million was recorded for costs associated with these plant closings, of which \$2.0 million related to employee severance and benefits and other plant exit costs, and \$3.1 million related to fixed asset impairment charges, primarily for real property and machinery and equipment associated with closed facilities. During the quarter ended March 31, 2003, adjustments totaling \$0.2 million were recorded to reverse certain of these previously established accruals which were no longer required.

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### **Manufacturing Activities**

Ethan Allen is one of the largest manufacturers of home furnishings in the United States. The Company manufactures and/or assembles approximately 70% of its products at 12 manufacturing facilities, including 2 sawmill operations, thereby maintaining better control over cost, quality and service to its customers. The Company's case good facilities are located close to sources of raw materials and skilled craftsmen, predominantly in the Northeast and Southeast regions of the country. Upholstery facilities are located across the country in order to reduce shipping costs to stores and are situated where skilled craftsmen are available. The Company believes that continued investment in its manufacturing facilities, combined with an appropriate level of outsourcing, both domestically and abroad, will accommodate future sales growth.

### **Raw Materials and Other Suppliers**

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

Fabrics and other raw materials are purchased both domestically and abroad. Ethan Allen has no significant long-term supply contracts, and has experienced no significant problems in supplying its operations. Ethan Allen maintains a number of sources for its raw materials which, the Company believes, contributes to its ability to obtain competitive pricing. Lumber prices fluctuate over time based on factors such as weather and demand, which, in turn, impact availability. Upward trends in prices could have a short-term impact on margins.

Appropriate amounts of lumber and fabric inventory are typically stocked so as to maintain adequate production levels. The Company believes that its sources of supply for these materials are sufficient and that it is not dependent on any one supplier.

The Company enters into standard purchase agreements with certain vendors, both domestically and abroad, to source selected case good, upholstery, and home accessory items. The terms of these arrangements are customary for the industry and do not contain any long-term contractual obligations on behalf of the Company. Ethan Allen believes it maintains good relationships with its vendors.

### **Distribution and Logistics**

Within the wholesale segment, Ethan Allen distributes its products primarily through a national network of 6 owned and 2 leased distribution centers strategically located throughout the United States. These distribution centers hold finished products received from Ethan Allen's manufacturing facilities and domestic and off-shore vendors for shipment to Ethan Allen retail stores or retail service centers. Ethan Allen stocks case goods and accessories to provide for quick delivery of in-stock items and to allow for more efficient production runs.

Approximately 30% of all shipments are made to and from the distribution and retail service centers by the Company's fleet of trucks and trailers. The remaining shipments are subcontracted to independent carriers. Approximately 45% of the Company's fleet (trucks and trailers) is leased under two to eight-year leases.

Ethan Allen's policy is to sell its products at the same delivered cost to all Company-owned and independently-owned stores nationwide, regardless of their shipping point. The adoption of this policy has created credibility by offering product at one suggested national retail price.

This policy has also discouraged the Company's retailers from carrying significant inventory in their own warehouses. As a result, Ethan Allen obtains more accurate information regarding sales in order to better plan production runs and manage inventory levels.

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### **Backlog and Net Orders Booked**

As of June 30, 2004, Ethan Allen had a wholesale backlog of \$51.4 million, compared to a backlog of \$48.0 million as of June 30, 2003. The backlog is anticipated to be serviced in the first quarter of fiscal 2005. Backlog at any point in time is primarily a result of net orders booked in prior periods, manufacturing schedules and the timing of product shipments. Net orders booked at the wholesale level from Ethan Allen stores (including independently-owned and Company-owned stores) for the twelve months ended June 30, 2004 were \$681.0 million as compared to \$659.7 million for the twelve months ended June 30, 2003. Net orders booked in any period are recorded based on wholesale prices and do not reflect the additional retail margins produced by Company-owned stores.

### **Advertising**

Ethan Allen has developed a highly coordinated, national advertising campaign designed to (i) capitalize on the Company's existing brand equity, and (ii) maintain top-of-mind awareness of the breadth of the Company's product and service offerings. Ethan Allen's in-house staff, working with a leading advertising firm, has developed and implemented what the Company believes is the most cohesive national advertising campaign in the home furnishings industry. This campaign is designed to communicate the Company's position as a full-service provider of home furnishing solutions and to increase the flow of traffic into stores.

In support of its Furnishing Solutions campaign, launched nationally in fiscal 2004, Ethan Allen continues to utilize television, direct mail, newspaper, magazines and radio to market its products and services. Ethan Allen believes that its ability to coordinate its advertising efforts for all of its stores provides a competitive advantage over other home furnishing manufacturers and retailers. With an exclusive network of more than 300 retail stores adhering to a uniform marketing approach and speaking with one voice, Ethan Allen believes it is better positioned to fulfill its brand promise on a consistent basis.

The Ethan Allen Interiors direct mail magazine, which features the Company's home furnishing collections in lifestyle settings, is one of Ethan Allen's most important marketing tools. Approximately 40 million copies of the magazine were distributed to consumers during the past year. The Company publishes and sells the magazines to retailers of both Company-owned and independently-owned stores, who, with demographic information collected through independent market research, are able to target potential customers.

Ethan Allen's television advertising and direct mail efforts are supported by strong print campaigns in various markets, and in leading home fashion magazines using advertisements and public relations efforts. The Company coordinates significant advertisements in major newspapers in its major markets. During fiscal 2004, the Company continued to distribute its publication entitled *Ethan Allen Style Create the Look You Love*. This hard-cover book, which is complemented by a complete catalogue of the Company's home furnishing collections, helps customers identify their own personal style using Ethan Allen product offerings. The Company believes these publications represent one of the most comprehensive and effective home decorating resources in the home furnishings industry.

### **Internet**

Ethan Allen is located on the worldwide web at [www.ethanallen.com](http://www.ethanallen.com). The Company's primary goal for the website is to drive additional business into the retail network through lead generation and information sourcing. Customers may access the Company's website to review home furnishing collections or to purchase selected home accessories. On average, approximately 17,400 daily users logged onto the Ethan Allen website during fiscal 2004.

The Company has also developed an extranet website which links the retail stores with consumer information captured on-line such as customer requests for design assistance and copies of the Company's catalogue. This medium has become the primary source of communications between the Company and its retail network

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providing a variety of information, including a Company-wide daily news flash, downloads of current advertising materials, prototype store display floor plans and detailed product information.

### ***The Retail Segment:***

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For fiscal years 2004, 2003, and 2002, the retail segment recorded net sales of \$576.2 million, \$526.4 million, and \$459.6 million, respectively. For fiscal 2004, net sales for the Company's retail segment represented approximately 60% of the Company's total net sales.

Ethan Allen sells its products through an exclusive network of 311 retail stores: 309 full-line and 2 Ethan Allen Kids stores. As of June 30, 2004, Ethan Allen owned and operated 127 stores (as compared to 119 at the end of the prior fiscal year) and independent retailers owned and operated 184 stores. See Item 2 Properties for the geographic distribution of all retail store locations. During 2004, the Company acquired 4 stores from independent retailers, opened 6 new stores (of which 4 were relocations), and closed 1 store. The Company-owned store count at June 30, 2004 also reflects the net addition of 3 stores stemming from Ethan Allen's fiscal 2004 acquisition of the 25% minority interest in a joint venture previously established in 1998 between the Company and an independent retailer, the purpose of which was to own and operate 4 stores in the Dallas market. Subsequent to the Company's acquisition of the minority interest, the assets of 1 store were sold to the joint venture partner. While the operations of these stores have been reflected in the Company's consolidated financial statements since inception of the joint venture as a result of the Company's 75% majority ownership, the stores have not been previously included in the Company's store count due to the fact that the stores were independently managed.

In the past five years, Ethan Allen and its independent retailers have opened 69 new stores, approximately one-third of which were relocations. Wholesale sales to independent retailers accounted for approximately 39% of total net sales of the Company in fiscal 2004. The ten largest independent retailers own a total of 36 stores, which, based on net orders booked, accounted for approximately 13% of total net sales in fiscal 2004.

Ethan Allen pursues further expansion of the Company-owned retail business by opening new stores, relocating existing stores and, when appropriate, acquiring stores from independent retailers. In addition, the Company continues to promote the development and growth of its independent retailers. All retailers are required to enter into license agreements with the Company which (i) authorize the use of certain Ethan Allen service marks and (ii) require adherence to certain standards of operation, including the exclusive sale of Ethan Allen products and a requirement to fulfill related warranty service agreements. Ethan Allen is not subject to any territorial or exclusive retailer agreements in the United States.

In October 2001, the Company formed a joint venture with MFI Furniture Group Plc to open a chain of retail stores in the United Kingdom. The initial phase of the agreement, which calls for the two companies to collaborate on the development of a retail store format that will market their respective retail concepts, involves up to five stores with approximately 8,000 to 15,000 square feet per store. The first of these stores, located in the London suburb of Kingston, opened in May 2002. The second, located in the suburb of Bromley, opened in December 2002. Both retail locations have been included as independently-owned stores in compiling the Company's store count as of June 30, 2004.

### Products

Ethan Allen's product strategy has been to position its brand as a preferred brand with superior quality and value while, at the same time, providing consumers with a comprehensive, one-stop shopping solution for their home furnishing needs. In carrying out its strategy, the Company continues to expand its reach to a broader consumer base through a diverse selection of attractively priced product lines, many of which have been designed to effectively complement one another, facilitating the recent trend toward more eclectic home decorating. During fiscal 2004, the Company

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introduced the New Country by Ethan Allen and Newport collections, both of which are produced, primarily, in the United States and have quickly become two of the Company's best selling product offerings. In addition, the Company added loveseats to its already successful Leather Expressions program, introduced a limited number of case good pieces to accommodate the growing interest in larger, flat screen (plasma and LCD) televisions, and added a small collection of bathroom vanities. These product lines, which all serve to broaden the Company's consumer reach, are reflective of Ethan Allen's continuing efforts to offer well valued, stylish home furnishings that appeal to a variety of customers and lifestyles.

The Company believes that the two most important style categories in home furnishings are the Formal and the Casual product lifestyles. As such, Ethan Allen collections are designed to reflect unique elements applicable to each lifestyle. To accomplish this, the Company's collections consist of case goods, coordinated upholstered products and home accessories, each styled with its own distinct design characteristics. Home accessories play an important role in Ethan Allen's marketing program as they enable the Company to offer the consumer the convenience of one-stop shopping by creating a comprehensive home furnishing solution. Ethan Allen's store interiors are designed to facilitate display of the Company's product offerings in complete room settings which utilize the related collections to project the category lifestyle.

Ethan Allen continuously monitors consumer demand through marketing research and communication with its retailers and store design consultants who provide valuable input on consumer trends. As a result, the Company believes that it is able to react quickly to changing consumer tastes. For example, since 1995, approximately 80% of the Company's current complement of collections is new. The balance has been

refined and enhanced through product redesign, additions, deletions, and/or finish changes. Such undertakings are indicative of the Company's ability to adapt to the recent consumer trend toward more casual and eclectic lifestyles while, at the same time, maintaining a classic appeal.

### **Retail Store Network**

Ethan Allen's interior and exterior store design is dependent on the store's location and size. Ethan Allen stores are located in busy urban settings as freestanding destination stores or as part of suburban strip malls, depending upon the real estate opportunities in a particular market. Currently, stores range in size from approximately 6,000 square feet to 35,000 square feet, with the average size of a store being approximately 15,000 square feet. Dedicated Ethan Allen Kids stores range in size from 2,400 to 3,100 square feet.

Ethan Allen maximizes uniformity of store presentation throughout the retail network through a comprehensive set of operating standards. These operating standards assist each store in presenting the same high quality image and offer retail customers consistent levels of product selection and service. A uniform store image is conveyed through Ethan Allen's ongoing program to model its retail stores with similar and consistent exterior facades and interior layouts. This program is carried out by all stores, including independently-owned stores.

Ethan Allen provides display planning assistance to all Company-owned stores and independent retailers to support them in updating the interior projection of their stores and to maintain a consistent image. Several years ago, the Company developed a standard interior design format for its retail stores which, through the use of focused lifestyle settings to display its products and information displays throughout the store to educate consumers, has positioned Ethan Allen as a specialist in Formal and Casual lifestyles and decorative accessory retailing.

### **People**

At June 30, 2004, Ethan Allen has approximately 6,600 employees. Approximately 5% of those employees are represented by unions under collective bargaining agreements, most which expire at various times throughout the next three years. The Company expects no significant changes in its relations with these unions and believes it maintains good relationships with its employees.

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The retail network, which includes both Company-owned and independently-owned stores, is staffed with a sales force of approximately 3,100 design consultants and professionals who provide customers with an effective home decorating solution at no additional charge. These employees receive appropriate training with respect to the distinctive design and quality features inherent in each of the Company's products, allowing them to more effectively communicate the elements of style and value that serve to differentiate Ethan Allen. As such, the Company believes its design consultants, and the complimentary service they provide, create a distinct competitive advantage over other home furnishing retailers.

Ethan Allen recognizes the importance of its retail store network to its long-term success. Accordingly, the Company believes it has established strong management teams within Company-owned stores and maintains an ongoing relationship with independent retailers. The Company also makes available services to the Ethan Allen stores in support of their marketing efforts, including coordinated national advertising, merchandising and display programs, and extensive training seminars and educational materials. Ethan Allen believes that the development of design consultants, sales managers, service and delivery personnel and retailers is important for the growth of its business. As a result, Ethan Allen has committed to make available a comprehensive training program that will help to develop retail managers/owners, design consultants and service and delivery personnel to their fullest potential.

### **Customer Service Offerings**

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

#### **Gift Card**

This program allows customers to purchase, through the Company's website or at any participating retail store, gift cards which can be redeemed for any of the Company's products or services.

#### **Wedding Registry**

The primary objectives of the wedding registry program are to increase customer traffic in Ethan Allen's network of retail stores (and on-line), capture consumers in the early stage of their lifecycle, capitalize on the growing trend for non-traditional registries and promote the Company's complimentary design service. Ethan Allen believes this program further strengthens its competitive advantage by enhancing its current complement of service offerings with a national gift registry.



### **On-Line Room Planning**

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

### **Ethan Allen Consumer Credit Programs**

The EA Finance Plus program offers consumers two financing options through the use of just one account. Consumers can choose between (i) the Simple Finance Plan which consists of fixed monthly payments ranging from 12 to 60 months at an interest rate of 9.99% per annum, and (ii) the revolving credit line which carries a variable interest rate currently ranging from 21.00% to 23.75% per annum. Both plans provide credit lines from \$1,000 to \$50,000. Financing offered through both programs is administered by a third-party financial institution and is granted on a non-recourse basis to the Company. Consumers may apply for an EA Finance Plus card at any participating retail store.

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### **Competition**

The home furnishings industry is highly competitive and fragmented. In recent years, the industry has experienced increased competitive pressure as a result of the growing level of imported finished goods and components, particularly for case good products. The continued development of manufacturing capabilities in other countries, specifically within Asia, has significantly increased overseas production capacities and created over-capacity for many U.S. manufacturers, including Ethan Allen, forcing them to consolidate their least efficient plants. The growing number of foreign manufacturers, many of which have substantially lower production costs, including the cost of labor and overhead, has also enabled imported product to be sold at a lower cost to consumers which, in turn, has led to some measure of industry-wide price deflation. The Company believes that the ability of industry participants to quickly and effectively react to such competitive pressures will likely prove critical to their survival.

The Company believes that properly adapting to industry globalization, and its resultant challenges, can also create opportunities. With respect to the issue of price deflation, Ethan Allen saw a low-cost supply of labor as an opportunity to introduce selected products to consumers at prices that, until recently, were not practical. As such, the Company has, in recent years, implemented a blended strategy, establishing relationships with certain manufacturers, both domestically and abroad, to source selected case goods, upholstery, and home accessory items. Ethan Allen intends to continue to balance its domestic production with opportunities to source from domestic and foreign manufacturers, as appropriate, in order to maintain its competitive advantage.

Ethan Allen considers its vertical integration a significant competitive advantage in this dynamic environment as it allows the Company to design, manufacture, source, distribute, market, and sell its products through the industry's largest sole-source retail store network. Still, the Company remains committed to the principles of its solutions-oriented business strategy, which it has been developing for more than a decade. By leveraging its vertically-integrated operating structure and adhering to a solutions-based approach, the Company believes it has an opportunity to further differentiate Ethan Allen as the preferred brand and the most comprehensive and effective provider of home decorating solutions for consumers.

Although Ethan Allen is currently among the ten largest domestic furniture manufacturers, industry estimates indicate that there are over 1,000 manufacturers of furniture in the United States alone, some of which produce furniture types not manufactured by Ethan Allen. Certain of these domestic manufacturers, as well as certain of the foreign manufacturers referred to previously, both of which compete directly with Ethan Allen, may have greater financial and other resources than the Company.

In July 2003, The American Furniture Manufacturers Committee for Legal Trade (the Committee) filed an anti-dumping petition with the U.S. Department of Commerce (DOC) and the International Trade Commission (ITC) seeking tariff protection on wooden bedroom furniture imported from China. In December 2003, the ITC ruled that the Committee's petition met the ITC's initial requirements resulting in a preliminary determination of injury and causing the DOC to move forward with a formal investigation of the matter. In June 2004, the DOC announced its preliminary determination of anti-dumping duties, establishing tariff rates ranging from 4.9% to 198.1% of import invoice value. More than 70% of the respondents were assigned tariffs of 12.9% or less while the remaining respondents were denied such preferential rates and, instead, subject to a more punitive country-wide rate of 198.1%. Respondents were assigned the more punitive rate for a variety of reasons, including, among others, correctible technical deficiencies noted in their submissions as a result of incomplete information, and inadequate translation of documents. Such respondents have been permitted to submit clarification of information already provided to the DOC in an attempt to reduce the assigned tariff. The DOC is currently accepting comments from interested parties on its preliminary determination and is scheduled to make a final determination in December 2004.

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While Ethan Allen fully supports all efforts undertaken to ensure fair trade, the Company remained neutral with respect to the matter set forth in the Committee's petition. As a result of the DOC preliminary ruling in June 2004, one of Ethan Allen's suppliers was assigned a tariff rate of 8.4% while the other was assigned the more punitive rate of 198.1%. This supplier subsequently remedied the technical deficiencies cited in its initial submission to the DOC, serving to reduce its preliminary tariff rate to 12.9%. At the present time, sales of case goods represent approximately 52% of the Company's wholesale sales. Imported case goods, which include items in addition to wooden bedroom furniture and which are sourced from various locations, including China, represent only a portion of those case good sales. The Company currently estimates that less than 5% of wholesale revenues are generated by sales of wooden bedroom furniture produced in China. As such, the Company believes that tariffs imposed on wooden bedroom furniture imported from China will not have a material adverse effect on its consolidated financial condition or results of operations.

Ethan Allen sells its products through an exclusive network of Company-owned and independently-owned retail stores. Ethan Allen's objective is to continue to develop and strengthen its retail network by (i) expanding the Company-owned retail business through the opening of new stores, relocation of existing stores and, when appropriate, acquisition of stores from independent retailers, and (ii) obtaining and retaining independent retailers, assisting in increasing the volume of such retailers' sales.

The home furnishings industry competes primarily on the basis of product styling and quality, personal service, prompt delivery, product availability and price. Ethan Allen believes that it effectively competes on the basis of each of these factors and that, more specifically, its store format and complimentary design service create a distinct competitive advantage, further supporting the Company's mission of providing consumers with a complete home decorating solution.

### **Trademarks**

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

### **Available Information**

The Company makes available, free of charge via its website, all Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and other information filed with, or furnished to, the Securities and Exchange Commission (SEC), including amendments to such reports. This information is available at [www.ethanallen.com/investors](http://www.ethanallen.com/investors) as soon as reasonably practicable after it is electronically filed with, or furnished to, the SEC.

In addition, charters of all committees of the Company's Board of Directors, as well as the Company's Corporate Governance guidelines, are available on the Company's website at [www.ethanallen.com/governance](http://www.ethanallen.com/governance) or, upon written request, in printed hardcopy form. Written requests should be sent to Office of the Secretary, Ethan Allen Interiors Inc., Ethan Allen Drive, Danbury, CT 06811.

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### **Item 2. Properties**

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

Ethan Allen has 12 manufacturing facilities (including 2 sawmill operations) located in 8 states. All of these facilities are owned, with the exception of a leased upholstery plant in California totaling 143,100 square feet. The Company's 12 facilities consist of 6 case good manufacturing plants (including 2 sawmill operations), totaling 2,381,187 square feet; 5 upholstery furniture plants, totaling 1,231,600 square feet; and 1 plant involved in the manufacture and assembly of Ethan Allen's home accessory products, totaling 295,000 square feet.

In addition, Ethan Allen owns 6 and leases 2 ancillary distribution centers, totaling 1,163,370 square feet, and owns 3 and leases 29 retail service centers, totaling 1,385,065 square feet. The Company's manufacturing and distribution facilities are located in North Carolina, Vermont, Pennsylvania, Virginia, Oklahoma, California, New Jersey, Indiana and Maine. The Company's retail service centers are located throughout the United States and serve to support Ethan Allen's various sales districts.

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The geographic distribution of the Company's retail store network as of June 30, 2004 is as follows:

	Retail Store Category	
	Company Owned	Independently Owned
United States	120	162
North America-Other (1)	7	3
Asia	-	13
Middle East	-	2
Europe	-	2
West Indies	-	1
Africa	-	1
Total	127	184

(1) Seven retail stores located in Canada were acquired by the Company during the first quarter of fiscal 2003.

Of the 127 retail stores owned and operated by the Company, 45 of the properties are owned and 82 of the properties are leased from independent third parties. Of the 45 Company-owned store locations, 8 are subject to land leases. The Company owns an additional 4 retail properties; 3 of which are leased to independent Ethan Allen retailers, and 1 which is leased to an unaffiliated third party.

Ethan Allen's manufacturing facility located in Maiden, North Carolina and the Inn at Ethan Allen located in Danbury, Connecticut, were financed, in part, with industrial revenue bonds. The Beecher Falls, Vermont manufacturing facility was financed, in part, by the State of Vermont Economic Development Authority. Ethan Allen believes that all of its properties are well maintained and in good condition.

Ethan Allen estimates that its manufacturing division is currently operating at approximately 80% of capacity. The Company believes it has additional capacity at many facilities, which it could utilize with minimal additional capital expenditures.

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### **Item 3. Legal Proceedings**

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

### **Environmental Matters**

The Company and its subsidiaries are subject to various environmental laws and regulations. Under these laws, the Company and/or its subsidiaries are, or may be, required to remove or mitigate the effects on the environment of the disposal or release of certain hazardous materials at various sites, including sites that have been designated as Superfund sites by the U.S. Environmental Protection Agency (EPA) pursuant to the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA), as amended, and which are included on the National Priority List (NPL).

As of June 30, 2004, the Company and/or its subsidiaries have received notices that they have been named as a potentially responsible party (PRP) with respect to the remediation of four sites currently listed or proposed for inclusion on the NPL under CERCLA. The sites are located in Lyndonville, Vermont; Southington, Connecticut; High Point, North Carolina; and Atlanta, Georgia.

With respect to the Lyndonville, Vermont site, the Company believes it has resolved its liability by completing remedial construction activities. The Company continues to work with the EPA to resolve its remaining issues in order to obtain a certificate of construction completion. The Company does not anticipate incurring significant costs with respect to the Southington, Connecticut and High Point, North Carolina sites as it believes that it is not a major contributor based on the very small volume of waste generated by the Company in relation to total volume at those sites. Specifically, with respect to the Southington site, the Company's volumetric share is less than 1% of over 51 million

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gallons disposed of at the site and there are more than 1,000 PRPs. With respect to the High Point site, the Company's volumetric share is less than 1% of over 18 million gallons disposed of at the site and there are more than 2,000 PRPs, including 1,100 de-minimis parties (of which Ethan Allen is one). With respect to the Atlanta site, a former solvent recycling/reclamation facility, the Company's volumetric share is currently under review, but it is believed to consist of less than 1% of over 20 million gallons disposed of at the site by more than 1,700 PRPs. In all three cases, the other PRPs consist of local, regional, national and multi-national companies.

Liability under CERCLA may be joint and several. As such, to the extent certain named PRPs are unable, or unwilling, to accept responsibility and pay their apportioned costs, the Company could be required to pay in excess of its pro rata share of incurred remediation costs. Ethan Allen's understanding of the financial strength of other PRPs has been considered, where appropriate, in the determination of the Company's estimated liability. As of June 30, 2004, the Company believes that established reserves related to these environmental contingencies are adequate to cover probable and reasonably estimable costs associated with the remediation and restoration of these sites.

Additionally, the Company was previously notified by the State of New York that it may be named a PRP in a separate, unrelated matter with respect to a site located in Carroll, New York. However, the EPA has still not conducted its initial environmental study at this site so the extent of any adverse effect on the Company's financial condition, results of operations, or cash flows with respect to this matter cannot be reasonably estimated at this time.

Ethan Allen is subject to other federal, state and local environmental protection laws and regulations and is 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

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of solid and hazardous wastes. The Company believes that its facilities are in material compliance with all such applicable laws and regulations.

Regulations issued under the Clean Air Act Amendments of 1990 required the industry to reformulate certain furniture finishes or institute process changes to reduce emissions of volatile organic compounds. Compliance with many of these requirements has been facilitated through the introduction of high solids coating technology and alternative formulations. In addition, the Company has 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. Ethan Allen remains 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 shop floor which serve to minimize emissions and safety risks for employees. The Company will continue to evaluate the most appropriate, cost effective, control technologies for finishing operations and design production methods to reduce the use of hazardous materials in the manufacturing process.

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

No matters were submitted to security holders of the Company during the fourth quarter of fiscal 2004.

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## **PART II**

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

The Company's Common Stock is traded on the New York Stock Exchange under ticker symbol ETH. The following table indicates (i) the high and low stock prices as reported on the New York Stock Exchange and (ii) dividends declared by the Company:

	Closing Market Price		Dividends Declared
	High	Low	
<u>Fiscal 2004</u>			
Fourth Quarter (1)	\$ 42.60	\$ 35.51	\$ 3.10
Third Quarter	46.08	40.55	0.10
Second Quarter	41.88	35.64	0.10

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

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	Closing Market Price		
First Quarter	39.56	34.05	0.10
<u>Fiscal 2003</u>			
Fourth Quarter	\$ 37.54	\$ 29.95	\$ 0.07
Third Quarter	35.75	27.41	0.06
Second Quarter	38.30	27.99	0.06
First Quarter	36.42	29.02	0.06

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

As of August 27, 2004, there were approximately 408 shareholders of record of the Company's Common Stock.

On July 27, 2004, the Company declared a dividend of \$0.15 per common share, payable on October 25, 2004 to shareholders of record as of October 11, 2004. The Company expects to continue to declare quarterly dividends for the foreseeable future.

### Issuer Purchases of Equity Securities

Certain information regarding purchases made by or on behalf of the Company or any affiliated purchaser (as defined in Rule 10b-18(a)(3) under the Securities Exchange Act of 1934, as amended) of our common stock during the three months ended June 30, 2004 is provided below:

<u>Period</u>	<u>Total Number of Shares Purchased</u>	<u>Average Price Paid Per Share</u>	<u>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (d)</u>	<u>Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs (d)</u>
April 2004 (a)	347,545	\$41.35	347,545	2,469,000
May 2004 (b)	272,900	\$38.76	272,900	2,196,100
June 2004 (c)	341,000	\$36.28	341,000	1,855,100
Total	961,445	\$38.81	961,445	

- (a) Purchased in nine separate open market transactions on nine different trading days.  
 (b) Purchased in seven separate open market transactions on seven different trading days.  
 (c) Purchased in five separate open market transactions on five different trading days.  
 (d) On November 21, 2002, the Company's Board of Directors approved a share repurchase program authorizing the Company to repurchase up to 2,000,000 shares of its common stock, from time to time, either directly or through agents, in the open market at prices and on terms satisfactory to the Company. On April 27, 2004, the Board of Directors increased the remaining authorization of 904,755 shares to 2,500,000 shares.

Subsequent to June 30, 2004 and through September 8, 2004, the Company repurchased, in thirteen separate open market transactions, an additional 462,000 shares of its common stock at a total cost of \$16.0 million, representing an average price per share of \$34.72.

### Stockholder Rights Plan

The Company has a Stockholder Rights Plan, a description of which is set forth in Note 10 to the Consolidated Financial Statements included under Item 8 of this Annual Report and incorporated herein by r