

Lumber Liquidators Holdings, Inc.
Form 10-Q
November 09, 2010
[Table of Contents](#)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2010

or

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

For the transition period from to

Commission File Number: 001-33767

Lumber Liquidators Holdings, Inc.

(Exact name of registrant as specified in its charter)

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Delaware
(State or other jurisdiction of
incorporation or organization)

27-1310817
(I.R.S. Employer
Identification No.)

3000 John Deere Road

Toano, Virginia
(Address of Principal Executive Offices)

23168
(Zip Code)

(757) 259-4280

(Registrant's telephone number, including area code)

Not Applicable

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

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

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

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

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

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

As of November 8, 2010, there were 27,424,089 shares of the registrant's common stock, par value of \$0.001 per share, outstanding.

Table of Contents

LUMBER LIQUIDATORS HOLDINGS, INC.

Quarterly Report on Form 10-Q

For the quarter ended September 30, 2010

TABLE OF CONTENTS

	Page
<u>PART I FINANCIAL INFORMATION</u>	
Item 1. <u>Condensed Consolidated Financial Statements</u>	3
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	8
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	17
Item 4. <u>Controls and Procedures</u>	17
<u>PART II OTHER INFORMATION</u>	
Item 1. <u>Legal Proceedings</u>	18
Item 1A. <u>Risk Factors</u>	18
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	19
Item 3. <u>Defaults Upon Senior Securities</u>	19
Item 4. <u>(Removed and Reserved)</u>	19
Item 5. <u>Other Information</u>	19
Item 6. <u>Exhibits</u>	19
<u>Signatures</u>	20

Table of Contents**PART I****FINANCIAL INFORMATION****Item 1. Financial Statements.****Lumber Liquidators Holdings, Inc.****Condensed Consolidated Balance Sheets****(in thousands, except share data)**

	September 30, 2010	December 31, 2009
	<i>(unaudited)</i>	
Assets		
Current Assets:		
Cash and Cash Equivalents	\$ 26,787	\$ 35,675
Merchandise Inventories	156,963	133,342
Prepaid Expenses	4,862	5,988
Other Current Assets	7,254	4,356
Total Current Assets	195,866	179,361
Property and Equipment, net	32,454	20,491
Deferred Income Taxes	1,654	2,002
Other Assets	4,524	4,026
Total Assets	\$ 234,498	\$ 205,880
Liabilities and Stockholders Equity		
Current Liabilities:		
Accounts Payable	\$ 23,248	\$ 32,608
Customer Deposits and Store Credits	21,308	9,805
Accrued Compensation	2,996	4,512
Sales and Income Tax Liabilities	3,066	2,770
Other Current Liabilities	7,955	5,566
Total Current Liabilities	58,573	55,261
Deferred Rent	2,508	2,185
Stockholders Equity:		
Common Stock (\$0.001 par value; 35,000,000 authorized; 27,421,589 and 27,234,222 outstanding, respectively)	27	27
Additional Capital	99,364	94,726
Retained Earnings	74,026	53,681
Total Stockholders Equity	173,417	148,434
Total Liabilities and Stockholders Equity	\$ 234,498	\$ 205,880

See accompanying notes to condensed consolidated financial statements

Table of Contents**Lumber Liquidators Holdings, Inc.****Condensed Consolidated Statements of Income**

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

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Net Sales	\$ 147,192	\$ 140,520	\$ 467,061	\$ 407,488
Cost of Sales	95,431	89,336	303,256	261,164
Gross Profit	51,761	51,184	163,805	146,324
Selling, General and Administrative Expenses	44,909	38,727	130,985	114,269
Operating Income	6,852	12,457	32,820	32,055
Interest and Other Income, net	(143)	(116)	(371)	(388)
Income Before Income Taxes	6,995	12,573	33,191	32,443
Provision for Income Taxes	2,711	4,812	12,846	12,649
Net Income	\$ 4,284	\$ 7,761	\$ 20,345	\$ 19,794
Net Income per Common Share Basic	\$ 0.16	\$ 0.29	\$ 0.74	\$ 0.74
Net Income per Common Share Diluted	\$ 0.15	\$ 0.28	\$ 0.72	\$ 0.72
Weighted Average Common Shares Outstanding:				
Basic	27,420,415	27,053,067	27,363,621	26,905,554
Diluted	28,234,339	27,892,790	28,236,042	27,535,516

See accompanying notes to condensed consolidated financial statements

Table of Contents**Lumber Liquidators Holdings, Inc.****Condensed Consolidated Statements of Cash Flows**

(in thousands)

(unaudited)

	Nine Months Ended September 30,	
	2010	2009
Cash Flows from Operating Activities:		
Net Income	\$ 20,345	\$ 19,794
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Depreciation and Amortization	3,993	3,470
Stock-Based Compensation Expense	2,355	2,298
Changes in Operating Assets and Liabilities:		
Merchandise Inventories	(23,621)	(15,326)
Accounts Payable	(11,135)	10,448
Customer Deposits and Store Credits	11,503	1,739
Prepaid Expenses and Other Current Assets	(1,671)	1,468
Other Assets and Liabilities	1,188	2,557
Net Cash Provided by Operating Activities	2,957	26,448
Cash Flows from Investing Activities:		
Purchases of Property and Equipment	(14,127)	(8,131)
Net Cash Used in Investing Activities	(14,127)	(8,131)
Cash Flows from Financing Activities:		
Proceeds from the Exercise of Stock Options	1,321	2,593
Excess Tax Benefits on Stock Option Exercises	1,110	743
Common Stock Purchased Pursuant to Equity Compensation Plans	(149)	(39)
Other		(1)
Net Cash Provided by Financing Activities	2,282	3,296
Net (Decrease) Increase in Cash and Cash Equivalents	(8,888)	21,613
Cash and Cash Equivalents, Beginning of Period	35,675	35,139
Cash and Cash Equivalents, End of Period	\$ 26,787	\$ 56,752

See accompanying notes to condensed consolidated financial statements

Table of Contents

Lumber Liquidators Holdings, Inc.

Notes to Condensed Consolidated Financial Statements

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

(unaudited)

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature and Organization of Business

Lumber Liquidators Holdings, Inc. and its subsidiaries (the Company) is a multi-channel specialty retailer of hardwood flooring, and hardwood flooring enhancements and accessories, operating as a single business segment. The Company offers an extensive assortment of exotic and domestic hardwood species, engineered hardwoods and laminates direct to the consumer. The Company also features the renewable flooring products, bamboo and cork, and provides a wide selection of flooring enhancements and accessories, including moldings, noise-reducing underlay and adhesives. These products are primarily sold under the Company's private label brands, including the premium Bellawood brand floors. The Company sells primarily to homeowners or to contractors on behalf of homeowners through a network of 213 store locations in primary or secondary metropolitan areas in 46 states. In addition to the store locations, the Company's products may be ordered, and customer questions/concerns addressed, through both the call center in Toano, Virginia, and the website, www.lumberliquidators.com. The Company finishes the majority of the Bellawood products on its finishing line in Toano, Virginia, which along with the call center, corporate offices, and distribution center, represent the Corporate Headquarters.

Basis of Financial Statement Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q for interim financial reporting pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). While these statements reflect all normal recurring adjustments which are, in the opinion of management, necessary for a fair presentation of the results of the interim period, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles (U.S. GAAP) for complete financial statements. Therefore, the interim condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes included in the Lumber Liquidators Holdings, Inc. annual report filed on Form 10-K for the year ended December 31, 2009.

The consolidated financial statements of the Company include the accounts of its wholly owned subsidiaries. All significant intercompany transactions have been eliminated in consolidation.

Results of operations for the three and nine months ended September 30, 2010 are not necessarily indicative of the results to be expected for the full year.

Fair Value of Financial Instruments

The carrying amounts of financial instruments such as cash and cash equivalents, notes receivable, accounts payable and other liabilities approximate fair value because of the short-term nature of these items. Of these financial instruments, the cash equivalents are classified as Level 1 as defined in the Financial Accounting Standards Board ASC 820 fair value hierarchy. The Company had cash equivalents of \$11,045 at September 30, 2010 and \$27,022 at December 31, 2009.

Table of Contents**NOTE 2. NET INCOME PER COMMON SHARE**

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Net Income	\$ 4,284	\$ 7,761	\$ 20,345	\$ 19,794
Weighted Average Common Shares Outstanding Basic	27,420,415	27,053,067	27,363,621	26,905,554
Effect of Dilutive Securities:				
Common Stock Equivalents	813,924	839,723	872,421	629,962
Weighted Average Common Shares Outstanding Diluted	28,234,339	27,892,790	28,236,042	27,535,516
Net Income per Common Share Basic	\$ 0.16	\$ 0.29	\$ 0.74	\$ 0.74
Net Income per Common Share Diluted	\$ 0.15	\$ 0.28	\$ 0.72	\$ 0.72

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Stock Options	287,017	12,864	287,017	12,864
Restricted Stock Awards	1,885	6,110	1,885	6,110

NOTE 3. RELATED PARTY TRANSACTIONS

As of September 30, 2010, the Company leased the Corporate Headquarters and 25 of its store locations from ANO LLC, a company that is wholly owned by the Company's founder and current chairman of the Board (the Founder). The Company also leased one store location from Wood on Wood Road, Inc. and one store location from BMT Holdings, LLC. Wood on Wood Road, Inc. is wholly owned by the Founder, and 50% of the membership interest of BMT Holdings, LLC is owned by the Founder. Rental expense related to these companies for the three and nine months ended September 30, 2010 was \$660 and \$1,978, respectively. Rental expense related to these companies for the three and nine months ended September 30, 2009 was \$630 and \$1,902, respectively.

NOTE 4. COMMITMENTS AND CONTINGENCIES

On September 3, 2009, a former store manager and a current assistant store manager at the time (together, the Plaintiffs) filed a putative class action suit against Lumber Liquidators, Inc. (LLI) in the Superior Court of California in and for the County of Alameda. The Plaintiffs allege that with regard to certain groups of current and former employees in LLI's California stores, LLI violated California law by failing to calculate and pay overtime wages properly, provide meal breaks, compensate for unused vacation time, reimburse for certain expenses and maintain required employment records. The Plaintiffs also claim that LLI did not calculate and pay overtime wages properly for certain of LLI's non-exempt employees, both in and out of California, in violation of federal law. In their suit, the Plaintiffs seek compensatory damages, certain statutory penalties, costs, attorney's fees and injunctive relief. LLI removed the case to the United States District Court for the Northern District of California. No class has been certified with regard to any of the alleged causes of action. LLI is vigorously defending the claims in this suit including class certification. While there is a reasonable possibility that a material loss may be incurred, the Company cannot estimate the loss or range of loss, if any, to the Company at this time.

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On or about September 7, 2010, a former store manager filed an action against LLI in the United States District Court for the Middle District of Florida. In the complaint, the former store manager alleges that LLI breached an alleged contract for the payment of a commission and violated the Fair Labor Standards Act (FLSA) by failing to pay him for overtime hours worked. In addition, he asserts a purported collective action on behalf of similarly situated LLI employees alleging that LLI denied them overtime wages in violation of the FLSA. No class has been certified with regard to the purported collective action. LLI intends to defend the claims in this suit vigorously including collective action certification. While there is a reasonable possibility that a material loss may be incurred, the Company cannot estimate the loss or range of loss, if any, to the Company at this time.

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

Table of Contents

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

Cautionary Note Regarding Forward-Looking Statements

This report includes statements of our expectations, intentions, plans and beliefs that constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 and are intended to come within the safe harbor protection provided by those sections. These statements, which involve risks and uncertainties, relate to matters such as sales growth, comparable store net sales, impact of cannibalization, price changes, earnings performance, stock-based compensation expense, margins, return on invested capital, strategic direction, the demand for our products, and store openings. We have used words such as may, will, should, expects, intends, plans, anticipates, believes, thinks, estimates, seeks, predicts, could, projects, potential and other similar terms and references to assumptions, in this report to identify forward-looking statements. These forward-looking statements are made based on expectations and beliefs concerning future events affecting us and are subject to uncertainties, risks and factors relating to our operations and business environments, all of which are difficult to predict and many of which are beyond our control, that could cause our actual results to differ materially from those matters expressed or implied by these forward-looking statements. These risks and other factors include those listed in this report and in our other reports filed with the SEC, including the Item 1A, Risk Factors, section of the Form 10-K for the year ended December 31, 2009.

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

This management discussion should be read in conjunction with the financial statements and notes included in Part I, Item 1. Financial Statements of this quarterly report and the audited financial statements and notes and management discussion included in our annual report filed on Form 10-K for the year ended December 31, 2009.

Overview

Lumber Liquidators is the largest specialty retailer of hardwood flooring in the United States, based on industry sources and our experience. We believe we have achieved a reputation for offering great value, superior service and a broad selection of high-quality hardwood flooring products. We offer an extensive selection of premium hardwood flooring products under multiple proprietary brands at everyday low prices designed to appeal to a diverse customer base. We believe that our vertically integrated business model enables us to offer a broad assortment of high-quality products to our customers at a lower cost than our competitors. As of September 30, 2010, we sold our products through 213 Lumber Liquidators stores in 46 states, a call center, websites and catalogs.

2010 Highlights

SAP Implementation.

Overview. In June 2009, we signed a software license agreement with SAP Retail, Inc. ("SAP") for a broad scope of SAP retail software products to implement an integrated business solution in multiple phases. On August 21, 2010, we implemented the first, and most significant, phase, which included:

An enhanced point-of-sale solution across our entire store base,

A warehouse management and inventory control system serving our entire distribution network,

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An integrated merchandising and product allocation system, and

Related management reporting functionality.

These new management information solutions were fully integrated with our website, call center and customer service systems.

Table of Contents

All critical information was converted from our previous information system and we have continued to operate our business without interruption since the conversion. However, the implementation of this system had a pervasive impact across our operations, primarily resulting in reduced productivity in our store and warehouse operations, adversely impacting our results in the quarter ended September 30, 2010. This reduction in productivity included:

The effectiveness of our store operations to satisfy existing customer orders, and generate new demand,

The efficiency of our product allocation and distribution, and

The allocation of resources required to operate our business.

The reduction in productivity was greatest in the initial weeks following implementation. Although the Company did not reach pre-implementation productivity by the end of the third quarter, operational efficiency and effectiveness improved during September and improvement has continued in the fourth quarter of 2010. Additional resources were allocated to address specific areas of concern in September, and we will continue to dedicate appropriate resources through the remainder of 2010 to improve operating productivity. In addition, general operating familiarity improved with continued execution. In an effort to focus appropriate resources on serving our domestic customers, we have postponed the opening of our first stores in Canada until the first quarter of 2011.

We remain confident in the long-term benefits of the integrated solution, and we believe our operations will ultimately benefit from enhancements not available through our previous information system. We expect the SAP system to enable us to further increase the discipline and efficiency with which we manage operations, and improve communication across our organization to support our growth plans. Our new system provides us with a platform that can grow and evolve as our supply chain network changes through additional warehouses and distribution centers. The new platform will also help facilitate our international expansion into Canada and other locations beyond North America, as well as the electronic exchange of information with our business partners. Additionally, we believe that we will benefit from better inventory information that will enable more precise allocations, automation of manual processes and improved management visibility which ultimately should positively impact net sales and margin dollars. We expect to enter 2011 with enhanced system capabilities that will offer us the opportunity to gain sales momentum and market share.

Impact on Third Quarter Results. Reduced productivity related to our SAP implementation impacted both our results of operations for the quarter ended September 30, 2010 and our financial position at that date, including:

Effective conversion of demand into net sales: Our total net sales for the third quarter of 2010 were \$147.2 million, 4.7% higher than net sales for the third quarter of 2009, and at our comparable stores,¹ net sales were down 5.7%. However, based on our results prior to implementation and customer demand through the quarter, we estimate that reduced productivity resulted in approximately \$12 million to \$14 million in unrealized net sales during the third quarter.

For the period of the third quarter prior to the implementation:

Net sales for the month of July 2010 were 15.5% higher and net sales at comparable stores were 4.6% higher than July 2009;

Net sales for the first 21 days of August 2010 were 23.6% higher and net sales at comparable stores were 11.5% higher than the comparable period in August 2009; and

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Customer deposits were \$13.4 million on August 21, 2010.

For the full month of August 2010, net sales increased only 1.8% in comparison to August 2009, and at our comparable stores, decreased 8.3%. In September 2010, net sales decreased 2.0% in comparison to September 2009 and comparable store net sales decreased 12.6%.

Customer demand, as evidenced by customer deposits on open orders, grew from \$13.4 million at implementation to \$16.1 million at the end of August 2010 and at September 30, 2010, our balance sheet reflects customer deposits and store credits of \$21.3 million. In comparison, the balance was \$12.2 million at September 30, 2009.

Customer deposits have historically represented one-half to two-thirds of our open orders at any given point in time. Our open orders are those where the customer has placed an order, but has not yet taken possession of the product. We generally require a 50% deposit on an open order, but depending on order-specific circumstances, we may receive a greater deposit. We recognize revenue when the customer takes possession of the merchandise, and until that time, a customer deposit is a liability on our balance sheet.

¹ We generally consider a store comparable on the first day of the thirteenth full calendar month after opening.

Table of Contents

We estimate this build in customer deposits over historic norms and over our expectations during the third quarter equated to approximately \$12.0 million to \$14.0 million in unrealized net sales during the third quarter.

Efficient product movement: Our gross margin for the third quarter of 2010 was 35.2%, which reflected less efficient transportation of products after implementation, increases in our inventory reserves and increases in certain finishing costs.

We estimate these costs reduced gross margin by approximately 30 basis points.

Prior to implementation, we significantly reduced product flow in preparation for a physical inventory at points within our distribution network, including our central warehouse operation. In the first few weeks following implementation, we were not able to re-establish the product flow as quickly as expected. Though we returned to anticipated levels of product distribution in mid-September, the unit count shipped during the third quarter of 2010 was significantly lower than our expectations. In addition, delays in shipping products necessary to fulfill orders resulted in more expedited modes of transportation, generally at higher costs.

We have historically utilized cycle counts of physical inventory on a sample basis to adjust our inventory reserves during the year, and performed a full physical count of all locations simultaneously in conjunction with our year-end closing procedures. Our annual shrinkage has generally been immaterial, and our related reserve is combined with an analysis of obsolescence. Together, those reserves were \$0.6 million and \$0.5 million at December 31, 2009 and December 31, 2008, respectively. As a result of physical inventory procedures performed prior to implementation, our evaluation of productivity within the new inventory control systems, and our general quarterly review procedures related to inventory, we increased our inventory reserve for loss and obsolescence. This reserve was \$1.7 million at September 30, 2010 and \$1.0 million at September 30, 2009.

The reduction in warehousing and merchandising productivity also impacted our finishing operations for the first few weeks following implementation. We finished fewer units per hour in comparison to historic norms due to the physical inventory procedures and slower ramp up of operations after implementation.

Additional supporting resources: We allocated a greater amount of internal and external resources than expected to stabilize our system after implementation, support operations and address the loss of productivity in certain key areas. As a result, capitalized costs associated with our implementation increased, and certain selling, general and administrative (SG&A) expenses were higher than expected. We believe these non-recurring costs were approximately \$0.5 million and included:

Warehousing costs, where loss of productivity increased our cost per throughput unit,

Store point-of-sale support,

Customer service support,

Supplemental training, and

Financial accounting and reporting.

Through September 30, 2010, we had capitalized approximately \$13.9 million related to our new integrated system, including work allowing for international operations. We now expect an additional \$1.5 million to \$2.5 million in capitalized costs by the end of 2010. We had previously expected capitalized costs to reach a total of \$13.0 million for the project by the end of 2010. Increases were primarily a result of scope expansion and the development of processes to enhance the visibility and the reporting required to stabilize the system after implementation and generally moderate the loss of productivity.

Increased inventory carrying levels and reduced liquidity: We believe our merchandise inventory levels at September 30, 2010 were approximately \$8.0 million higher than the levels would have been had the open demand discussed above been converted into invoiced sales. In addition, we aggressively increased inventory levels prior to implementation, and as result, our relationship of accounts payable to merchandise inventory at the end of the third quarter of 2010 was not comparable to prior periods.

Table of Contents

Expectations and Risks for the Fourth Quarter. We continue to experience the impacts of reduced productivity in the fourth quarter of 2010, though operational efficiency and effectiveness are improving. We currently expect to regain much of the pre-implementation productivity during the fourth quarter, but we anticipate that achievement will continue to require resources greater than expected. Amongst our key challenges in the fourth quarter:

Timely service of the significant build in open orders existing at September 30, 2010 to convert that demand into invoiced sales. While we have reduced open demand in October 2010, we may continue to carry open orders at a higher level than our historic norm through December 31, 2010. As such, we may not fully convert that demand into invoiced sales in the fourth quarter.

Increase in-store comfort with the new functionality to serve new demand. The productivity of our store operations must continue to improve to allow both conversion of demand existing at September 30, 2010 into fourth quarter sales, and provide appropriate service to new customers.

Enhance efficiency of product flow. While we believe we have restored appropriate product flow through our distribution network, we continue to allocate greater resources to those areas, resulting in greater costs per unit than our historic norm.

Our October 2010 net sales increased approximately 14.5% over the prior year period, and net sales at our comparable stores increased 2.9%. Customer deposits and store credits at October 31, 2010 were approximately \$17.0 million, down from \$21.3 million at September 30, 2010 and comparable to \$12.2 million at October 31, 2009.

Outlook.

In addition to the productivity challenges described above, we believe that, relative to historical metrics, the wood flooring market is likely to remain in a weakened state through the remainder the fourth quarter of 2010. The wood flooring market for homeowners is highly fragmented and dependent on home-related discretionary spending, which is impacted by a number of complex economic and demographic factors that may vary locally, regionally and nationally. Many of the economic indicators associated with the wood flooring market and generally associated with consumer discretionary spending remain weak. While our results have been impacted by the implementation of our integrated business solution, we continue to believe we deliver a unique value proposition to our customers, which translates to gains in our share of the wood flooring market.

Based on our results to date and current trends, we expect the following for the fourth quarter and full year 2010:

Total net sales for the fourth quarter of 2010 increasing 10% - 15% over the fourth quarter of 2009 for a range of \$151 million to \$157 million. Comparable store net sales are expected to increase in the low to mid-single digits.

Total net sales for the full year of 2010 in the range of \$618 million to \$624 million and comparable store net sales increases in the low single digits.

Opening nine to 11 new store locations domestically in the fourth quarter of 2010, for a total of 36 to 38 new store locations in 2010.

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Fourth quarter 2010 earnings per diluted share in the range of \$0.21 to \$0.27, and full year 2010 earnings per diluted share in the range of \$0.93 to \$0.99, based on a diluted share count of approximately 28.2 million shares and an effective tax rate in the range of 38.7% to 39.0%.

Results of Operations

Net Sales

	For the three months ended		For the nine months ended	
	September 30, 2010	September 30, 2009	September 30, 2010	September 30, 2009
	(dollars in thousands)			
Net sales	\$ 147,192	\$ 140,520	\$ 467,061	\$ 407,488
Percentage increase	4.7%	14.2%	14.6%	11.4%
Comparable store net sales (decrease) increase	(5.7)%	1.9%	2.4%	(1.8)%

Table of Contents

Net sales for the third quarter of 2010 increased \$6.7 million, or 4.7%, over the third quarter of 2009 as a result of an increase of \$14.7 million in non-comparable store net sales which was partially offset by a decrease of \$8.0 million in comparable store net sales. Net sales for the nine months ended September 30, 2010 increased \$59.6 million, or 14.6%, over the same prior year period as a result of a \$9.9 million increase in comparable store net sales and an increase of \$49.7 million in non-comparable store net sales. In addition to effects from our system implementation, our net sales have been impacted by the following factors:

New store locations continue to drive our net sales growth. In the first nine months of 2010, we opened 27 new stores, 13 of which were in new markets. Of the 27 new stores opened in the first nine months of 2009, 18 were in new markets. For the full year 2009, we opened 36 new stores, including 24 in new markets. We have opened 70 of our 213 store locations in the 24 months after September 30, 2008, and our recent store opening activity is as follows:

	2010	2009
Number of stores at January 1	186	150
New stores opened during the first quarter	11	10
Number of stores at March 31	197	160
New stores opened during the second quarter	6	8
Number of stores at June 30	203	168
New stores opened during the third quarter	10	9
Number of stores at September 30	213	177

Net sales benefited from more consistent in-stock positions of certain key product lines, such as laminates, moldings and accessories. These product lines are included within our "never out of stock" program through which we have strengthened our in-stock commitment to our top selling products by region across all product lines. Our sales mix of moldings and accessories increased to 14.0% and 13.7% of total net sales in the three and nine months ended September 30, 2010, respectively, from 13.1% and 12.4% in the three and nine months ended September 30, 2009, respectively.

Consumer demand throughout 2009 and 2010 has generally shifted our mix of products sold, or sales mix, to certain key product lines which generally have a lower than average retail price per unit, resulting in decreases in our average sale². However, these sales mix trends have begun to stabilize in the most recent six months. We believe we have grown our market share in these product lines. Changes to comparable prior year results were as follows:

	For the three months ended		For the nine months ended	
	September 30, 2010	September 30, 2009	September 30, 2010	September 30, 2009
			increase (decrease)	
Comparable Stores:				
Net sales	(5.7)%	1.9%	2.4%	(1.8)%
Customers invoiced ¹	(5.2)%	14.1%	6.8%	10.4%
Average sale ²	(0.6)%	(10.7)%	(4.1)%	(11.0)%
Average retail price per unit sold ³	0.3%	(10.6)%	(4.2)%	(10.2)%

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- ¹ Approximated by applying our average sale to total net sales at comparable stores
- ² Average sale is calculated on a total company basis
- ³ Average retail price per unit sold is calculated on a total company basis and excludes certain service revenue

- ² Average sale is defined as the average invoiced sale per customer, measured on a monthly basis and excluding transactions of less than \$250 (which are generally sample orders, or add-ons or fill-ins to previous orders) and of more than \$30,000 (which are usually contractor orders).

Table of Contents**Gross Profit and Gross Margin**

	For the three months ended		For the nine months ended	
	September 30, 2010	September 30, 2009	September 30, 2010	September 30, 2009
	(dollars in thousands)			
Net Sales	\$ 147,192	\$ 140,520	\$ 467,061	\$ 407,488
Cost of Sales	95,431	89,336	303,256	261,164
Gross Profit	\$ 51,761	\$ 51,184	\$ 163,805	\$ 146,324
Gross Margin	35.2%	36.4%	35.1%	35.9%

Gross profit increased \$0.6 million and \$17.5 million, or 1.1% and 11.9%, for the three and nine month periods ended September 30, 2010, respectively, from the comparable prior year periods. The gross margin decline in comparing the three and nine months ended September 30, 2010, to those ended September 30, 2009, was primarily due to the following factors:

Less efficient unit flow following the SAP system implementation, including expedited transportation, and certain adjustments to inventory reserves, reduced gross margin for the third quarter of 2010 by approximately 30 basis points.

In aggregate, sales mix shifts were neutral to gross margin in comparing both the three and nine month periods ended September 30, 2010 and 2009, as follows:

Our sales mix increased in certain product lines that generally carry a higher than average gross margin, including laminates, bamboo and engineered hardwoods. In addition, consumers continued to generally prefer the premium products within these product categories, such as strand bamboos and handscraped engineered hardwoods. Further, moldings and accessories continued to benefit from a strengthened in-stock position, and these product lines generally carry a gross margin higher than our average.

Liquidation deals, used as promotional opportunities to generate incremental traffic, have generally yielded lower gross margins in 2010 than in 2009, and in each year, those gross margins have been lower than average.

Continued weakness in the macroeconomic environment has generally resulted in a shift away from certain hardwood product lines that traditionally carry higher than average retail prices per unit sold, but slightly lower than average gross margins. However, in the third quarter of 2010, the sales mix of exotic hardwoods in total improved slightly relative to the third quarter of 2009.

Increased product costs, primarily transportation costs and certain finishing costs, reduced gross margin by approximately 120 basis points and 80 basis points in comparing the three and nine months ended September 30, 2010 and 2009, respectively. The increase in product costs resulted primarily from the following factors:

Inbound transportation costs capitalized into the unit cost of products sold were substantially higher in the first nine months of 2010 than in 2009. Overall, the gross margin impact of falling international container rates reached a low point against our

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historic norm in the third quarter of 2009, with an up to 60 basis point benefit against that historic norm. In the first six months of 2010, these international container rates approximated our historic norm.

Partially offsetting these rising inbound transportation costs were increased direct shipments received by our stores, either through our China consolidation center or direct from the mill to the store. In the third quarter of 2010, 23.7% of our purchases were received directly at the store, up from 14.4% in the same period of 2009. For the nine months ended September 30, 2010, 16.4% of our purchases were received directly at the store, compared to 17.3% in the same period of 2009.

Transportation costs of moving our products from our warehouse in Toano to the store locations, between store locations, and to the customer from our store locations are charged to cost of sales as incurred. These costs increased due to both a per mile increase, primarily due to increases in fuel surcharges, and an increase in the number of miles driven, primarily due to a greater number of units shipped. This increase in units shipped primarily resulted from a combination of our increase in sales volume, including the sales mix shift to a lower average retail price, and generally higher in-store average inventory levels.

Table of Contents

Our efforts to expand and regionalize our assortment of Bellawood products resulted in 2010 per unit finishing costs generally higher than those in 2009, primarily due to greater demand for products which are less efficient to finish.

Operating Income and Operating Margin

	For the three months ended		For the nine months ended	
	September 30, 2010	September 30, 2009	September 30, 2010	September 30, 2009
	(dollars in thousands)			
Gross Profit	\$ 51,761	\$ 51,184	\$ 163,805	\$ 146,324
SG&A Expenses	44,909	38,727	130,985	114,269
Operating Income	\$ 6,852	\$ 12,457	\$ 32,820	\$ 32,055
Operating Margin	4.7%	8.9%	7.0%	7.9%

Operating income for the third quarter ended September 30, 2010 decreased \$5.6 million over the third quarter of 2009 as the \$0.6 million increase in gross profit discussed above was offset by a \$6.2 million increase in SG&A expenses. SG&A expenses for the third quarter of 2010 included approximately \$0.5 million in incremental expenses related to the SAP system implementation. Operating income for the nine months ended September 30, 2010 increased \$0.8 million over the same period in 2009 as the \$17.5 million increase in gross profit discussed above was primarily offset by a \$16.7 million increase in SG&A expenses. The increases in SG&A expenses were principally due to the following factors:

Salaries, commissions and benefits increased \$2.1 million and \$8.8 million for the three and nine months ended September 30, 2010, respectively, from the comparable prior year periods. As a percentage of net sales, salaries, commissions and benefits increased to 11.8% and 11.1% for the three and nine months ended September 30, 2010, respectively, from 10.9% and 10.6% for the three and nine months ended September 30, 2009, respectively.

Store salaries, commissions and benefits expense increased approximately \$1.4 million in comparing the three months ended September 30, 2010 and 2009, and increased \$5.9 million in comparing the nine months, primarily due to the 36 new stores opened subsequent to September 30, 2009, increased overtime related to the SAP system implementation and increases in certain store-level incentives.

Our corporate store-support infrastructure, including bonus accruals, decreased approximately \$0.2 million in comparing the third quarter of 2010 to 2009 and increased approximately \$0.2 million in comparing the nine months ended September 30, 2010 to 2009.

Labor costs for our distribution, warehousing and finishing functions increased approximately \$0.9 million and \$2.7 million in comparing the three and nine months ended September 30, 2010 and 2009, respectively, due primarily to increased sales volume, higher in-stock positions of merchandise inventories and additional overtime incurred related to the SAP system implementation.

Advertising expenses increased \$1.2 million to \$13.3 million, or 9.0% of net sales, for the three months ended September 30, 2010, from \$12.1 million, or 8.6% of net sales, for the comparable prior year period. For the nine months ended September 30, 2010, advertising expenses increased \$1.9 million to \$39.1 million, or 8.4% of net sales, down from 9.1% of net sales for the nine months ended September 30, 2009. While our advertising spend has historically featured national campaigns, we have more recently emphasized flexibility in message and media to optimize our spend within a changing marketplace, expanding localized and targeted programs. As a result of our continued investment in enhancing the effectiveness of our campaigns coupled with the growth in our

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store base, particularly in existing markets, we have reduced advertising expenses as a percentage of net sales in comparing the nine-month periods ended September 30, 2010 and 2009. We believe we would have leveraged advertising spend in the third quarter of 2010 had we converted open orders into sales at rates commensurate with our historic norms.

Occupancy costs increased \$0.8 million to \$5.6 million, or 3.8% of net sales, in the three months ended September 30, 2010, from \$4.8 million, or 3.4% of net sales in the third quarter of 2009. For the nine months ended September 30, 2010, occupancy costs increased \$2.8 million to \$16.3 million, or 3.5% of net sales, from \$13.5 million, or 3.3% of net sales, for the first nine months of 2009. These increases were primarily due to the 36 stores opened between September 30, 2009 and September 30, 2010.

Depreciation and amortization expenses were \$1.4 million and \$3.8 million in the three and nine months ended September 30, 2010, respectively. As a percentage of net sales, depreciation and amortization expenses were 1.0% and 0.8% in the three and nine months ended September 30, 2010, respectively, and 0.8% and 0.9% in the three and nine months ended September 30, 2009, respectively. We began depreciating our new SAP system in August 2010.

Table of Contents

Stock-based compensation expense was 0.6% and 0.5% of net sales for the three and nine months ended September 30, 2010, respectively, compared to 0.5% and 0.6% of net sales for the three and nine months ended September 30, 2009, respectively.

Other SG&A expenses increased \$1.6 million and \$2.8 million for the three and nine months ended September 30, 2010, respectively, from the comparable prior year periods. As a percentage of net sales, these expenses were 4.4% and 3.7% in the three and nine months ended September 30, 2010, respectively, and 3.4% and 3.6% in the three and nine months ended September 30, 2009, respectively. The increase was primarily due to higher information technology expenses related to the SAP implementation, store-base growth and certain bankcard discount rate fees, which increased due to greater consumer preference for certain extended-term promotional programs. As a result of the SAP system implementation, other expenses in the third quarter of 2010 included additional training and travel expenses.

Provision for Income Taxes

	For the three months ended		For the nine months ended	
	September 30, 2010	September 30, 2009	September 30, 2010	September 30, 2009
	(dollars in thousands)			
Provision for income taxes	\$			